

CHAPTER ELEVEN

THIRD PARTY RIGHTS AND DUTIES

11.1 Introduction

In most situations, only the parties who actually make a contract together have any rights or duties under that contract. This is because those who are not parties to the original contract--who are generally called "third parties"--usually have no legal interest in the contract.

However, in certain situations, third parties may actually have rights or duties under a contract--even though they are not parties to the contract! This can occur where there is an assignment of rights or delegation of duties, or where there is a third party beneficiary. This Chapter discusses these events.

It may seem odd that third parties can gain such rights or duties. Some basic reasons that the law provides for this possibility are to give effect to the real intentions of the parties who made the original contract, and to further important social and economic goals. These reasons will be discussed further in Section 11.2 below.

***** *ADDITIONAL REFERENCE:*** Chapter 1 ("Basic Aspects of Contract Law"), Section 1.4j has a concise discussion of third party rights and duties.

11.2 Third Parties May Have Rights or Duties under Contracts in Several Important Situations

This Chapter examines three important situations where third parties may have rights or duties under a contract. These situations are where:

- (1) a contract party assigns his rights under a contract to a third party (Section 11.3);
- (2) a contract party delegates his duties under a contract to a third party (Section 11.4); and
- (3) a third party beneficiary gains rights under a contract (Section 11.5).

Each of these situations is briefly summarized below.

An assignment of rights occurs where a party to a contract transfers his rights under the contract to a third party who is not a party to the original contract. This transfer is not a promise or a contract, but a present-time transfer--like a gift. It is not subject to the common law requirement of consideration, though assignments without consideration are revocable in certain cases in common law jurisdictions. Contract rights can generally be assigned. However, many jurisdictions say contract rights cannot be assigned: if the assignment would materially change the duty of the other party to the original contract, materially increase the risk to that party because of the contract, or substantially reduce the value of the performance that party will receive; if a valid part of the original contract forbids the assignment; or if the assignment violates a statute or public policy. An example of rights which may not be assignable are rights to receive personal services. When a party assigns his rights to a third party, the third party gains those rights like the party would gain property, and the transferring party no longer has the rights. So the third party basically "stands in the shoes" of the transferring party, with the same rights and subject to the same defenses as the transferring party previously was. Assignment of rights is discussed in Section 11.3 below.

A delegation of duties occurs where a party to a contract transfers his duties under the contract to a third party who is not a party to the contract. When a party delegates his duties to a third party, the third party may have the option to perform, or he may promise to perform. The third party becomes responsible for performing those duties only if he has promised to perform them. However, unlike in the situation where a party assigns rights, the delegating party remains responsible for the performance of the duties, even after he has delegated them. Contract duties can be delegated as long as the party with the right to receive performance of the duties will still receive the substantial benefit of his original bargain, and no valid part of the original contract forbids the delegation. Duties are less likely to be effectively delegated if they involve personal services or other types of unique skills or abilities, such as the professional services of physicians. Delegation of duties is explained in Section 11.4.

A third party beneficiary can actually gain rights under a contract, even though that third party was not a party to the contract. Many jurisdictions say this occurs only where the third party was an intended beneficiary. That means that the parties to the original contract intended that the third party gain the right to enforce their contract. But if a third party is merely an incidental or unintended beneficiary, he cannot enforce the contract. Intended beneficiaries may be donee beneficiaries, who exist where the party receiving the promise that will benefit the third party beneficiary is basically trying to make a gift to the beneficiary. Or they may be creditor beneficiaries, who exist where the party receiving the promise that will benefit the third party beneficiary is actually trying to fulfill some existing legal duty that he owes or believes he owes to the beneficiary. Important examples of donee beneficiaries include third party beneficiaries under life insurance policies. Important examples of creditor beneficiaries include loan creditors like banks after

a third party assumes a debtor's duty to repay to such a creditor a loan secured by a mortgage on real property. Third party beneficiaries are discussed in Section 11.5.

A crucial difference between the situation where assignment or delegation occurs, and the situation where a third party beneficiary gains contract rights, is how the rights or duties are created. The rights of third party beneficiaries are created by the original contract. But assignment and delegation occur after the original contract has been created, through some later action of one of the parties to that contract.

It is also important to distinguish between the situation where assignment or delegation occurs, and the situation where a novation occurs. As discussed in Chapter 9 ("Performance and Discharge of Duties"), Section 9.7e, a novation exists where both parties to the original contract agree with a new third party that that third party will substitute for one of the parties to the original contract, and that the original contract will be ended. So a novation frees one of the original parties from any obligation under the contract, and results in a new contract between one of the original parties and the third party. By contrast, an assignment or delegation can generally occur even if only one of the original contract parties wants it to happen. And the original contract duties are not discharged. When a delegation occurs, the delegating party is not released from his duties--he remains liable until the third party to whom the duties are delegated actually performs.

***** ADDITIONAL REFERENCE:** Chapter 9 ("Performance and Discharge of Duties"), Section 9.7e contains more detailed discussion of the effects of novations.

***** WHY IS THIS IMPORTANT?** Why does the law say that third parties can actually have rights or duties under a contract in certain situations, even though they were not parties to the contract?

In general, only those who are actually parties to a contract have any legal interest in the contract. So only those parties can generally enforce the contract, or bring legal claims about the rights and duties in the contract. This is an important part of the freedom of contract. It generally allows parties to do as they wish with their contracts, without fear of interference from anyone else. It helps them achieve their economic and social goals, and helps the free market function efficiently.

However, in certain situations, many jurisdictions say that third parties do have rights and duties under contracts they did not make. As noted above, some basic reasons that the law provides for this possibility are to give effect to the real intentions of the parties who made the original contract, and to further important social and economic goals.

First, where there is a valid assignment or delegation, or an intended third party beneficiary, one or both parties to the original contract have indicated that they wish a third party to have rights or duties created by their contract. In a way, respecting their wishes in this way is another way to give them the freedom to conduct their relations as they wish--as the freedom of contract does.

Recognizing third party rights and duties also promotes important economic and social goals. It allows parties the flexibility to conduct business and transfer property in efficient ways. That helps the parties and the economy work better. One example occurs where a party assumes a loan secured by a mortgage on real property (a delegation). Another example is where a party assigns the right to repayment of a long term loan to a party who may have more interest in the loan, or ability to collect the loan from the debtor.

These kinds of transfers also help many parties obtain commercial financing. Such parties may be able to get loans to conduct their businesses, or start new ventures, by offering as collateral their rights to receive payment under other contracts. For example, builders may make this kind of assignment in order to get the funds they need to actually build structures.

In addition, third party rights and duties can serve important social interests. For example, many parties buy life insurance policies. Such parties designate third party beneficiaries--often their family members such as spouses and children--to receive money or other benefits in the event that the policyholder dies. These beneficiaries can gain the right to enforce the insurance contract, even though they were not parties to it. This can be a useful way to protect the future of family members, even if the policyholder cannot do so himself. Parties can provide for these needs in a variety of other contract situations as well.

Of course, great unfairness and economic chaos could result if parties had an unlimited ability to transfer rights and duties to third parties, or if third parties were allowed to interfere in contracts that really had nothing to do with them. That is why the law applies the important limits on third party rights and duties which are noted above, and further explained in the rest of this Chapter.

11.3 An Assignment of Rights Occurs Where a Party to a Contract Transfers His Rights under the Contract to a Third Party

Perhaps the most important way a third party can gain a right or duty discussed in this Chapter is assignment of rights. This Section will explain

some of the more important aspects of assignment of rights. Specifically, it will discuss:

- (1) the basic elements of an assignment of rights (Section 11.3a);
- (2) what contract rights can be assigned (Section 11.3b); and
- (3) some of the legal effects of an assignment (Section 11.3c).

11.3a What Is an Assignment of Rights?

Assignments of contract rights occur frequently in free market jurisdictions, and they are important to the working of modern economies. So this text will examine assignment in some detail.

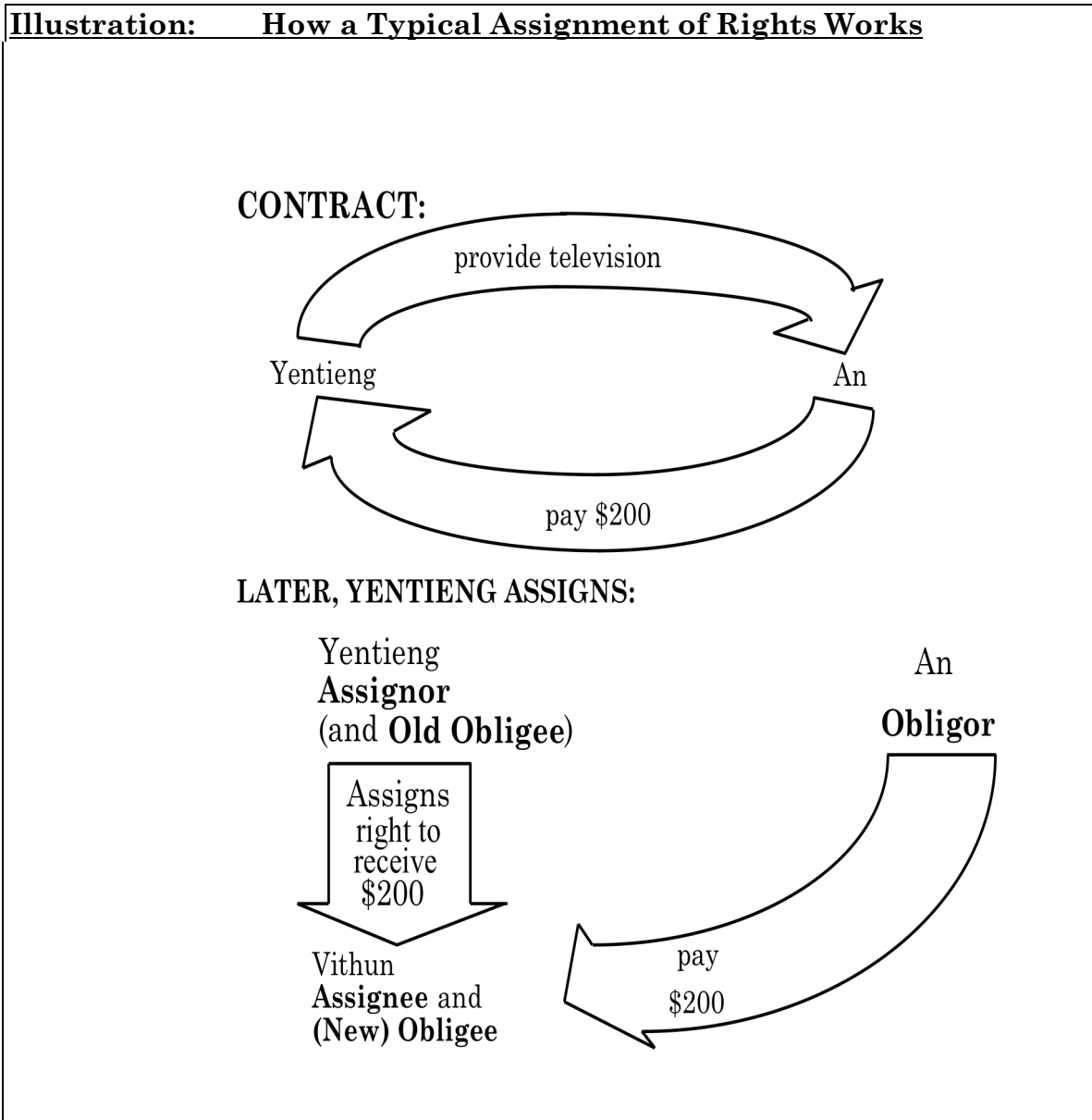
***** DEFINITION:** An **assignment of rights** is a present-time transfer of contract rights from one party to a contract to a third party.

In addition to the fundamental definition above, there are also some related terms that are necessary to a discussion of assignment. First, the party who actually makes the assignment of contract rights is called the assignor. The third party who receives the rights is called the assignee. The assignee is also called the obligee (or "new obligee"). This is because the assignee is also the party to whom one of the original contract parties is now obligated to provide performance. (The assignor might also be called the "old obligee," since he was previously the party to receive performance.) And the original contract party who did not make the assignment is called the obligor, because he is the party who still has the obligation to perform. Only the party who is to receive the benefit of that performance has changed, from the assignor to the assignee.

An assignment is a present-time transfer of contract rights. In this way, assignment is like a gift. It is not a promise or a contract, although it may be part of a contract between the assignor and the assignee. Because an assignment is a present transfer, a promise to transfer contract rights in the future is not an assignment. And while an assignment results in the assignee gaining contract rights, it also results in the assignor losing those rights. After an assignment, the assignor no longer has the rights he has transferred.

For example, suppose An and Yentieng make a contract under which An agrees to buy a television from Yentieng for \$200. Yentieng has the duty to provide the television, and An has the right to receive the television. An has the duty to pay \$200, and Yentieng has the right to receive that money. Suppose that, after this contract is made, Yentieng assigns his right to receive the \$200 to Vithun, perhaps because Yentieng owes Vithun \$200 from some prior transaction. In this situation, Yentieng is the assignor (and "old obligee"), because he has assigned his contract rights to Vithun. Vithun is the assignee, because he is the third party who has received the contract rights. Vithun is also the obligee (or "new obligee"), because Vithun--not Yentieng--

is now the party to whom An owes the obligation of paying \$200. And An is the obligor, because he still has the obligation to pay \$200. The result of this assignment is that Vithun has an enforceable right to receive \$200 from An, and that Yentieng no longer has that right. The following chart illustrates how assignment of rights works, using this example.



Of course, in this example, it is not clear what happens to Yentieng's duty to provide the television to An. Yentieng may still have that duty. Or he may delegate the duty to Vithun, in addition to assigning his rights to receive payment to Vithun. This will depend on the particular situation, as will be discussed below.

An important problem with regard to assignment may occur where a party says that he is "assigning the contract" or "assigning all my rights under

the contract." It can be very difficult to decide what is really happening here, and courts may have different approaches.

First, it appears that many jurisdictions would interpret "assigning the contract" to mean that the assignor is transferring the contract rights and the contract duties, unless the circumstances indicate otherwise, or the party receiving the duties has not agreed to the delegation. In the above example, this interpretation would mean that Yentieng assigned his rights and delegated his duties to Vithun, and that Vithun agreed to the delegation. In that situation, Vithun would have the right to receive \$200. But he would also have the duty to provide the television required by the contract. In that case, either the assignor Yentieng or the obligor An could actually enforce the contract against Vithun, if Vithun failed to perform. This will be further discussed in Section 11.4, below.

A second possible interpretation of the expression "assign the contract" is that the assignor is merely assigning his rights under the contract, and the duties remain with him. In the above example, that would mean Yentieng transfers to Vithun his right to receive \$200 from An. But the duty to provide the television to An would remain with Yentieng. This often occurs.

A third possibility which sometimes occurs where parties "assign the contract" is that a party assigns his contract rights, but it is clear that if the assignee wants to receive the benefit of those rights, the assignee must actually perform the contract duties. The key difference between this possibility and the first possibility is that the assignee here is not obligated to perform the duties. In other words, he has the option to perform them or not. This is a kind of delegation, as will be discussed in Section 11.4, below.

A common way this third possibility might occur is where an assignor "assigns" an executory contract to buy real property to an assignee in exchange for a payment from the assignee that is small compared to the size of the contract. For example, suppose Yentieng assigned to Vithun an executory contract to buy a big new villa for \$200,000, making the assignment in exchange for a \$500 payment from Vithun. Vithun would probably have the right to receive the villa only if he actually paid the \$200,000 purchase price to the villa owner.

***** *ADDITIONAL REFERENCE:*** Chapter 8 ("Interpretation of Contracts") contains further discussion about how courts interpret contracts.

In order for a valid assignment to occur, a basic requirement in many jurisdictions is that the assignor clearly communicates to the assignee an intention to transfer a contract right to the assignee. This intention may be communicated directly to the assignee, or to someone on his behalf.

It also important to know about other elements that may be required in order for a valid assignment to occur. First, in many common law

jurisdictions, notice to the obligor is not required in order for the assignment to be effective. However, if the assignee fails to give notice, and the obligor continues to provide contract benefits to the assignor, the assignee will not be able to recover from the obligor for what the obligor has provided to the assignor. So it is very important that the assignee provide notice to the obligor about the assignment as soon as possible if the assignee wishes to enforce the assignment against the obligor. Other jurisdictions, including civil law jurisdictions such as France, may require that the obligor be notified in order for the assignment to be effective.

Second, assignments do not generally require consideration in order to be effective in common law jurisdictions. This is because, as noted above, assignments are not contracts, but instead are present transfers. However, if there is no consideration, the assignment may be terminated by certain events. This will be explained in more detail in Section 11.3c, below.

Third, a valid assignment need not be written unless a specific statute requires it. However, statutes in many jurisdictions do require that assignments be written in particular situations. Important situations where many jurisdictions generally require a writing include where a party assigns a contract right:

- (1) to an interest in real estate;
 - (2) to the payment of money arising from contracts for services or the sale or lease of goods;
 - (3) to a security interest in personal property or fixtures;
- or (4) as part of a contract that the law requires to be written.

A "security interest" basically occurs where one party receives an interest in property to secure another party's duty to repay money or do something else for the first party. Perhaps the most common example of this occurs where a party mortgages property to secure a loan to pay for that property. This generally means that the creditor can only exercise his right to take and sell the property if the loan is not repaid according to the loan contract. The exact circumstances where these kinds of assignments may occur can be very complex, and the legal requirements vary in different jurisdictions.

CASE STUDY 246

FACTS The Royal Construction Company makes contracts to build 10 new buildings in various places in Battambang, for payments totaling \$1,000,000. Royal Construction is very excited about these opportunities, and it wants to begin work right away. However, it does not have enough cash to get all the equipment, materials, and services it needs to pursue the projects. And the construction contracts do not provide for substantial payments to Royal to occur for several months.

In order to get the money it needs to perform the construction, Royal makes a loan contract with the New Nation Bank. This written contract provides that the Bank will lend Royal \$900,000 in one payment to be made immediately, and that in exchange Royal assigns to the Bank its rights to all the payments under the construction contracts it has recently made. The duties to build remain with Royal. The Bank provides the \$900,000 to Royal and promptly notifies the property owners about the assignments. Royal starts work.

The time comes for some property owners to pay money under the construction contracts Royal made. The owners make their payments to the New Nation Bank. But Royal objects. Royal says that the Bank is not a party to those construction contracts, and that only Royal has the right to receive those payments.

QUESTION OF LAW Does the New Nation Bank have the right to receive the payments originally due to Royal under the construction contracts, even though New Nation is not a party to those contracts?

DECISION Yes. The New Nation Bank does have the rights to receive these payments, because Royal Construction made a valid assignment of those rights to the Bank.

An assignment of contract rights occurs where one party to a contract clearly indicates an intention to transfer his contract rights to a third party. In this case, Royal Construction made a loan contract with the New Nation Bank in which Royal expressed a clear intention to assign its rights to receive \$1,000,000 in payments under various construction contracts to the Bank, in exchange for an immediate loan of \$900,000 by the Bank. As soon as the Bank got the assignment of these rights, it had the right to receive these payments--and Royal no longer had that right. This is true even though it was Royal who still had the duty to build the buildings. And it is true even though the Bank was not a party to the original construction contracts Royal made with the property owners. In addition, since the assignment was written, it would meet the writing requirements many jurisdictions have for assignments of the right to receive money under contracts for services.

11.3b Contract Rights Can Generally Be Assigned

Most contract rights are assignable. As discussed above in Section 11.2, assignment of rights is an important part of the economies of many free market jurisdictions. So these jurisdictions want to promote the use of assignment, and avoid unnecessary restrictions on that right. In fact, this might be called the "freedom of assignment!"

However, there are a number of situations where rights cannot be assigned. These limits exist because assignment in some situations would be unfair to obligors, or harm other important economic or social interests.

In these cases, the law is trying to balance the importance of assignments with other important policies.

Five situations where the law in many jurisdictions limits the ability of parties to assign contract rights are where the assignment:

- (1) would materially change the obligor's duty;
 - (2) would materially change the risk to the obligor because of the contract;
 - (3) would substantially reduce the value of what the obligor would receive under the contract;
 - (4) is prohibited by a valid provision in a contract;
- or
- (5) is prohibited by statute or public policy.

Each of these five situations is examined below.

(1) An Assignment Is Not Valid If It Would Materially Change the Obligor's Duty

An assignment is not valid if it would materially change the obligor's duty. One situation in which this might occur would be in a personal services contract. In some cases, the assignment of the right to receive personal services could make a fundamental change in what the obligor would be required to do under the contract. Consider the following Case Study.

CASE STUDY 247

FACTS Peng makes a contract to teach Chinese to Rithya for three months. However, soon after the contract is made, Rithya gets busier at work, and he no longer has time to take the lessons. So he tries to assign his rights to receive the lessons to his friend Kieth.

Peng objects, saying Kieth is a very different student, because Kieth is far less advanced and more difficult to teach, and because Kieth wants to learn in a dangerous part of the city. Peng says this kind of assignment is not fair to him.

QUESTION OF LAW Can Rithya assign his rights to receive Chinese lessons to Kieth in this way?

DECISION Probably not. Rithya probably cannot assign his rights to receive the lessons to Kieth, because it would probably result in a material change in Peng's duties under the contract.

Contract rights cannot be assigned where the assignment would result in a material change in the duties of the obligor. In this case, Rithya tried to assign to Kieth Rithya's rights to receive Chinese lessons from Peng.

Rithya may be unable to assign his rights to Kieth under this personal services contract. This is because the assignment might cause a material change in the duties of Peng, the obligor. Teaching Rithya appears to require a different range of skills and activities by Peng. Peng says Kieth is a far less advanced student, and more difficult to teach, and that Kieth wants to learn in a more dangerous location than Rithya. This assignment would seem to result in a material change to Peng's duties under the contract. So it would probably not be effective.

Another area in which changes in the obligor's duty might occur would be in output and requirements contracts. These contracts were already discussed in some detail in Chapter 3 ("Consideration"), Section 3.5d. For example, a buyer in a requirements contract might be unable to assign his rights to receive goods under the contract to a different party. The reason is that that different party might have very different requirements from the assignor. This would obviously change the duties of the seller--the obligor. Some jurisdictions, such as those that apply the Uniform Commercial Code in the United States, say that parties generally can assign their rights under output or requirements contracts if the assignee's output or requirements are not clearly disproportionate to the output or requirements of the assignor. Of course, this appears similar to the "material change" rule discussed above.

*** **ADDITIONAL REFERENCE:** Chapter 3 ("Consideration"), Section 3.5d contains more detailed discussion of output and requirements contracts.

(2) An Assignment Is Not Valid If It Would Materially Change the Risk to the Obligor

An assignment is not valid if it would materially change the risk to the obligor because of the contract. This might happen because the assignment would change a risk that an obligor is assuming under the terms of the contract. Or it might occur because the assignment would increase the risk that the obligor would not receive the performance due to him under the original contract.

An example of a material change in the risk an obligor assumes under the contract would be the risk of an insurance company in an insurance contract. For instance, suppose a car owner has an insurance policy on her car. She sells the car, and tries to assign her rights under the insurance policy to the buyer. This assignment is probably not valid. That is because the risk of the insurance company (the obligor) under the insurance contract was probably based to a large extent on the driving record and habits of the policyholder (assignor). But the car buyer (assignee) in this situation may have a completely different driving record and different habits. So an assignment like this could materially change the risk of the obligor.

Situations where an assignment of rights would materially increase the risk that the obligor will not receive performance under the contract

would be less common. This is because merely transferring the assignor's rights would not usually affect the obligor's chances of receiving performance of the assignor's duties. However, this kind of change could still occur where the transfer of the rights would actually affect the assignor's ability to provide performance to the obligor.

For example, suppose a sale of goods contract provided that the seller would receive pre-payment from the buyer, in order to help the seller get the goods from another source. An assignment by that seller of his rights to payment could actually affect the seller's ability to provide the goods. This is because, without the pre-payment, the seller might be unable to obtain the goods. So that kind of assignment could materially affect the buyer's (obligor's) chances of receiving performance.

(3) An Assignment Is Not Valid If It Would Substantially Reduce the Value of What the Obligor Would Receive

An assignment is not valid if it would substantially reduce the value of what the obligor would receive under the contract. This situation would not seem to occur often.

One case where it might happen would be where an assignor tries to transfer his rights under an output or requirements contract. As noted above, this kind of assignment could change the obligor's duties. But it could also reduce the value of what the obligor would receive. This might occur if the assignee of a buyer's rights in a requirements contract actually needed far less of the goods involved in the contract than the original parties expected, or if the assignee of a seller's rights in an output contract produced far less. In those cases, the obligor might receive far less than he expected under the original contract. So such an assignment might not be valid.

(4) An Assignment Is Not Valid If It Is Prohibited by a Valid Provision of the Contract

Many jurisdictions will give some effect to contract provisions which forbid assignment. For example, a contract may say that "rights under this contract shall not be assigned." These provisions are sometimes called "anti-assignment clauses." Courts generally enforce such provisions. They often appear in contracts, because most obligors would rather not have to deal with assignees! Obligor's generally prefer to deal only with those with whom they actually make contracts. And where obligors make that preference clear in their contracts, the law in many cases respects their preference.

However, many jurisdictions limit the ability of parties to prohibit assignment, and limit the effects of those assignments even where they are permitted. The basic reason for these limits--which actually limit the freedom of contract--is that these jurisdictions believe that assignments are important for the financing of business activity, and for other economic and

social reasons, as discussed in Section 11.2, above. So in this situation, the law balances competing goals--the freedom of contract and the freedom of assignment.

One important type of limit in this area is that statutes in many jurisdictions simply say that anti-assignment clauses are ineffective with regard to many important kinds of assignments. For example, the Uniform Commercial Code in the United States basically makes ineffective any restriction on the assignment of rights to receive payment for services or goods sold or leased, or to a security interest in personal property or fixtures.

Many other limits relate to how courts interpret anti-assignment clauses. Several of these limits are discussed below.

Sometimes a contract provision basically says that the "contract shall not be assigned." Many jurisdictions actually interpret that to mean that the parties cannot delegate duties under the contract, but that they can still assign rights, subject to the other limits discussed in this Section.

Of course, if a contract provision basically says that the "rights shall not be assigned," then courts in many jurisdictions do interpret that as a promise not to assign rights. Courts will enforce that promise, and provide a remedy to a party harmed by a failure to follow that promise. However, many jurisdictions say that an assignment that violates a promise like that is still effective! It is only that the assignor is liable to the obligor for breach of the contract promise not to assign.

Sometimes a contract provision basically says that contract rights "shall not be assigned without the consent" of the other party. Many courts interpret that kind of provision to mean that a party cannot unreasonably withhold his consent.

Finally, where a contract basically says that "any attempted assignment is void," many jurisdictions interpret that to mean that any assignment is not effective against the obligor--but that it is still effective between the assignor and the assignee! So while the obligor is not required to deal with the assignee, the assignor is still responsible to the assignee for any legal damage caused by the improper assignment. Such damage will be further discussed in Section 11.3c.

Obviously, courts in many jurisdictions work hard to promote the use of assignments! Parties who want to limit that use must draft their contracts carefully. And even then, they may be unable to limit the use of assignments the way they wish.

CASE STUDY 248

FACTS The Elated Restaurant has a contract with the Friendly Fish Supply Company under which Friendly will supply a certain quantity of fish every month, for a certain price, for one year. The contract says that the "contract shall not be assigned."

However, after a few months, Friendly is short of cash it needs to pay some creditors. Friendly attempts to assign its rights to receive payment for the fish under its Elated contract. The attempted assignee is Triv, the owner of one of the fishing boats that supply Friendly.

Elated objects to this assignment, saying it does not like Triv, and that the supply contract forbids assignment. Friendly says that the contract clause is ineffective.

QUESTION OF LAW Does the anti-assignment clause in the fish supply contract between Elated and Friendly prevent this assignment?

DECISION Probably not. In many jurisdictions, the assignment clause in this contract would be ineffective under a statute, and even if it was not, it would probably be interpreted to permit the kind of assignment that Friendly tried here.

Anti-assignment clauses in contracts are often enforceable, but many jurisdictions impose limits on them. Some jurisdictions say such clauses are ineffective with regard to assignments of rights to receive payment for goods or services. Many jurisdictions also interpret such clauses in a way that promotes assignments, such as by saying that phrases forbidding parties to "assign the contract" really only forbid delegation of duties.

In this case, the Friendly Fish Company tried to assign its right to payment under a fish supply contract with the Elated Restaurant to Triv. Elated objected, noting the contract clause saying the contract could "not be assigned." However, many jurisdictions would say that this anti-assignment clause was not effective to prohibit this assignment, and so the assignment was effective. Many jurisdictions completely prohibit anti-assignment clauses that try to prevent assignments of rights to payment for goods or services--the kind of assignment Friendly attempted here. And many jurisdictions also say that clauses forbidding parties to assign "the contract" only mean that the parties cannot delegate the contract duties--not that they cannot assign the contract rights, as Friendly did here. So this anti-assignment clause is unlikely to be enforced. Friendly's assignment to Triv is probably effective.

(5) An Assignment Is Not Valid If It Is Prohibited by Law

Finally, the law in many jurisdictions simply says that certain contract rights cannot be assigned, regardless of what the contract may say.

For example, many jurisdictions ban or limit parties' ability to assign their rights to receive wages or salary for personal services. And many jurisdictions also limit parties' ability to assign rights related to government pensions, and alimony and child support agreements. Basic reasons for these limits would seem to be to protect assignors from being pressured into assigning important rights that serve to protect them, and to protect obligors like the government from being forced to deal with new assignees.

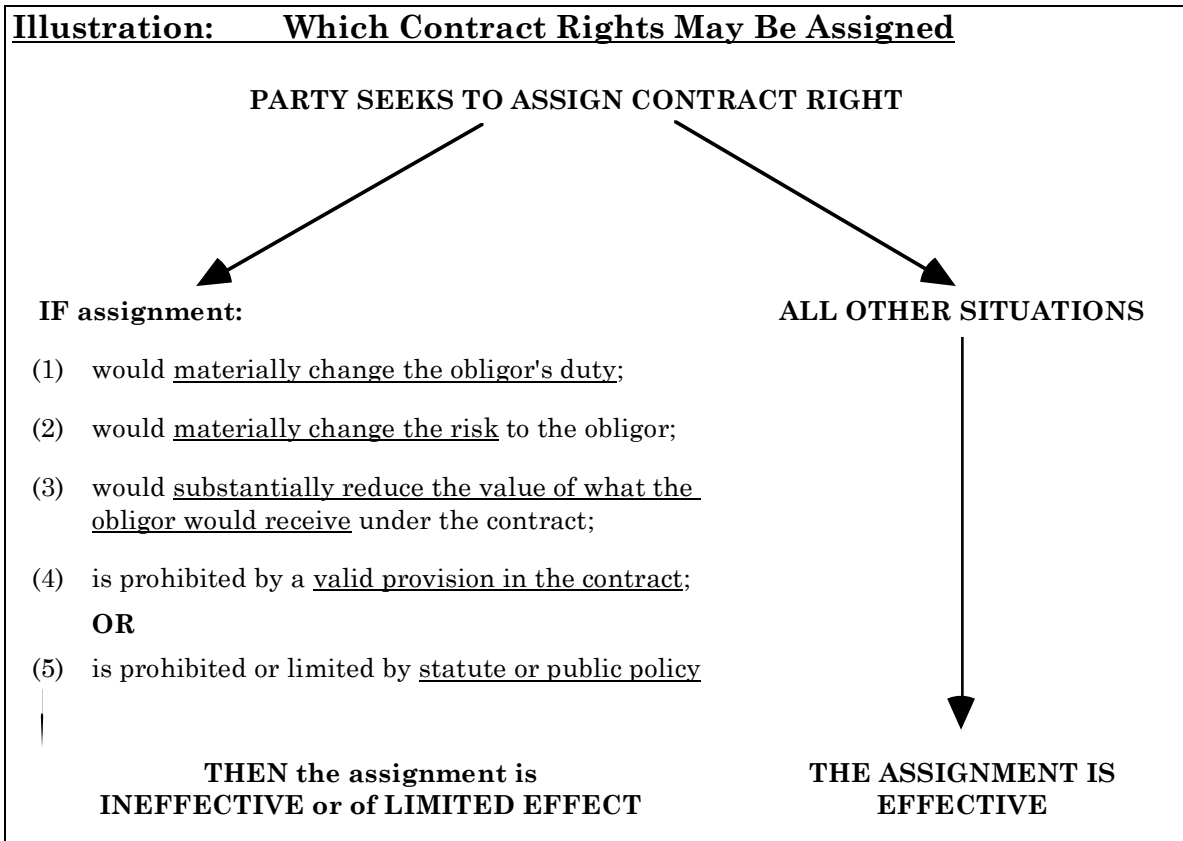
Another traditional general limit many jurisdictions have applied is that parties cannot assign rights under contracts that do not exist yet--contracts that parties expect to be formed in the future. It does not matter whether the right being assigned has actually been "earned" at the time it is assigned--whether the assignor has actually performed his duties under the original contract--as long as that contract actually exists at the time of the assignment. Of course, a party can promise to assign a right that he expects to exist in the future. But the traditional rule is that there must be an existing contract right at the time of assignment, or else there is really no "right" to assign, and no valid assignment.

Some jurisdictions have changed this traditional general rule to some extent. These jurisdictions say that a party can actually make a valid present transfer--an assignment--of a right that is not part of an existing contract in the special situation where the right is expected to arise out of an existing business or employment relationship. In addition, statutes in some jurisdictions say that for assignments in certain situations--such as those of rights to receive payments for goods or services, or for security--the assignor can basically agree with the assignee that rights under future contracts will be assigned the instant those contracts do exist, without the need for any further action by the parties.

(6) Summary of Some Basic Ideas about Which Contract Rights Can Be Assigned

The following chart shows some of the basic ideas that many jurisdictions have about which contract rights may be assigned.





11.3c The Effects of an Assignment

As noted above, the general effect of an assignment is that the assignor makes a present-time transfer to the assignee of rights under a contract. This means that, after the transfer, the assignee possesses those rights, and the assignor no longer does.

In effect, the assignee "stands in the shoes" of the assignor. This means that the assignee generally:

- (1) has the same rights that the assignor had, including the right to make any claims the assignor could have made about the contract;
- and (2) is subject to the same defenses that the obligor could have made against the assignor about the contract.

The first part of this general rule means that the assignee has the right to enforce the contract in the same way that the assignor could have enforced it before the assignment. For instance, in the television sale example above, where Yentieng assigned to Vithun his right to receive \$200 from An, suppose An paid Vithun only \$100. Vithun would have the right to enforce the contract, and ask a court for a remedy for damage he suffered because An failed to pay the remaining \$100.

The second part of this general rule means that the obligor generally has the same defenses that he would have had against the assignor before the assignment. These include defenses regarding problems with the formation of the original contract, and defenses about the performance of the contract. For example, if the television sale contract was actually the result of a unilateral mistake by An, or if An never received the television as required by the contract, An could raise those issues as defenses against a claim by Vithun for the \$200.

One important defense an obligor might make is simply that he has already paid or provided what he was obligated to pay or provide under the contract. This can occur where the assignee claims the obligor never paid him, and the obligor claims that he already paid the assignor. Many jurisdictions say that prior payment is a valid defense until the assignee has given notice to the obligor about the assignment. But after the assignee has notified the obligor about the assignment, the obligor can no longer successfully defend against the assignee's claim for payment by saying he already paid the assignor. So it is essential that an assignee notify the obligor about the assignment as soon as possible if he wishes to enforce the rights he has received against the obligor. This rule was already noted in Section 11.3a.

For instance, in the television example above, suppose Vithun notified An about the assignment, but An forgot about the assignment, and later paid the \$200 to Yentieng. Then Vithun brought a claim against An for the \$200. Many jurisdictions would say that An could not defend the claim on the basis that he already paid the \$200 to Yentieng. That is because An had notice about the assignment before he paid the \$200, and he should not have paid Yentieng. In that situation, An might actually have to pay another \$200! But suppose Vithun failed to notify An about the assignment, and An paid the \$200 to Yentieng as the original contract required. If Vithun then brought a claim against An for the money, An would have a good defense on the basis that he already paid Yentieng.

Another important issue is whether the assignee can recover against the assignor where the assignee has difficulty getting the benefits of the rights that have been assigned to him. In many common law jurisdictions, if the assignment was gratuitous--not for consideration--then the assignee can probably recover from the assignor only if the assignee reasonably relied to his detriment on the assignment. Of course, this idea is similar to promissory estoppel, as discussed in Chapter 7 ("Other Contract Formation Problems"), Section 7.8.

But if the assignment was in exchange for something of value--if there was consideration--then many common law jurisdictions say the assignor is actually making some implied promises along with the assignment.

The assignee can bring a claim against the assignor for breach of those promises, which are that:

- (1) the assignor will do nothing to interfere with the assignee's enforcement of the rights against the obligor;
- (2) the assigned rights are valid and not subject to undisclosed defenses;
- and (3) any documents evidencing the transferred rights are genuine.

However, the assignor does not make implied promises that the obligor is willing or able to perform.

For instance, in the television example above, suppose Yentieng assigned to Vithun his rights to receive \$200 from An, in exchange for some consideration. Yentieng would be making implied promises that he actually has the right to receive the \$200, and that he will not try to transfer the same rights to someone else, which could interfere with Vithun's ability to enforce the assignment. But he would not be making an implied promise that An was willing or able to pay the \$200.

In some cases assignments may be terminated, even though they are present-time transfers. However, many common law jurisdictions say that an assignment cannot be terminated if:

- (1) the assignor makes it in exchange for consideration;
- (2) the assignor delivers to the assignee a document that symbolizes the rights being transferred (such as an insurance policy or stock certificate);
- (3) the assignor delivers a written assignment to the assignee;
- (4) the assignee justifiably relies to his detriment on the assignment;
- OR (5) the obligor actually provides the performance owed to the assignee, the assignee gets a court judgment against the obligor with regard to the assigned right, or the assignee and obligor modify the assigned right with a new contract.

These rules basically mean that assignments for consideration cannot be terminated. Gratuitous assignments can be terminated except where one of the other situations listed above exists.



In many jurisdictions, where an assignment can still be terminated, it terminates when:

- (1) the assignor revokes it through notice to the assignee or obligor;
 - (2) the assignor dies or loses capacity;
 - (3) bankruptcy proceedings with regard to the assignor begin;
 - (4) the obligor demands or accepts performance from the assignor;
- OR (5) the assignor assigns the same rights to someone else.

CASE STUDY 249

FACTS Sem makes a contract to buy 100 tons of gravel from Yuthy. Yuthy assigns his right to receive the payment for the gravel to his mother Veyrith, delivering a written document to her that assigns the right. Veyrith thanks her son, but she promises nothing in return for his assignment.

When Sem finds out about this assignment, he is unhappy, because he does not like Veyrith. Sem immediately demands performance from Yuthy, saying that Yuthy's assignment was gratuitous and that he is terminating it. Yuthy says the assignment can no longer be terminated.

QUESTION OF LAW Can Yuthy's assignment to his mother be terminated?

DECISION No. Yuthy's assignment to his mother Veyrith could no longer be terminated because, although the assignment was gratuitous, it was made in a writing delivered to Veyrith.

Gratuitous assignments can often be terminated. However, they cannot be terminated in certain situations. One of these situations is where the assignor delivers a written assignment to the assignee.

In this case, Yuthy assigned to his mother Veyrith his rights to receive payment under the gravel sale contract he had with Sem. Sem tried to terminate this assignment by demanding performance from the assignor Yuthy. That would normally have the effect of terminating an assignment that could still be terminated. But this assignment could no longer be terminated, because Yuthy gave his mother a written assignment. So Sem will have to pay the money to Veyrith.

Sometimes parties assign some but not all of their rights under a contract. Courts allow this kind of partial assignment. However, one potential problem with this is that the obligor might have to defend more than one lawsuit about the same contract. To protect the obligor from that possibility, many jurisdictions say the obligor can force the assignee to join the assignor in--force him to be part of--any lawsuit to enforce the assigned rights.

In other cases, assignors try to assign the same rights to more than one assignee, perhaps because they are short of money. This kind of "multiple assignment" can be a big problem. Of course, if the first assignment can be terminated, the assignment to a new assignee will terminate the first assignment, as noted above. In that case, the second assignee will have the assigned rights.

If the first assignment cannot be terminated, and the assignor later assigns the same rights to another assignee, the later assignment violates any implied promises made as described above. The assignor is liable for harm caused by that kind of breach.

But another problem is which of the assignments is valid--which of the assignees will have the right to receive performance from the obligor. Jurisdictions have different and often complex rules about this, and this text cannot fully explain them. Briefly, many jurisdictions say that the first assignee to receive an assignment that cannot be terminated has the rights, unless:

- (1) the other assignee gave consideration for the rights, in good faith, and without knowing or having reason to know of the first assignment;
- AND (2) (a) the other assignee received the performance covered by the assigned rights, a court judgment against the obligor, or a document symbolizing the transferred rights; OR
- (b) the other assignee made a new contract with the obligor.

The Uniform Commercial Code in the United States basically says that, for assignments of a security interest in personal property or fixtures, the first assignee to file a financing statement with the proper public authority has the assigned rights. A basic purpose of filing these financing statements is to give notice to other potential assignees and creditors about the assignment. Other jurisdictions appear to say that the first assignee to give notice to the obligor has the assigned rights.

Many contracts say not only that assignment is permitted, but also that the obligor waives defenses that obligor might have against the assignee. This kind of "waiver of defense" clause is often used in sale or lease contracts. It allows the seller or lessor to assign strong rights to collect payment to someone else if he chooses to do so--strong because they are not subject to the usual defenses! These "waiver of defense" clauses can be very powerful. They could actually result in an obligor having to pay for goods or services that are defective, or never provided at all! For example, in Case Study 249, a waiver of defense clause might mean that the obligor Sem could not assert any defenses against the assignee Veyrith, even if the assignor Yuthy failed to provide the gravel as the contract required.

Many jurisdictions will enforce these "waiver of defense" clauses, but there are often limits on the ability of parties to use them. Consumer protection statutes limit their use, and doctrines like unconscionability and adhesion may also do so. Unconscionability and adhesion were discussed in Chapter 7 ("Other Contract Formation Problems"), Section 7.7.

Another issue related to the assignee's rights is whether the assignor and obligor can modify the original contract in a way that changes the assigned rights. Many jurisdictions permit these changes only in certain situations. For example, jurisdictions that apply the Uniform Commercial Code in the United States allow such changes before the obligor receives notice of the assignment, and after the obligor receives such notice if the assignor has not yet fully performed--but in both cases only if the changes are made in good faith and in accord with reasonable commercial standards.

***** ADDITIONAL REFERENCE:** Chapter 7 ("Other Contract Formation Problems"), Section 7.7 discusses unconscionability and adhesion contracts, and Section 7.8 discusses promissory estoppel; and Chapter 10 ("Remedies") discusses remedies parties may have where there is some problem in the formation or performance of a contract.

11.4 A Delegation of Duties Occurs Where a Party to a Contract Transfers His Duties under the Contract to a Third Party

The other important type of transfer of contract elements to third parties is delegation of duties. This Section will explain the basic elements and effects of such a delegation, and what contract duties can be delegated. Specifically, it will discuss:

- (1) the basic elements of a delegation of duties (Section 11.4a); and
- (2) what contract rights can be delegated (Section 11.4b).

11.4a What Is a Delegation of Duties?

Delegation of duties is probably less common than assignment of rights. But it is still important to the operation of free market economies.

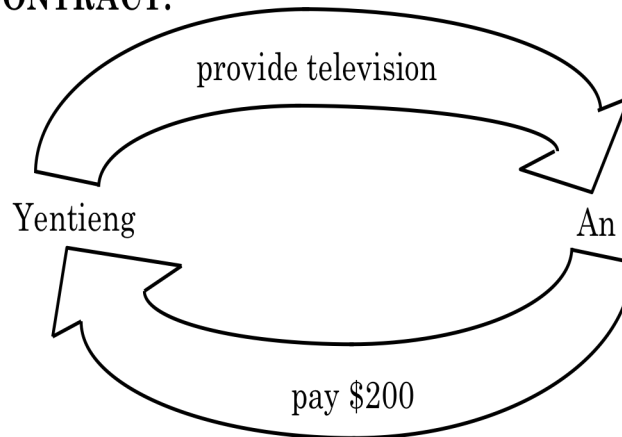
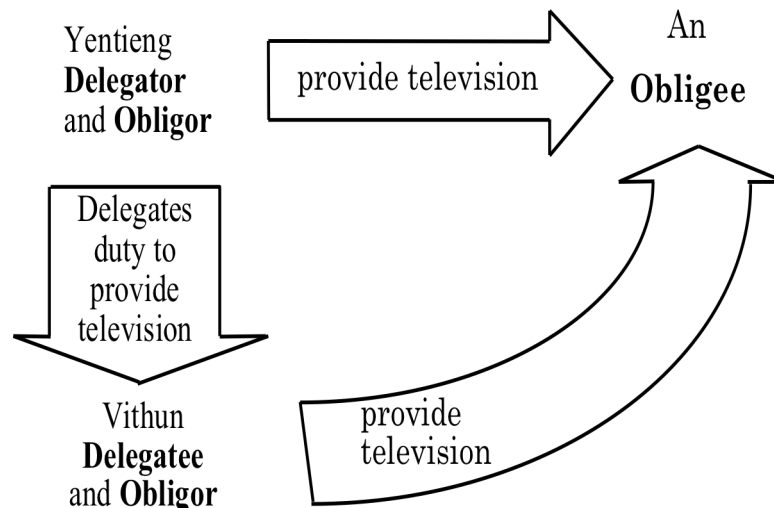
***** DEFINITION:** A **delegation of duties** is a transfer of contract duties from one party to a contract to a third party.

In addition to the fundamental definition above, there are also some related terms that are necessary to a discussion of delegation. First, the party who actually makes the delegation of contract rights is called the delegator. The delegator remains an obligor, since the delegator remains responsible for the duties even after he has delegated them. The third party who receives the duties is called the delegatee. The delegatee may also be an obligor, because he may now also have the duty to perform under the original contract.

And the original contract party who did not make the delegation is called the obligee, because he is the party to whom the delegator and possibly the delegatee owe the duty to perform.

For instance, recall the example from Section 11.3 above, in which An agreed to buy a television from Yentieng for \$200. Suppose that, after this contract is made, Yentieng delegates to Vithun his duty to provide the television. Vithun promises to supply the television, perhaps because Vithun owes Yentieng money from some prior transaction. In this situation, Yentieng is the delegator, because he has delegated his contract duties to Vithun. Yentieng remains an obligor, since delegators remain liable for the duties they delegate. Vithun is the delegatee, because he is the third party who has received the contract duties. Vithun is also an obligor, because Vithun has actually promised to perform. He now has the duty to provide the television. And An is still the obligee, because he still has the right to receive the television. The result of this delegation is that An has an enforceable right to receive the television from Vithun--and the right to receive the television from Yentieng, if Vithun fails to provide it. The following chart illustrates how a typical delegation of duties works, using this example.



Illustration: How a Typical Delegation of Duties Works**CONTRACT:****LATER, YENTIENG DELEGATES:**

Perhaps the most important aspect of delegations is that the delegator remains liable for performance of the duty--even though he has transferred it to the delegatee. In most cases, the delegatee performs the duty, and the delegator need not get involved any further. However, if the delegatee fails to perform the duty according to the original contract, the obligee can require the delegator to perform, or seek a remedy for breach of contract. In the above example, that means that if Vithun fails to supply the television according to the contract, An may seek a remedy from Yentieng.

One basic reason that the delegator remains liable is that, without this rule, delegators might not have a strong motivation to delegate to responsible delegates. Obligees could be harmed in that way. In addition,

without this rule, parties could escape a variety of obligations by simply delegating them to a party who could not perform them, and who could not be held fully responsible, such as a bankrupt person.

In a way, the responsibility of the delegator is like that of a surety. This is because the delegator is responsible to provide performance to a creditor (the obligee) in the event that a debtor (the delegatee) fails to perform.

*** **ADDITIONAL REFERENCE:** Chapter 6 ("Formality"), Section 6.3d contains further discussion of suretyship contracts.

Of course, there is a way for the delegator to end his obligations under the contract: a novation. As the reader will recall from Section 11.2 and from Chapter 9 ("Performance and Discharge of Duties"), Section 9.7e, a novation occurs where the parties to an existing contract agree with a third party that the third party will actually take the place of one of the parties to the existing contract. The effect of a novation is that the duties of the party being replaced in the contract are discharged. Of course, a novation requires the consent (express or implied) of the obligee; a delegation does not.

*** **ADDITIONAL REFERENCE:** Chapter 9 ("Performance and Discharge of Duties"), Section 9.7e contains further discussion of novations.

The basic requirements for an effective delegation are that:

- (1) the delegator clearly indicates an intent to transfer a contract duty to the delegatee;
- AND (2) the duty is effectively delegated, which occurs if the obligee will still receive the substantial benefit of his bargain and no valid contract provision forbids the delegation.

The second requirement will be discussed in detail in Section 11.4b, below.

As for the first requirement, the delegator can indicate an intent to transfer a contract duty in two ways:

- (1) the delegator delegates to the delegatee the option to perform the duty, but the delegatee does not promise to do so;
- or (2) the delegator delegates the duty, and the delegatee promises to perform it.

In the first situation above, the delegatee has the option to perform or not. If he does not, then of course the delegator must perform, or be liable to the obligee. In the second situation above, where the delegatee promises to perform, it appears that the delegation requires a contract between the delegator and the delegatee. That contract is subject to all the usual requirements of contracts. The reason for this is fairness to the delegatee.

It would generally not be fair to expect a party to perform contract duties if he never agreed to do so! This is a basic principle of free market contract law.

As with assignments, it is also important to know what is generally not required for an effective delegation. In general, the parties need not notify the obligee, and the obligee need not consent to the delegation. In addition, the usual contract requirements do not apply unless the delegatee actually promises to perform the duties, as noted above.

The main effect of a delegation is that the delegatee has the option or duty to perform. But in either case, the delegator is still responsible for the performance of the duty.

Where the delegatee has promised to perform, the delegatee is liable for failing to perform the contract duties he has assumed. The reason is that he has basically made a contract with the delegator to perform them. The delegator can enforce this contract against the delegatee. And it appears that the obligee can also enforce the contract between the delegator and the delegatee. This is because he will generally be a third party beneficiary of that contract. This is very common, and would appear to be the case unless the circumstances show that the delegatee actually meant his promise to benefit only the delegator, and not the obligee. In any case, when a delegatee promises to perform the delegated duty and will therefore be liable to the obligee, many jurisdictions say that the delegatee "assumes" the duty. Third party beneficiary contracts will be discussed in more detail in Section 11.5, below.

CASE STUDY 250

FACTS Pheap makes a contract to buy Chhean's house and land. At the time of the sale, Chhean still owes \$20,000 to the Pailin Bank under a mortgage which Chhean took several years earlier in order to borrow enough money to buy the property. As part of the contract between Chhean and Pheap, Pheap agrees to "assume" Chhean's duties to pay this \$20,000 according to the loan contract with the Bank.

A few months later, Pheap grows short of money. He stops making payments to the Bank. When the Bank president Sary asks Pheap what the problem is, Pheap says he never made a contract with the Bank, so he has no obligation to pay the Bank. After negotiation fails, the Bank asks the court for help.

QUESTION OF LAW Can the Bank enforce Pheap's promise to pay the rest of the money Chhean owed to the Bank under his original loan contract?

DECISION Yes. The Bank can enforce Pheap's promise, because Pheap's promise in the property sale contract was a delegation to Pheap of Chhean's duty to repay money under Chhean's loan agreement with the Bank.

When one party agrees to "assume" a contract obligation of another party, that is a delegation of duties to the party who assumes the obligation. It means that the delegatee is liable to the obligee for the performance of that obligation.

In this case, Pheap agreed, in his property sale contract, to assume Chhean's obligation to repay the remainder of Chhean's debt to the Pailin Bank under a loan agreement. This means that Chhean delegated to Pheap Chhean's duty to make these payments. Pheap will be liable for a failure to make those payments to the Pailin Bank, the obligee, and also liable to Chhean, the delegator. The Bank is a third party beneficiary of the property sale contract. Of course, Chhean also remains liable to the Bank, since delegators remain liable to obligees for the performance of delegated duties. So if the Bank cannot get the amount due from Pheap, it can still seek it from Chhean.

11.4b Duties Can Be Delegated If the Obligee Will Still Receive the Substantial Benefit of His Bargain

Many jurisdictions say that duties can generally be delegated if the obligee will still receive the substantial benefit of his bargain. This is true even if the obligee objects to the delegation.

To determine whether the obligee will receive the substantial benefit of his bargain, many courts basically ask two key questions:

- (1) can this duty be delegated at all?
- and (2) if so, can it be delegated to the delegatee in this particular situation?

If the answer to both questions is "yes," then the delegation is effective. Whether a duty is delegable at all depends on whether the obligee has a substantial interest in receiving performance only from the delegator, and not from someone else. Assuming the duty is delegable, courts then ask whether the particular delegation in a case will allow the obligee to receive the substantial benefit of his bargain. In practice, it seems that a delegatee who is especially qualified may be able to receive duties that would not usually be delegable. So the answers to the two questions above may be related. The basic reason for these limits is to protect obligees from delegations which would harm them. That would in turn harm the freedom of contract and valuable economic activity.

The "substantial benefit" rule means that certain kinds of duties are more likely to be effectively delegated than others. In some cases, it is less likely that the obligee will have a substantial interest in getting performance

only from the delegator. In particular, the following kinds of duties are likely to be delegable:

- (1) duties to pay money;
- (2) duties to provide commonly available goods; and
- (3) duties to provide relatively simple or straightforward services, including construction and repair services.

The kinds of services that are probably delegable include relatively "impersonal" or "objective" activities such as building or painting a simple building, transporting some cargo, or digging a well.

However, most duties which involve truly personal services, especially those involving special or unique skills, are unlikely to be effectively delegated. Important examples of these kinds of more "unique" or "subjective" duties include:

- (1) duties to teach;
- (2) duties to provide aesthetic performances, such as singing;
- (3) duties to provide unique manufacturing, construction or repair services; and
- (4) duties to provide professional services, such as those of physicians or attorneys.

This distinction between activities that can be more easily measured "objectively" and those that cannot is comparable to some extent to the distinctions many jurisdictions make in analyzing conditions of approval. These were discussed in detail in Chapter 9 ("Performance and Discharge of Duties"), Section 9.4l.

***** ADDITIONAL REFERENCE:** Chapter 9 ("Performance and Discharge of Duties"), Section 9.4l discusses conditions of approval.

Of course, whether a duty is effectively delegated often depends on the particular situation involved. A relatively straightforward contract duty may not be effectively delegated if the proposed delegatee is simply not competent to perform it, or if the facts show that the obligee really wanted only the delegator to perform it. For example, a company might normally be able to delegate the duty to supply wood to another company. But if the facts show that the buyer was relying on the skills of the employees or agents of the delegator, the delegation might not be effective. On the other hand, a duty involving more special skills might be delegable if the facts show that the delegatee actually has those special skills, just as the delegator did. For example, a party might be able to delegate duties that call for the building of a large new port--which would probably require special skills--to a highly qualified builder with a great deal of relevant experience.

So as already noted, the answers to the two key questions discussed above may be related.

In general, it seems that parties have far more power to control through contract provisions whether their duties will be delegated than they do whether rights can be assigned. Parties can agree in the contract itself that duties can be delegated. If they do, that provision will generally be enforced, and the duties can be delegated even if they would seem too personal or unique to be effectively delegated under the rules discussed above.

Contracts may also prohibit the delegation of duties through "no delegation clauses." Such provisions will also generally be enforced. A "no delegation clause" might result in a duty that would normally seem to be delegable not being delegable. For example, a duty to build a relatively simple structure like a latrine would probably be delegable in most cases. But if a contract provision forbids delegation of that duty, courts are likely to enforce the provision. It appears that some jurisdictions do not interpret no delegation clauses to forbid the delegation of completely non-personal duties, like the duty to pay money. And as noted in Section 11.3b above, many jurisdictions interpret a contract provision saying that the "contract shall not be assigned" to mean only that the duties cannot be delegated.

CASE STUDY 251

FACTS Vannpok's computer broke. So he took it to the Cambodian Technologies Computer Shop. The Shop found several things wrong with the computer. The Shop said that the computer would not be too difficult for the Shop to fix. Cambodian Technologies and Vannpok made a contract under which the Shop agreed to repair the computer for a certain price within one week.

A few days later, the Shop became extremely busy. It decided to delegate some of its duties to repair computers, because otherwise it would have trouble completing all its work on time. It attempted to delegate its duty to repair Vannpok's computer to Phaveng, an attorney who was a friend of the Shop's owner--but who had no skill or experience with computer repair! Vannpok objected.

QUESTION OF LAW Was the Shop's attempted delegation to Phaveng of the Shop's duty to repair Vannpok's computer effective?

DECISION Probably not. Although the duty to repair the computer was probably delegable, it is unlikely that it could properly be delegated to Phaveng, who was not competent to repair computers.

Duties can generally be delegated if the obligee will still receive the substantial benefit of his bargain. To determine whether a delegation is effective, many jurisdictions ask whether the duty can be delegated at all,

and then whether it has been effectively delegated in the particular situation involved.

In this case, the Cambodian Technologies Computer Shop tried to delegate its duties to perform relatively straightforward repairs on Vannpok's computer to Phaveng. These duties were probably delegable in general. They were relatively straightforward, and there is no indication that the obligee Vannpok had a substantial interest in having only the Shop do the work. However, it seems that Vannpok will probably not receive the substantial benefit of his bargain. This is because the particular delegatee the Shop chose--Phaveng--was an attorney with no skills or experience in fixing computers. Therefore, this attempted delegation is probably not effective, and Vannpok could refuse to accept performance from Phaveng. Of course, as the delegator, the Shop remains liable in any case.

11.5 A Third Party Beneficiary May Be Able to Enforce a Contract, Even Though He Is Not a Party to That Contract

It is also possible for a third party to gain contract rights under a contract between two other parties at the time that contract is made, even though the third party is not a party to the contract. This occurs frequently, and the rights of such third party beneficiaries can be very important.

This Section will explain some basic aspects of third party beneficiaries. In particular, it will discuss:

- (1) when third party beneficiaries gain the rights to enforce contracts (Section 11.5a);
- (2) particular situations where third party beneficiaries may exist (Section 11.5b); and
- (3) the rights and duties of parties where there is a third party beneficiary (Section 11.5c).

11.5a An Intended Third Party Beneficiary Can Enforce a Contract, but an Unintended or Incidental Beneficiary Cannot

Not every third party who will receive some benefit from the performance of a contract gains rights under that contract. In fact, many jurisdictions say that a third party gains such rights only where the third party was an intended beneficiary. That means that the parties to the original contract intended that the third party have the right to enforce their contract. But if a third party is merely an incidental or unintended beneficiary, he cannot enforce the contract.

There are also two other important terms to know in the area of third party beneficiaries. The contract party making the promise whose performance will benefit the third party beneficiary is called the promisor.

The contract party receiving the promise whose performance will benefit the third party is called the promisee. Of course, most contract parties are both promisors and promisees. The use of these terms here is simply to help explain the relationship of the contract parties to each other and to the third party beneficiary.

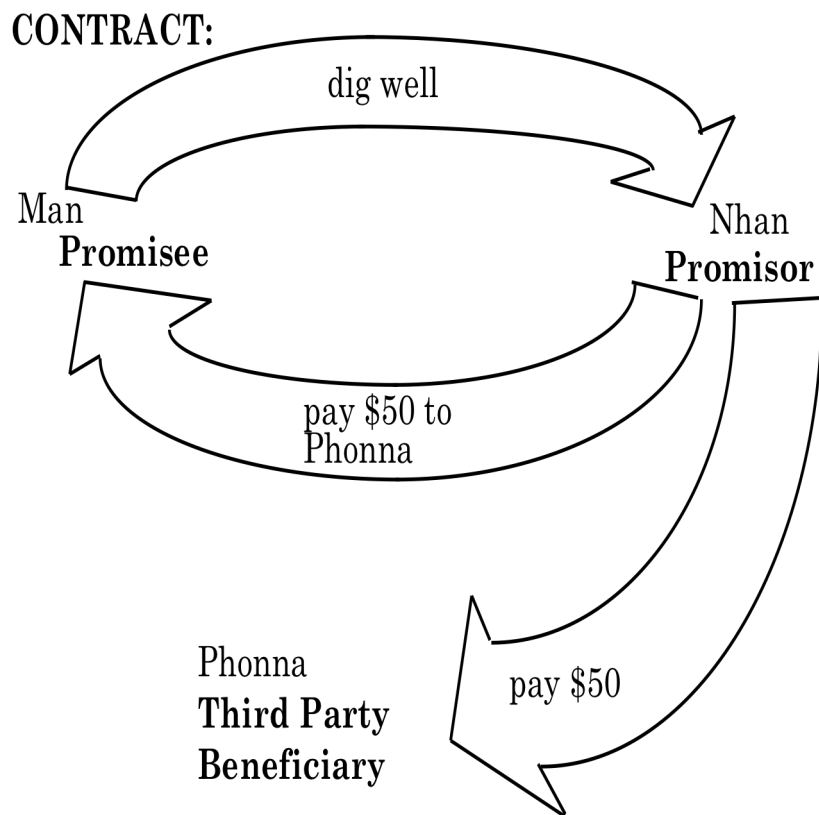
The most important issue courts must decide with respect to third party beneficiaries is whether a third party really was an intended beneficiary or not. Sometimes this is easy.

For example, suppose Man and Nhan made a contract under which Man agreed to dig a well for Nhan, and in exchange Nhan agreed to pay \$50 to Phonna. In this case, Phonna is not a party to the contract between Man and Nhan. He is a third party. However, it is clear that the contract parties intended to benefit him in their contract, since they agreed that Nhan would pay Phonna \$50. So Phonna is an intended third party beneficiary of this contract, and Phonna can enforce the contract against Nhan. In this situation, Nhan would be the promisor with regard to this promise, since it is her promise that will benefit Phonna. Man would be a promisee, since he received the promise.

However, suppose that the well Man agreed to dig would also benefit Nhan's neighbor Banh, because it would make Banh's land more valuable if there was a well next to it. Banh is probably an unintended beneficiary. This is because, even though the performance of the contract will benefit Banh, there is nothing to show that the parties' intent in making the contract was to benefit Banh.

The following chart shows how intended third party beneficiaries may be created.



Illustration: How Third Party Beneficiaries Are Created

Of course, in this illustration, Man is the "promisee" and Nhan is the "promisor" with regard to the promise to pay \$50--the promise that benefits Phonna. With regard to the promise to dig the well, Man is the promisor, and Nhan is the promisee.

Sometimes it is not so easy to tell if a third party beneficiary is intended or not. Suppose that Man, instead of agreeing to dig a well, agreed to be a night guard for Nhan. In exchange, Nhan promised to pay Man a certain salary. Suppose also that Nhan's friend Phonna is at Nhan's house one night, when a robber overpowers Man and robs Phonna. Phonna might claim to be an intended beneficiary of the guard contract between Man and Nhan, since the main purpose of the contract was to provide security at Nhan's house. However, based on these facts, a court would probably find that Phonna was not an intended beneficiary. This is because there is nothing to show that Nhan and Man intended to benefit Phonna in particular. As an unintended or incidental beneficiary, Phonna cannot enforce the contract in this situation.

Traditionally, many jurisdictions have said that there are two main kinds of intended beneficiaries:

- (1) donee beneficiaries, and
- (2) creditor beneficiaries.

Different jurisdictions have not agreed about exactly which beneficiaries fall into these categories. But basically, donee beneficiaries exist where the promisee is trying to make a gift to the beneficiary. Creditor beneficiaries exist where the promisee is trying to fulfill some existing legal duty that he owes or believes he owes to the beneficiary. Both donee and creditor beneficiaries can enforce contracts.

It appears that the main reason that jurisdictions make this donee/creditor distinction is that they may apply different rules about when the rights of the beneficiary "vest" in the two different situations. To "vest" basically means to become the present property of the holder of the right. The distinction might also affect what remedies will be available if the promisor fails to perform. A creditor beneficiary can generally sue the promisor or the promisee (under the prior legal obligation). But a donee beneficiary can generally enforce only the promise of the promisor against that promisor (since there is generally no prior legal obligation between the promisee and beneficiary in that case). This will be further discussed in Section 11.5c, below.

11.5b Particular Situations Where Third Party Beneficiaries May Exist

There are a number of important examples of situations where intended beneficiaries may exist. This Section will discuss a few of these situations.

One situation where third party beneficiaries may exist is where loan creditors like banks become beneficiaries of contracts in which a party assumes a debtor's duty to repay to the creditor a loan secured by a mortgage or other security interest in property. Some jurisdictions limit the amount that creditors can recover from debtors in this situation.

For instance, in Case Study 250, Pheap promised in his contract to buy Chhean's land that he would repay money Chhean owed to the Pailin Bank under a loan agreement secured by a mortgage. In that situation, Chhean delegated his duties to Pheap. The Bank was an intended third party beneficiary of the property sale contract. This is because Chhean (the promisee) and Pheap (the promisor) clearly intended to benefit the Bank when they made their agreement. Of course, the Bank was a creditor beneficiary, since Chhean obviously made the agreement partly in order to satisfy the existing debt he had to the Bank, and not as a gift to the Bank. So the Bank could enforce promises to repay the debt against Pheap or Chhean.

However, it is important to look closely to see whether a party in a situation like Case Study 250 has really "assumed" the loan obligations, or whether he has bought property "subject to" the loan obligations. If a buyer buys property "subject to" a secured loan of the seller, many jurisdictions say that the buyer is not personally liable for the debt to the creditor. The buyer will probably still lose the property if the debt is not paid according to the loan contract. But the buyer will not be liable beyond that for the amount of the debt which is still owing to the creditor, if any.

Another important type of intended beneficiary is a third party beneficiary under a life insurance policy. These kinds of policies can help to protect people from financial difficulties in the event of the death of someone on whom they depend.

CASE STUDY 252

FACTS Kheng buys a life insurance policy from the Bad Day Insurance Company. The policy basically states that, in the event of Kheng's death during the term of the policy, Bad Day will pay Kheng's beneficiaries \$50,000. Kheng designates her two young children as her beneficiaries.

Unfortunately, Kheng dies while the insurance policy is in force. The Insurance Company claims it has no obligation to pay, and Kheng is not alive to enforce the contract she made. But Kheng's children say they have the right to enforce the policy against the insurance company.

QUESTION OF LAW Can Kheng's children enforce this insurance policy against the Bad Day Insurance Company, even though the children are not parties to the contract?

DECISION Yes. Kheng's children can enforce the insurance policy against Bad Day because they are third party beneficiaries of the contract.

Third party beneficiaries can enforce contracts which are intended to benefit them, even though they are not parties to the contracts. In this case, Kheng and the Bad Day Insurance Company made a contract which basically said that, if Kheng died during the term of the policy, Bad Day would pay \$50,000 to Kheng's beneficiaries--her children. Kheng did die while the policy was in force, but Bad Day refused to pay.

In this situation, Kheng's children can enforce the insurance contract even though they were not parties to it. That is because the children are intended third party beneficiaries of the contract. The promisee Kheng and the promisor Bad Day clearly intended to benefit the children by making the life insurance contract, since the main reason for the contract was to protect Kheng's beneficiaries in the event of her death. Kheng's children are donee beneficiaries. So they can enforce the contract against Bad Day, and collect the proceeds of the policy.

Other types of contracts which may protect children as third party beneficiaries are divorce agreements and child support agreements. These agreements may provide that one party will provide certain payments or other performances to the children of a couple who will no longer be married. In these cases, the parties clearly intend that the children named in the contract will receive certain benefits. And the children who are named are generally third party beneficiaries who can enforce the promises against the promisor.

Sometimes the issue of third party beneficiaries can arise in contracts where the government is a party. Often, governments make contracts with private parties to perform activities whose main purpose is to provide benefits to a certain group of citizens. In these cases, citizens in these groups might argue that they were intended third party beneficiaries, so they should be able to enforce the contracts! For example, a government might hire a private company to provide job training to some of its poorest citizens.

In these kinds of cases, the general rule seems to be that such citizens do not have the right to sue such promisees if they fail to perform their contracts with the government. It appears that courts feel the parties do not generally intend citizens to have that right.

However, some jurisdictions say that citizens may actually have such a right in two special cases. These are where: (1) the contract actually says they have that right; and (2) the government has a duty to provide the service it has hired the private company to provide, such as the duty of a municipality to keep its streets in good condition. For example, suppose a person is injured because a private company fails to perform a contract to maintain streets in a situation like that. Some jurisdictions would allow the injured person to sue the government or the private company as a third party beneficiary. Consider also the following Case Study.

CASE STUDY 253

FACTS The What Is Chicken? Company is about to open a new chicken processing plant in a large town in Kampot province. As part of its preparations to open, the Company makes a contract with this town to use the town's sewage system to carry away the waste that will be produced by the plant.

A clause in the contract requires the Company to remove certain dangerous types of waste before the Company's waste reaches the town's sewage system. The reason for this clause is to protect the landowners and other citizens who are farther down the sewage system from the plant from the harmful effects of these dangerous kinds of waste.

A few months after the plant opens, a local farmer named Meng notices that many of his animals are sick. After examining the animals, Meng believes that the reason for these illnesses is that the new chicken plant

has been failing to remove the dangerous kinds of waste that it promised to remove in its contract with the town. Meng asks the manager of What Is Chicken? to comply with the contract, and to compensate him for the damage he has suffered. The Company refuses. Meng asks the court for help.

QUESTION OF LAW Can Meng enforce the What Is Chicken? Company's promise to remove dangerous parts of waste which the Company made in its sewage disposal contract with the town?

DECISION Yes, in some jurisdictions. Some jurisdictions would say that downstream land owners like Meng were intended third party beneficiaries of the sewage disposal contract the town made with What is Chicken?, and that Meng could enforce the Company's promise to remove the dangerous wastes.

Third party beneficiaries can enforce contracts which are intended to benefit them, even though they are not parties to the contracts. In this case, the What Is Chicken? Company made a contract with a town to use the town's sewage system to dispose of waste from its new plant. The Company agreed in the contract to remove certain dangerous wastes before they got to the town's sewage system, in order to protect landowners and others downstream from the plant.

However, Meng believes that the Company has not removed these wastes as required by the contract, and that that is the reason some of Meng's animals are ill. Some jurisdictions would say that Meng is an intended third party beneficiary of this contract, and that Meng can therefore enforce against the Company its promise to remove the dangerous waste. Meng might be able to recover from the town as well. This is because the town probably has a duty to the public to protect them from these kinds of dangerous waste.

11.5c Rights and Duties Where There Is a Third Party Beneficiary

As noted above, where there is an intended third party beneficiary to a contract, that third party can enforce the contract. This means that the third party can enforce the contract promise against the promisor, whether the third party is a creditor beneficiary or a donee beneficiary. In general, the beneficiary would probably have the range of potential remedies discussed in Chapter 10 ("Remedies").

If the third party is a creditor beneficiary, the third party may be able to recover against the promisee also. This is because of the original legal duty of the promisee that motivated the promisee to make the contract that benefits the beneficiary. If the third party does bring legal action against the promisee based on the original obligation, then the promisee will likely be damaged because of the promisor's failure to perform his promise. In that situation, the promisee can take legal action against the promisor.

Of course, if the third party is a donee beneficiary, it would appear that he cannot recover against the promisee, since the promisee has no legal obligation to the beneficiary. It might also seem that the promisee might not be able to recover much against the promisor in a donee beneficiary case. That is because the promisee is unlikely to have many damages where he was simply trying to give the beneficiary a gift. However, many common law jurisdictions will allow the promisee to specifically enforce the promise on behalf of the donee beneficiary, and to get restitution from the promisor.

For instance, recall the example in Section 11.5a above in which Man agreed to dig a well for Nhan, and in exchange Nhan agreed to pay \$50 to Phonna. Phonna is an intended third party beneficiary of this contract. So Phonna gains the legal right to enforce the contract against the promisor Nhan.

Suppose Man asks Nhan to pay Phonna because of a debt Man owes to Phonna from the past. In that case, Phonna is a creditor beneficiary. If Nhan fails to pay Phonna, Phonna can bring legal action against Nhan. Phonna can also sue Man, because of the old debt. And if Phonna does bring a claim against Man because of Nhan's failure to pay, Man can bring an action against Nhan for the damage caused to Man.

Now suppose Man asked Nhan to pay Phonna simply because Nhan likes Phonna and wants to give him a gift. Phonna would be a donee beneficiary. Phonna could enforce Nhan's promise against Nhan. Phonna would probably have nothing to enforce against Man, who was simply trying to give him a gift. However, in many common law jurisdictions, Man could enforce Nhan's promise against Nhan. Even though Man would be unlikely to have much in damages, he could ask a court for restitution of any benefits he had given to Nhan. He could also ask for specific performance of Nhan's promise to pay Phonna.

One very important issue about the rights of third party beneficiaries is whether the promisor and promisee can change those rights after they are created. This depends on when the rights "vest." As noted above, to vest basically means to become the present property of the holder of a right. It means not only that the right is enforceable--which happens as soon as the contract is formed--but that it cannot generally be taken away by other parties. So if the rights of a third party beneficiary have vested, then the promisor and promisee cannot change them to the detriment of the beneficiary without the beneficiary's consent.



Different jurisdictions have different rules about when vesting occurs. So it is important to look closely at the relevant law. Potential times when such rights may vest include at the time:

- (1) the contract is made;
- (2) the beneficiary learns of and agrees to accept the benefits;
- and (3) the beneficiary justifiably relies on the promise, such as by bringing a lawsuit about the promise.

The time of vesting may vary based on whether the beneficiary is a donee or a creditor. In some jurisdictions, the rights of donee beneficiaries vest at the time the contract is made, or as soon as the beneficiary learns of and agrees to accept the benefits, whereas the rights of creditor beneficiaries vest at the time they justifiably rely. Justifiable reliance in this situation would be similar to the kind of reliance discussed with respect to promissory estoppel, which was explained in Chapter 7 ("Other Contract Formation Problems"), Section 7.8.

Some jurisdictions say the rights of minors vest earlier, often at the time of the contract. This is because it can be unfair to expect minors to learn of and agree to the benefits.

Finally, the promisor and promisee can agree in the contract that the rights they are creating cannot be changed without the consent of the beneficiary. Such clauses are enforceable.

CASE STUDY 254

FACTS Jim and Sam make a contract together. In the contract, Jim agrees to pay Sam \$1,000. In exchange Sam agrees to supply new commercial law books to Sathya, Sovannara, Charavuth, Neam, Sethik, Sorit, Phally, Sarun, Much, and Saray, so that they can use the books in their important legal development and reform work. Jim immediately informs these ten people about how he has arranged to get the books for them, and they all agree to accept the books.

Jim pays Sam \$1,000 as the contract requires. However, Sam does not supply any law books. Meanwhile, Jim has gone to Thailand and no one can find him. The ten people above ask Sam for the books. But Sam says that, just before Jim went to Thailand, he and Sam agreed to rescind the contract, and that in any case, Sam no longer works in law.

The ten people ask their attorney what they can do. The attorney finds out that they live in a jurisdiction where vesting occurs when a third party beneficiary justifiably relies on a promise, or brings a lawsuit about it, or agrees to accept the benefits of it.

QUESTION OF LAW Can the ten people above enforce Sam's promise to supply them with law books?

DECISION Yes. The ten people above can enforce Sam's promise, because their rights under the contract between Jim and Sam vested before any potential rescission could have occurred.

Third party beneficiaries can enforce contracts which are intended to benefit them. Once these third party rights have vested, they cannot be changed by the parties to the contract. In this jurisdiction, vesting occurs when a third party beneficiary justifiably relies on a promise, or brings a lawsuit about it, or agrees to accept the benefits of it.

In this case, Sam and Jim made a contract under which Jim would pay \$1,000 to Sam. In exchange, Sam was to supply law books to Sathya, Sovannara, Charavuth, Neam, Sethik, Sorit, Phally, Sarun, Much, and Saray. This made these ten people third party beneficiaries. Jim told the beneficiaries about the promise of Sam, and they all agreed to accept the books. However, although Jim paid the money to Sam, Sam never provided the books as the contract required. Instead, Sam claimed that he and Jim had rescinded the contract just before Jim left for Thailand.

In this situation, the ten people above can enforce Sam's promise to supply them with law books, even if what Sam claims is true. The reason is that Jim told the beneficiaries about the promise of Sam, and they all agreed to accept the books, before Sam claims the rescission occurred. In this jurisdiction, that meant that the rights of the third party beneficiaries vested. After vesting, the rights could not be taken away by a modification or rescission of the agreement by the promisor and promisee. In this case, the ten beneficiaries can recover from Sam.

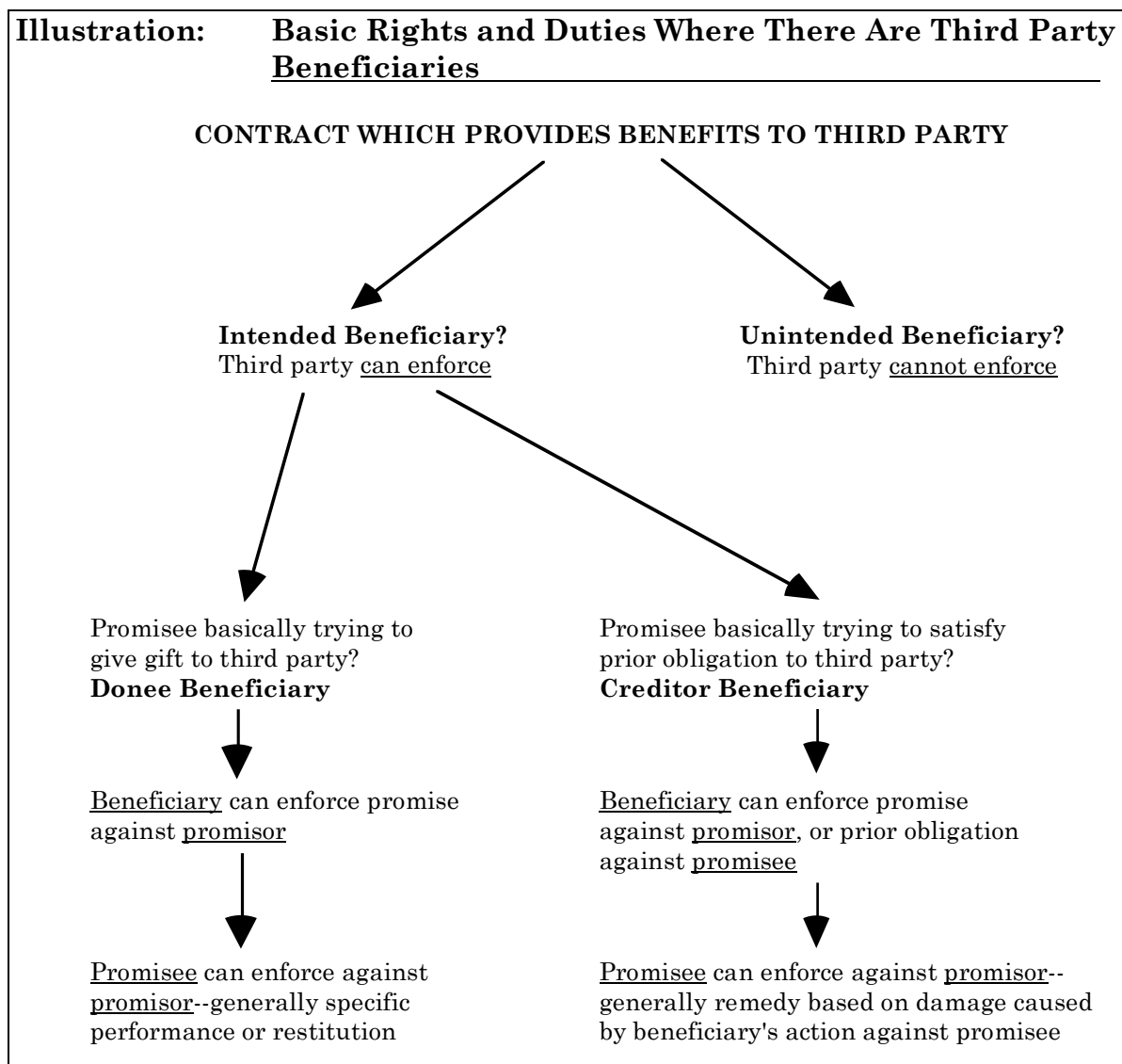
A final important issue is the defenses of the promisor in the event that a third party beneficiary tries to enforce his rights. In general, the promisor has all the defenses against the third party which the promisor would have if the promisee sued the promisor under the original contract. That means that, if the third party beneficiary tries to enforce the contract against the promisor, the promisor can defend himself on the basis of the full range of formation problems discussed in Chapters 2-7 of this text. The promisor can also defend himself on the basis that the promisee did not perform as required by the contract, or that some other event caused the promisor's duty to perform to not become due or to be discharged. These issues were discussed in detail in Chapter 9 ("Performance and Discharge of Duties").

There are limits on the potential defenses of the promisor. If the beneficiary's rights have vested, the promisor cannot argue that the original contract has been rescinded or modified. In addition, the promisor cannot use defenses based on transactions between the third party beneficiary and

the promisee. Such transactions would exist primarily where there was a creditor beneficiary.

For instance, in the well digging example above, Man agreed to dig a well for Nhan, and in exchange Nhan agreed to pay \$50 to Phonna. Suppose Nhan failed to pay Phonna, and Phonna tried to enforce Nhan's promise against Nhan. Nhan could defend herself on the basis that there was some formation problem, such as legality or duress. Nhan could also use the defense that her duty to pay never became due because Man failed to dig the well, and that the digging of the well was a condition precedent to Nhan's duty to pay. But she not could not raise issues related to any transactions between Man and Phonna.

The following chart illustrates some of the basic rules discussed above about the rights and duties of the parties in a third party beneficiary situation.



***** ADDITIONAL REFERENCE:** Chapters 2-7 discuss various problems in the formation of contracts; Chapter 7 ("Other Contract Formation Problems"), Section 7.8 discusses promissory estoppel; Chapter 9 ("Performance and Discharge of Duties") discusses when duties become due, and when they are discharged; and Chapter 10 ("Remedies") discusses remedies that may be available where parties fail to perform contracts.

11.6 Third Party Rights and Duties in the Cambodian Legal Tradition and the Civil Law Tradition

The approaches of the Cambodian law tradition and the civil law tradition to third party rights and duties seem generally compatible with the approach discussed in this Chapter, although there are some differences in the ways the different traditions discuss the issues.

***** CAMBODIAN LAW PERSPECTIVE:** The current Contract Law of Cambodia (Decree #38D (1988)) contains a number of provisions relevant to third party rights and duties. They seem generally compatible with the ideas discussed earlier in this Chapter. Some are briefly discussed below.

Article 22 of Decree #38D states that a "contract binds only the parties to the contract." This is consistent with the general free market rules about third parties, as discussed above.

Chapter 2, Section 1 deals with sales contracts. A number of articles pertain to objections by third parties who claim some right in the property being sold. Article 41 notes that third parties lose their rights to object to real property sales at the time the sale deed is certified and registered, and to personal property sales at the time of delivery, or at the time of deed certification, where that practice is used. Articles 43-46 deal with the seller's duties to protect the buyer from claims by third parties. Article 48 gives the buyer the right to rescind and get damages where the seller obtained the property through a crime. Article 52 provides that a buyer who has the sale item can suspend payment to the seller in the event of a third party claim until that claim is resolved.

Chapter 2, Section 8 regulates leases. Article 103 provides that lessors must "protect" lessees from the claims of third parties who may assert rights in leased property, such as a "right of mortgage."

Chapter 2, Section 9 governs suretyship contracts. Article 112 defines a suretyship contract as one in which "a third party called a 'surety' agrees with the creditor by contract to undertake or to perform the obligations of the debtor in the event that the debtor fails to perform his/her obligations to the creditor."

***** CIVIL LAW PERSPECTIVE:** The civil law approach to third party rights and duties appears to be generally compatible with the one discussed in this Chapter. Of course, the exact rules about third party rights and duties vary from one jurisdiction to another, so it is always important to check the relevant local law.

It appears that civil law jurisdictions apply doctrines which are comparable to the concepts of assignment of rights and delegation of duties which are discussed in this Chapter. For example, in France, the doctrine of *cession de créance* which is contained in the *Code civil* appears to be similar in many ways to the ideas about assignment of rights which were discussed in this Chapter. This doctrine allows parties to transfer contract rights to third parties. In order for such a transfer to be effective, the obligor must receive notice of it, or accept the transfer in a certified instrument. The *Code* basically provides that the transferor warrants that the right being transferred actually exists at the time of transfer. However, the transferor does not generally warrant that the obligor is solvent.

Civil law jurisdictions may also apply doctrines which are comparable to the idea of third party beneficiaries as discussed in this Chapter. For example, in France, the *Code civil* contains the doctrine of *stipulation pour autrui*. This important doctrine appears to basically say that, where it is clear that the parties to a contract intended in their contract to benefit a third party, the third party has the right to enforce the promise of that benefit against the promisor. This kind of *stipulation* can be express or implied. It appears to be required that the third party who will be benefited show an intention to accept the benefit--such as by simply claiming the benefit--in order to recover. It also seems that, until that showing occurs, the contract party receiving the promise has the power to revoke the *stipulation*. This doctrine appears to apply in cases related to life insurance, the assumption of mortgages, and other important situations.

With regard to enforcement under the doctrine of *stipulation pour autrui*, the party who is to provide the benefit to the third party can generally make any defenses against the third party that he would have had against the other party to the contract. And the other party to the contract can also enforce the promise against the party who made the promise, with the usual range of potential remedies, particularly specific performance, which might be more useful in cases where the party receiving the promise has no real damages.



11.7 Questions for Review

CHAPTER 11 – QUESTIONS FOR REVIEW

1. In what situations could third parties have rights or duties under a contract even though they are not parties to the contract?
2. What are the differences between the situation where an assignment of rights or delegation of duties occurs, and the situation where a novation occurs?
3. Why does the law say that third parties can have rights and duties in the situations discussed in this Chapter?
4. What is an assignment of rights?
5. What are some key limits on what contract rights can be assigned?
6. What are some important effects of an assignment?
7. When and how can an assignment be terminated?
8. What is a delegation of duties?
9. What is required for an effective delegation to occur?
10. When can third party beneficiaries enforce contracts?
11. What are some important examples of situations where intended third party beneficiaries may exist?
12. What are some key rights and duties of the promisor, promisee and third party where an intended third party beneficiary exists?
13. Is the Cambodian law approach to third party rights and duties generally compatible with the approach discussed in this Chapter?
14. Is the civil law approach to third party rights and duties generally compatible with the approach discussed in this Chapter?