

# Third-party Beneficiaries in Construction Litigation

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## Introduction

A party may form a contract with the intention of bestowing a benefit upon a stranger to the contract. The benefit may be intended as a gift or to satisfy a legal obligation. In either case, the party intended to receive the benefit is a third-party beneficiary of the contract. This third party acquires rights under the contract.<sup>1</sup>

Since 1937, third-party beneficiary law in Michigan has been controlled by statute MCL 600.1405, which provides, in pertinent part:

Any person for whose benefit a promise is made by way of contract, as hereinafter defined, has the same right to enforce said promise that he would have had if the said promise had been made directly to him as the promisee...

(1) A promise shall be construed to have been made for the benefit of a person whenever the promisor of said promise has undertaken to give or to do or refrain from doing something *directly* to or for said person. (*emphasis added*).

The test for determining whether a person is a third-party beneficiary is objective, based on the contract language; the parties' subjective intentions are irrelevant. In *Greenlees v. Owen Ames Kimball Co.*,<sup>2</sup> the Michigan Supreme Court quoted approvingly from 12 Am.Jur., Contracts, § 282, p. 834:

The principle that one not a party or privy to a contract but who is the beneficiary thereof is entitled to maintain an action for its breach is not so far extended as to give to a third person who is only indirectly and incidentally benefited by the contract the right to sue upon it. An incidental beneficiary has no rights under the contract. A third person cannot maintain an action upon a simple contract merely because he would receive a benefit from its performance or because he is injured by the breach thereof. Where the contract is primarily for the benefit of

the parties thereto, the mere fact that a third person would be incidentally benefited does not give him a right to sue for its breach.

Accordingly, before a third party is allowed to maintain an action for breach of contract, the party will have to demonstrate that it is a direct beneficiary of the contract. More often than not, this dichotomy comes into play in construction litigation.

## Incidental Third-party Beneficiaries in Construction Contracts

Construction projects typically involve different parties performing under several different contracts and subcontracts. A general contractor who has entered into a contract and provided a bond to the owner may contract with a number of subcontractors. Those subcontractors in turn may contract with others to complete portions of the subcontractors' project. In this scenario, one party's performance often depends on timely and complete performance by another party.<sup>3</sup>

In Michigan, contractors, subcontractors, their employees, and material suppliers are generally held *not* to be third-party beneficiaries of the contract between the general or supervisory contractor and the project owner.<sup>4</sup> The Michigan Court of Appeals' decision in *Dynamic Const. Co. v. Barton Malow Co.*<sup>5</sup> has been cited and relied on by numerous courts. It is generally considered to be the controlling authority on the issue of third-party beneficiaries in construction litigation. *Dynamic* involved a breach of contract claim, brought on the grounds that the plaintiff, Dynamic Construction Company, was a third-party beneficiary of a contract between the University of Michigan and defendant Barton Malow. The university had hired Malow to act as construction manager to supervise the planned expansion of its hospital. The contract between Malow and the university contained specific language that nothing in the agreement could be deemed to give any third party a claim or right of action against the owner (university) or the construction man-

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ager (Malow) that did not otherwise exist without regard to the agreement. By separate contract, the university hired Dynamic as a general contractor for the project. There was no contract between Dynamic and Malow. After the project was finished, Dynamic filed a number of claims with the university for extra compensation allegedly attributable to differing site conditions, defective plans and specifications, change of field orders, and unanticipated extra work and delays. When those parties could not settle their claims, Dynamic began an action against the university. Dynamic later added a breach of contract claim against Malow. Malow moved for summary disposition on the basis that Dynamic failed to state a claim for breach of contract because there was no contract between Dynamic and Malow. The trial court denied the motion, ruling that Dynamic was a third-party beneficiary of Malow's contract with the university. The Michigan Court of Appeals reversed the decision. The court opined that when determining whether the parties to a contract intended to make a third person a third-party beneficiary, one should examine the contract using an objective standard.<sup>6</sup> The court held that third-party beneficiary status requires an *express promise* to act to the benefit of the third party and, where no such promise exists, that third party cannot maintain an action for breach of the contract.<sup>7</sup> A person who incidentally benefits from the performance of some duty required under a contract has no rights under the contract.<sup>8</sup>

The *Dynamic* court, relying on previous decisions by Michigan courts, held that in Michigan, contractors, subcontractors, and their employees are generally held *not* to be third-party beneficiaries of the contract between the general or supervisory contractor and the project owner.<sup>9</sup> The court focused on the contract between Malow and the university and held that it showed no express promises to act to the benefit of Dynamic. In fact, the contract expressly stated that it did not give rise to any third-party beneficiary status in favor of any other contractors involved in the project. Although Malow's contractual duties to supervise and manage the project would necessarily have affected, and possibly benefited Dynamic, such benefits were incidental and did not make Dynamic a third-party beneficiary of the contract. *Dynamic's* rationale has been relied upon by the Michigan courts where contracts expressly

disclaim third-party beneficiary status upon any party in construction litigation.<sup>10</sup>

Prior to the *Dynamic* decision, in *Rieth-Riley Const. Co., Inc. v. Department of Transp.*,<sup>11</sup> the Michigan Court of Appeals had ruled on the issue of indirect beneficiaries. Plaintiff Rieth-Riley was a subcontractor on a road construction project that provided bituminous base coarse materials to the general contractor, which had a contract with the Michigan Department of Transportation. Rieth-Riley sued the department for the department's failure to include a materials escalator clause in the contract for bituminous base coarse materials, as it did for other materials in the contract. While the department acknowledged that the omission for the escalator clause was inadvertent, it denied that the subcontractor was a third-party beneficiary. The court of appeals affirmed summary judgment for the department, concluding that because the department did not promise to do anything directly to or for the plaintiff and also because the plaintiff did not extract a promise from the department to bestow a benefit on the plaintiff, the plaintiff was an incidental beneficiary and had no claim against the department.

Generally, the courts have concentrated their focus on the construction contract to decide the issue of third-party beneficiaries. In *Kammer Asphalt Paving Co., Inc. v. East China Tp. Schools*,<sup>12</sup> subcontractor Kammer Asphalt commenced an action against a school district for payment for work performed on school facilities. This occurred after the general contractor failed to pay subcontractor Kammer, and payment bonds furnished by the general contractor were determined to be invalid. The court of appeals affirmed summary disposition in favor of the school district. The Michigan Supreme Court, after granting the subcontractor's application for leave to appeal, held, among other things, that the subcontractor could not recover from the school district as a third-party beneficiary of the contract between the school district and the general contractor. The court reasoned that a plaintiff may not recover as a third-party beneficiary because the defendant in this case was the promisee of the bonds, not the promisor. The contract between the general contractor and the defendant did not contain promises on behalf of the plaintiff subcontractor. In fact, the contract explicitly stated that nothing contained in the contract documents could create any contractual relationship be-

tween the owner or the architect and any subcontractor or sub-subcontractor. Therefore, the court held that at best the plaintiff was an incidental beneficiary of the contract and also that the plaintiff subcontractor was asserting the claim against the wrong party.<sup>13</sup>

Further, merely having a financial stake in the construction project does not turn an investor into a third-party beneficiary. In *Windwood Development, LLC v. Pelley*,<sup>14</sup> Pelley was an investor in a residential subdivision construction scheme. Pelley also had a contract with the developers to construct the roadway, storm sewer, sanitary sewer, and water main for the subdivision. The developer at the same time retained Abonmarche Consultants to act as the engineer for the project. After the sewer lines constructed by Pelley failed the town inspection, the developer was forced to hire another contractor to make the necessary repairs. The developer consequently withheld payment and filed suit against Pelley for breach of contract. Pelley filed a third-party complaint against Abonmarche for breach of contract/quasi-contract and as a third-party beneficiary. Pelley asserted that he, being an investor in the project, was a third-party beneficiary of the contract between Abonmarche and the developer. Pelley argued that Abonmarche neglected to have the site inspected and delayed inspections, causing avoidable additional expense, and therefore any damages that the developer suffered were due to Abonmarche's actions. The trial court disagreed and granted Abonmarche's motion for summary disposition. The Michigan Court of Appeals, in an unpublished opinion, affirmed the trial court's decision and held that Pelley had failed to establish that the contract between Abonmarche and the developer was made directly for his benefit as an investor in the project.<sup>15</sup> Evidently, investors, in order to maintain successfully a third-party action, must show that the contract was made *directly* for their benefit. The mere fact of being an investor in a project does not grant one third-party beneficiary standing.<sup>16</sup>

In *Local 80 Sheet Metal Workers Intern. Ass'n, AFL-CIO v. Tishman Const. Corp.*,<sup>17</sup> union employees of a subcontractor failed in their attempt to assert third-party beneficiary claims under a contract between a general contractor and a subcontractor. The union plaintiffs argued that their layoff was caused by the general contractor's failure to provide heat during freezing weather. The court of appeals disagreed and held that the prom-

ised benefit was to provide simply a safe and suitable environment and not a promise of permanent employment. Also, the court relied on a provision of the collective bargaining agreement that specifically gave the plaintiff's employer the right to discharge without cause, holding this provision to be "dispositive of plaintiffs' third-party beneficiary action."<sup>18</sup>

More recently, in an unpublished opinion, the Michigan Court of Appeals held that a business invitee of a shopping mall was not a third-party beneficiary of a snow removal contract between the mall and the mall's contractor. The court held that the contractor did not specifically undertake to benefit mall patrons. The pertinent clause in the contract for snow removal merely set forth how contractor's services should be performed, and, if the contract benefited anyone besides the mall, it would be the stores in the mall and not any invitee of the mall.<sup>19</sup>

### Direct Third-party Beneficiaries in Construction Contracts

When a construction contract specifically provides direct benefits to a third party, Michigan courts have generally enforced the specific provisions. In *Greenlees v. Owen Ames Kimball Co.*,<sup>20</sup> a defendant construction company performed remodeling work on a building for a landlord under a contract that provided that the work was to be performed in such a way as to cause minimum disturbance to daytime operations in the building. The supreme court reversed summary judgment and remanded the case for trial, holding that, because the contract was for his direct benefit, a tenant was entitled to maintain a cause of action. The court held that the contract between landlord and defendant contractor provided that the work of remodeling was to be performed "in such a way as to cause a minimum of disturbance to the daytime operations in the building."<sup>21</sup> The court reasoned that the tenant-plaintiff's display of its fur goods to the view of customers was thus directly and intentionally provided for. The contract was for the direct protection of plaintiff tenant and plaintiff's tenancy and display was a notice to the defendant of plaintiff's rights.

Similarly, in another case, owners of a private abutting property were held to have a third-party beneficiary claim against a contractor because a contract provided that the contractor would protect all of his work

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“from damage and shall protect all city property and private abutting property from injury or loss arising in connection with this contract.”<sup>22</sup>

In *Ohio Farmers Ins. Co. v. Shamie*,<sup>23</sup> the court held that the complaint sufficiently alleged that the plaintiff insurer was an intended third-party beneficiary of the defendants’ contract to prepare a construction company’s financial statements, which the defendants knew the plaintiff would rely on in making a decision to issue performance and surety bonds. The plaintiff, thereby, was the intended recipient and beneficiary of defendants’ accounting services.

Intended beneficiaries need not always be named or clearly identified. Michigan cases allow the contracting parties to designate a class of persons as the intended beneficiaries of a contract, and that unnamed and unascertained persons qualify as third-party beneficiaries if they belong to that class.<sup>24</sup> In a recent unpublished case, a homeowner whose roof was repaired by a roofing contractor pursuant to a contract between a contractor and a city agency was held to be an intended third-party beneficiary of the contract. The homeowner thus could bring a breach of contract action against the contractor, even though the homeowner was not personally identified in the contract. The contract made clear that its purpose was to benefit homeowners who could not afford weatherproofing services and were receiving services from the city agency, and the homeowner was a member of that class.<sup>25</sup>

### Conclusion

Michigan courts, when asked to rule on the issue of third-party beneficiaries in construction litigation, have focused their attention on the underlying contract. Although contracts that have specified third-party beneficiaries have been enforced, the courts have been extremely reluctant to extend third-party beneficiary status to a person who is only indirectly and/or incidentally benefited by the contract. Thus, in Michigan an incidental beneficiary has no rights under the contract and cannot maintain an action on a contract merely because that party would receive a benefit from its performance or may be injured by a breach. Where the contract is primarily for the benefit of the parties, the mere fact that a third person would be incidentally benefited does not bestow third-

party beneficiary status or give that person a right to sue for its breach.

### NOTES

1. *Michigan Contract Law*, §8.1 (John R. Trentacosta, ed. ICLE 1998 & supps.)
2. 340 Mich 670, 676, 66 NW2d 227 (1954).
3. See *Michigan Contract Law*, *supra*.
4. See *Dynamic Const Co v Barton Malow Co*, 214 Mich App 425, 543 NW2d 31 (1995).
5. *Id.*
6. *Id.* at 427 citing *Kammer Asphalt Paving Co, Inc v East China Twp Schools*, 443 Mich. 176, 189, 504 NW2d 635 (1993); *Arrow Sheet Metal Works, Inc v Bryant & Detwiler Co*, 338 Mich. 68, 79-80, 61 NW2d 125 (1953).
7. *Id.* at 427 citing *Fishbach-Natkin, Inc v Shimizu America Corp*, 854 F Supp 1294, 1303 (ED Mich 1994).
8. *Id.*
9. *Id.* at 428; also see, *Arrow Sheet Metal Works, Inc v Bryant & Detwiler Co*, 338 Mich 68, 79-80, 61 NW2d 125 (1953); *Nat’l Sand, Inc v Nagel Construction, Inc*, 182 Mich App 327, 451 NW2d 618 (1990); *Rieth-Riley Construction Co, Inc v Dep’t of Transportation*, 136 Mich App 425, 357 NW2d 62 (1984); *Local 80 Sheet Metal Workers Int’l Ass’n, AFL-CIO v Tishman Construction Corp*, 103 Mich App 784, 303 NW2d 893 (1981).
10. See e.g. *Badie v Brighton Area Schools*, 265 Mich App 343 (2005).
11. 136 Mich App 425, 357 NW2d 62 (1984).
12. 443 Mich 176, 504 NW2d 635 (1993).
13. *Id.* at 190; Michigan courts have dismissed other third-party beneficiary claims that were improperly brought against the promisee and not the promisor. See e.g. *Reed & Noyce, Inc v Muni Contractors, Inc*, 106 Mich App 113, 119, 308 NW2d 445 (1981).
14. No 237990, 2003 Mich App LEXIS 1414 (June 12, 2003).
15. *Id.*
16. See *Smith v Globe Life Ins Co*, 460 Mich 446, 597 NW2d 28 (1999)
17. 103 Mich App 784, 303 NW2d 893 (1981)
18. *Id.* at 791.
19. *Komara v Meridian Mall Ltd Partnership*, Not Reported in NW2d, 2006 WL 932312 (Mich App); also see *Domin v City of Novi*, No 190479, 1997 Mich App LEXIS 1568 (May 9, 1997).
20. 340 Mich 670, 676, 66 NW2d 227 (1954).
21. *Id.*
22. *Hardware Dealers Mut Ins Co v RH Hidey, Inc*, 349 Mich 490, 496, 84 NW2d 795 (1957)
23. 235 Mich App 417, 597 NW2d 553 (1999), *vacated in part and remanded on other grounds*, 462 Mich 852, 611 NW2d 800 (2000)
24. See *Koenig v South Haven*, 460 Mich. 667, 597 NW2d 99 (1999)
25. *Williams v VR Thomas Const Co*, Not Reported in NW2d, 2006 WL 515443 (Mich App)

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