

A carpenter owed a bank \$22,000 on an outstanding personal loan. The carpenter and a homeowner entered into a contract under which the carpenter agreed to perform work for the homeowner and the homeowner agreed to pay \$22,000 to the bank within 30 days of completion of the work.

The carpenter completed the work, but the homeowner incurred costs of \$2,000 to correct minor deficiencies in the work.

What amount, if any, is the homeowner obligated to pay the bank?

- A. \$20,000, because the bank, as an intended beneficiary of the homeowner's contract with the carpenter, stands in the position of the carpenter.
- B. \$22,000, and the homeowner can seek damages from the carpenter for the deficiencies in the work.
- C. Nothing, because the bank is an incidental beneficiary of the homeowner's contract with the carpenter.
- D. Nothing, because the carpenter's breach discharged the homeowner's obligation to pay the bank.

Incorrect

Correct answer A

Collecting Statistics

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Explanation:

A **third-party beneficiary** is a nonparty to a contract who receives some advantage or benefit from that contract. There are two types of third-party beneficiaries:

Intended – receive a *direct benefit* from the contract because the **contracting parties so intended** (eg, the contract provides that payment will go directly to a third party)

Incidental – receive some *indirect benefit* from the contract even though there was **no contractual intent** to benefit them (ie, all third-party beneficiaries who are not intended beneficiaries)

Intended beneficiaries have **contractual rights** and may sue to enforce them. However, a party to the contract can **assert any defense or claim against the beneficiary** that the party **would have against the other contracting party**.

Here, the bank is an *intended* beneficiary to the contract between the carpenter and the homeowner because the contract provides that the homeowner will pay the bank for the carpenter's services (**Choice C**). Therefore, the bank has a contractual right to the payment. But since the carpenter's work was deficient (homeowner's defense against carpenter), the homeowner may assert that defense against the bank and withhold the \$2,000 incurred to correct the deficiencies from the \$22,000 owed the bank. As a result, the homeowner must pay the bank \$20,000.

(Choice B) The homeowner may withhold the \$2,000 incurred to correct the deficiencies in the carpenter's work from the \$22,000 the homeowner owes the bank under the contract. The homeowner is not required to pay the full amount and then seek damages from the carpenter.

(Choice D) The carpenter's breach was not a **material breach** because the carpenter **substantially performed** the duties under the contract by completing the work. Instead, the minor deficiencies in the work constitute a minor breach, so the homeowner's obligation to pay the bank was not discharged.*

*Even if the carpenter's breach was considered material, the bank likely could still recover the value of the work done by the carpenter as **restitution**.

Educational objective:

Intended beneficiaries receive a direct benefit from a contract because the contracting parties so intended. An intended beneficiary has contractual rights and may sue to enforce them. However, a party to the contract can assert any defense or claim against an intended beneficiary that the party would have against the other party.

References

Restatement (Second) of Contracts § 302 (Am. Law Inst. 1981) (defining intended and incidental beneficiaries).

Restatement (Second) of Contracts § 309 (Am. Law Inst. 1981) (explaining that a promisor can assert defenses and claims against an intended beneficiary that the promisor would have against the promisee).

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