An accountant and a bookkeeper, as part of a contract dissolving their accounting business, agreed that each would contribute $100,000 to fund an annuity for a clerk who was a longtime employee of the business. The clerk's position would be terminated at the dissolution, and he did not have a retirement plan. The accountant and the bookkeeper informed the clerk of their plan to fund an annuity for him. The clerk, confident about his financial future because of the promised annuity, purchased a retirement home. The accountant later contributed his $100,000 to fund the annuity, but the bookkeeper stated that he could afford to contribute only $50,000. The accountant agreed in writing that the bookkeeper should contribute only $50,000.

Does the clerk have a valid basis for an action against the bookkeeper for the unpaid $50,000?

A. No, because the clerk was bound by the modification of the contract made by the accountant and the bookkeeper.

B. No, because the clerk was only a donee beneficiary of the contract between the accountant and the bookkeeper and had no vested rights.

C. Yes, because the clerk's reliance on the promised annuity prevented the parties from changing the terms of the contract.

D. Yes, because the promise to establish the annuity was made binding by consideration from the clerk's many years of employment.

Explanation:

Third-party beneficiaries

(ie, nonparties who benefit from contract)

Type	Definition	Right to enforce
Intended	• Receive *direct* benefit from contract because contracting parties intended to benefit them • Eg, A promises to paint B's house if B promises to pay $500 to C	Yes
Incidental	• Receive *indirect* benefit from contract even though there was no contractual intent to benefit them • Eg, A promises to buy B a car manufactured by C	No

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**. Only intended (not incidental) beneficiaries have **enforceable rights under the contract**. Those rights **vest** 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. Any efforts to **rescind or modify** the contract **after vesting** are **void unless the beneficiary agrees** to the rescission or modification.

Here, the clerk was an intended beneficiary of the accountant-bookkeeper contract because the parties' promise to fund an annuity for the clerk was clearly intended to benefit him. The clerk detrimentally relied on the promised annuity by purchasing a retirement home (vesting). And since he did so *before* the accountant and the bookkeeper agreed that the bookkeeper would contribute $50,000 less, their attempt to modify the contract was void. As a result, the clerk has a valid basis for an action against the bookkeeper for the unpaid $50,000 **(Choice A)**.

(Choice B) A *donee* beneficiary is an intended beneficiary of a *gift promise*, while a *creditor* beneficiary is an intended beneficiary to whom the promisee *owed money*. The rule for vesting is the same for both.

(Choice D) Under the bargained-for exchange test for consideration, past performance (eg, the clerk's many years of employment) does *not* constitute the consideration required to enforce a contract. Instead, the clerk can enforce the accountant-bookkeeper contract because of his third-party beneficiary status.

Educational objective:

An intended beneficiary's contractual rights vest when the beneficiary (1) detrimentally relies on the rights created, (2) manifests assent to the contract, or (3) files a lawsuit to enforce it. Any efforts to rescind or modify the contract after vesting are void unless the beneficiary agrees to the rescission or modification.

References

- Restatement (Second) of Contracts § 302 (Am. Law Inst. 1981) (intended and incidental beneficiaries).
- Restatement (Second) of Contracts § 311 (Am. Law Inst. 1981) (variation of a duty to a beneficiary).