

A seller borrowed \$5,000 from a bank. Soon thereafter the seller filed for bankruptcy, having paid nothing on his debt to the bank.

Five years after the debt had been discharged in bankruptcy, the seller contracted to sell certain goods to a buyer for \$5,000. The contract provided that the buyer would pay the \$5,000 to the bank. The only debt that the seller ever owed the bank is the \$5,000 debt that was discharged in bankruptcy. The seller delivered the goods to the buyer, who accepted them.

If the bank becomes aware of the contract between the seller and the buyer, and the buyer refuses to pay anything to the bank, is the bank likely to succeed in an action against the buyer for \$5,000?

- A. No, because the buyer's promise to pay the bank was not supported by consideration.
- B. No, because the seller's debt was discharged in bankruptcy.
- C. Yes, because no consideration is required to support a promise to pay a debt that has been discharged in bankruptcy.
- D. Yes, because the bank was an intended beneficiary of the contract between the buyer and the seller.

Explanation:

A **third-party beneficiary** is a nonparty to a contract who receives some advantage or benefit from that contract. If the contracting parties intended for the contract to benefit the third party, the third party is an **intended beneficiary** with **enforceable rights under the contract**. That right **vests** when the beneficiary:

- **detrimentally relies** on the rights created
- **manifests assent** to the contract at one party's request *or*
- **files a lawsuit** to enforce the contract.

Once this occurs, the original contracting parties are bound to perform the contract.

Here, the bank was an intended third-party beneficiary of the buyer-seller contract because the seller agreed to sell the buyer goods in exchange for the buyer paying the bank \$5,000. The bank's right to enforce the buyer-seller contract will vest once the bank files a lawsuit to enforce it. Therefore, the bank will likely succeed in an action against the buyer for \$5,000.

(Choice A) The buyer's promise to pay the bank *was* supported by consideration since the buyer agreed to pay the bank \$5,000 in exchange for the seller's goods.

(Choice B) The fact that the seller's debt to the bank was discharged in bankruptcy is irrelevant because an intended beneficiary can be a creditor *or* a donee beneficiary. A creditor beneficiary can recover to satisfy a debt. A donee beneficiary can recover to receive a gift. Therefore, the bank is likely an intended donee beneficiary.

(Choice C) Although no consideration is required to support a promise to pay a debt discharged in bankruptcy, this is not a reason for the bank to succeed. Instead, the bank will succeed because it is an intended beneficiary.

Educational objective:

Intended third-party beneficiaries receive a direct benefit from a contract because the contracting parties intended to benefit them. They have the right to file a lawsuit to enforce the contract.

References

- Restatement (Second) of Contracts § 302 (Am. Law Inst. 1981) (intended and incidental beneficiaries).
- Restatement (Second) of Contracts § 304 (Am. Law Inst. 1981) (duties owed to intended beneficiaries).

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Third-party beneficiaries

Nonparties who benefit from contract

Intended beneficiaries

- Receive direct benefit because parties intended to benefit them
- Eg, A promises to paint B's house if B promises to pay \$500 to C

Right to enforce contract

Incidental beneficiaries

- Receive indirect benefit even though parties did not intend to benefit them
- Eg, A promises to buy B a car manufactured by C

No right to enforce contract