

Third-Party Beneficiary Rights In Construction Contracts Must Be In Writing

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Certain construction contracts have language written into them explicitly stating that the contract does not convey any rights, including contractual rights, to third-parties. The reason for this language is to prevent unknown individuals or entities to claim a right under a contract not involving or relating to, the unknown individual or entity. For example, this is especially the case for a project owner who does not want a subcontractor to a general contractor to claim a right under the owner's agreement with the general contractor.

In contrast, third-party rights can also be specifically included in an agreement. For example, a general contractor agreement may state that the owner's architect is a third-party beneficiary to the agreement. This would mean that the architect would have the ability to enforce rights and seek damages from the general contractor. Additionally, third-party rights can be conveyed in an indemnification and/or additional insured provision.

The general rule with respect to construction contracts is that there must be express contractual language stating that the contracting parties intended to benefit a third party by permitting that third party to enforce the terms of the contract. This rule reflects the nature of construction and construction contracts in that there are often several contracts between various entities, where performance is benefiting all of the entities involved.

In a recent case, the Court of Appeals, New York's highest court, was asked to determine whether the public owner of a project was an intended third-party beneficiary of the architectural services contract between the public authority developing the project and the project's architect.

This public improvement involved an agreement between the public owner and the public authority which provided that the public authority would finance and manage the design and construction of the project for the public owner. To effectuate that agreement, the public authority was authorized to enter into contracts with the necessary contractors and consultants, including the project's architect.

In furtherance of the agreement with the public owner, the public authority entered into a contract with an architect to provide design, architectural and engineering services and to supervise the construction (architect agreement). As part of the architect agreement, the architect agreed that it would indemnify and hold harmless the public authority and the public owner from any claims arising out of the architect's negligent acts or omissions, including design errors. Although the public owner was named in architect agreement, there was no specific language that conveyed third-party beneficiary rights to the public owner.

The public authority then entered into a separate contract with a contractor to provide excavation and foundation work for the Project (excavation contract). Unlike the architect

agreement, the excavation contract did provide that the public owner is an intended third-party beneficiary of the contract for the purposes of recovering any damages caused by the contractor.

After work began, the contractor failed to properly install an excavation support system which led to substantial damages and delays. In particular, existing adjacent buildings began to settle and adjacent structures (including sidewalks, sewers and water mains) required emergency repairs.

An action was commenced by the public authority against the contractor for breach of contract damages. The architect was later added as a party to the action for breach of contract damages and professional negligence. The action against the architect was based upon the allegation that the architect failed to provide adequate design for the project and failed to supervise the contractors retained, including the failure to advise of the risks to adjacent buildings posed by the installation of the excavation support system. The public owner was also a party to the action and it asserted breach of contract and negligence causes of action against the architect.

The architect moved for summary judgment, seeking, among other things, dismissal of the public owner's claims. The motion court dismissed the public owner's claims and held that the public owner was not an intended third-party beneficiary of the architect agreement. On appeal the Appellate Division held that the public owner had raised an issue of fact whether it was an intended third-party beneficiary to the architect agreement.

The architect then appealed to the New York Court of Appeals questioning whether the Appellate Division improperly held that the public owner was an intended third-party beneficiary to the architect agreement.

The Court of Appeals reversed the Appellate Division decision and held that the public owner failed to raise an issue of fact concerning its status as a third-party beneficiary to the architect agreement. In so holding, the Court noted that the architect agreement did not expressly name the public owner as an intended third-party beneficiary, nor authorize the public owner to enforce any obligations thereunder. The Court noted that although the performance of a construction-related contract may have benefited a third-party end-user, like the public owner, that did not in itself establish enforcement rights in favor of the third-party. In reaching this holding the Court also reviewed the excavation contract. The Court found that, unlike the architect agreement, the excavation contract expressly reserves third-party beneficiary enforcement rights to the public owner.

Commentary

This case is a lesson to all to think about whether there are any individuals and/or entities that should have third-party rights, including enforcement rights. In the instant case, the public owner who was clearly harmed by the actions of either or both the architect and contractor, based upon the express language of the architect agreement and excavation agreement, was left with only the recourse of pursuing its damages against the contractor.

As explained by the Court of Appeals, even when everyone understands that the construction is going to benefit a third-party end-user (such as the public owner here), that does not in itself establish enforcement rights in that third-party. Therefore, contracts must be expressly clear when determining whether a third-party should have rights under the various contracts being entered into for the project. Upstream contracts like a general contractor's agreement with the owner should be reviewed before entering into subcontracts because the general contract may require the owner to be named as a third-party beneficiary to all subcontracts. The failure to expressly name the owner as a third-party beneficiary may result in the general contractor being held in breach its agreement with the owner.

Feel free to contact me to discuss third-party rights on construction projects.