Solution and Answer Guide

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Chapter 18: Third Party Rights

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# Critical Thinking Questions in Cases

Case 18.1

1. The contract between McNeill and Rodeo Ford provided that “any change to [it] must be in writing and we must sign it.” Based on this provision, should the court have ruled in favor of McNeill? Explain.

Solution

No, the court should not have ruled in McNeill’s favor based on the provision in his contract that “any change to [it] must be in writing and we must sign it.”

Rights under a contract cannot be assigned without the obligor’s consent if the assignment will significantly alter the obligor’s risks or duties. The contract between Rodeo Ford and McNeill expressly recognized this principle by stating that “any change to this contract must be in writing and we must sign it.”

But the assignment of the contract from Rodeo Ford to JP Morgan Chase Bank did not alter the terms of the deal or materially increase the burden on McNeill. And, in fact, as the appellate court pointed out, “To the contrary, the terms and conditions of the sale remained unchanged after the assignment.”

1. Suppose that as part of the assignment of McNeill’s contract to Chase, instead of decreasing the annual interest rate, the bank had increased it. Would the result have been the same? Discuss.

Solution

No, the result in this case would not have been the same if, as part of the assignment of McNeill’s contract to JP Morgan Chase Bank, the bank had increased the annual interest rate instead of decreasing it.

Generally, contract rights cannot be assigned without the obligor’s consent if the assignment will materially alter the obligor’s risks or duties. In McNeill’s case, a potentially applicable state statute recognized that assignments are enforceable “unless otherwise agreed” and “except where the assignment would \* \* \* increase materially the burden or risk imposed on the other party.” And the contract between Rodeo Ford and McNeill expressly stated that “any change to this contract must be in writing and we must sign it.”

The assignment of the contract from Rodeo Ford to Chase neither altered the terms of the contract nor materially increased the burden on McNeill. The appellate court pointed out that “the terms and conditions of the sale remained unchanged or favored McNeill,” except for Chase’s lowering of the annual interest rate, which “favored McNeill.”

If, however, the bank had *increased* the annual interest rate instead of *decreasing* it, McNeill’s obligation under the contract would have been significantly altered. In that circumstance, without his consent, the court would most likely have considered the assignment to be invalid, rendering the contract void, as McNeill claimed.

Case 18.2

1. The MPN stated that “applicable state law . . . may provide for certain borrower rights.” The Nelnet companies are based in Nebraska. Nebraska’s commercial code provides that the delivery of a check marks the date of payment. How might this provision affect the decision of the lower court on remand?

Solution

If the lower court applies the Nebraska provision in the question to the facts in the *Mirandette* case, the decision of the court will favor the plaintiff. Further, the court’s reasoning will likely reflect the plaintiff’s payment-on-receipt theory. The remedy should include at least a refund of “the wrongful accrual of interest and late fees,” with any applicable penalties and interest.

In the case, Mirandette borrowed funds to pay for his daughter’s education. The accompanying note did not specify when payments on the loan were to be credited. Nelnet, Inc. and Nelnet Servicing, LLC credited Mirandette’s payments ten to thirty days after he mailed the checks. Alleging that this was a manipulation to accrue interest and late fees, Mirandette filed a suit in a federal district court against the Nelnet companies, claiming breach of contract. The defendants filed a motion to dismiss, which the court granted. The U.S. Court of Appeals for the Sixth Circuit reversed.

The defendants argued that Mirandette’s contract was with a third-party lender, not with them—they had been delegated the duty to service the loan. This argument “failed” because the Nelnets did not show that they had “no obligation to the debtor arising from their acceptance of the asserted delegation.” They also argued that the note did not state when payments were to be credited, so they could credit them any time. The court concluded that this was an “absurdity” and could not have been intended by the contracting parties. Mirandette theorized that his payments should be credited on receipt. Because the lower court had not addressed this theory, the appellate court remanded the case for consideration of this theory.

1. According to the defendants’ reasoning, borrowers would have no contract remedies if loan servicers overcharged them. What effect might this circumstance have in the market for credit? Discuss.

Solution

If borrowers had no contract remedies against loan servicers’ overcharges, the market for credit could be either non-existent for lack of borrowers or chaotic with an abundance of bad deals from the borrowers’ perspective. Without possible remedies, there would be considerably less incentive to contract.

Of course, honest lenders with integrity might be willing to include remedies in their loan contracts. Potential borrowers would likely seek out such lenders. And sophisticated borrowers might require the inclusion of remedies in their loan contracts (or they might at least insist on sufficient specific details in the deals to avoid an onerous result.)

Case 18.3

1. Capitol Records will, of course, contend that Bozzio’s agreement to look solely to MPI for payment of all royalties and not to bring any claims against Capitol Records bars her suit in this case. What is Bozzio’s best response to this contention? Discuss.

Solution

Bozzio’s best response to Capitol’s contention about the interpretation and effect of the band member’s agreement not to pursue claims against the recording company might be that the agreement bars only claims arising *after* royalties have been paid to the band’s loan-out corporation. Her complaint in this case concerns royalties that have allegedly *not yet* been paid. Thus, her agreement not to file claims against Capitol does not apply.

In this case, the plaintiff was Dale Bozzio, a former frontwoman for a Los Angeles, new wave band. She asserted that she was a third-party beneficiary of a contract between Capitol Records, the band’s recording company and distributor, and Missing Persons, Inc. (MPI), a loan-out corporation formed by the band members to receive the band’s royalties. The contract at the center of the case concerned the payment of those royalties. MPI had been suspended for its failure to pay state taxes and thus lacked the capacity to sue.

The lower court ruled that Bozzio could not maintain this suit due to MPI’s suspended status and dismissed the complaint. The appellate court reversed the dismissal. The appellate court found no controlling case law to support the lower court’s ruling and concluded that the corporation’s suspended status was irrelevant with respect to Bozzio’s right to bring her third-party claim.

1. What effect might an ultimate decision in the plaintiff’s favor in this case have on the licensing and sale of digital music? Explain.

Solution

The effect that an ultimate decision in the plaintiff’s favor in this case might have on the licensing and sale of digital music would seem to be mostly positive. The artists who create the music licensed and sold in digital format would realize a fair share of the profits from their efforts. They would thus be more likely to promote licenses and sales in these formats and be motivated to create more compositions for those markets.

The recording and distributing companies that record, produce, license and sell the music would certainly profit from their transactions in digital markets. And they would likewise realize benefits from the artists who tout their products and have an incentive to create more.

# Chapter Review

Practice and Review

Myrtle Jackson owns several commercial buildings that she leases to businesses, one of which is a restaurant. The lease states that tenants are responsible for securing all necessary insurance policies but the landlord is obligated to keep the buildings in good repair. The owner of the restaurant, Joe McCall, tells his restaurant manager to purchase insurance, but the manager never does so. Jackson tells her son-in-law, Rob Dunn, to perform any necessary maintenance for the buildings. Dunn knows that the ceiling in the restaurant needs repair but fails to do anything about it. One day a customer, Ian Faught, is dining in the restaurant when a chunk of the ceiling falls on his head and fractures his skull. Faught files suit against the restaurant and discovers that there is no insurance policy in effect. Faught then files a suit against Jackson. He argues that he is an intended third-party beneficiary of the lease provision requiring the restaurant to carry insurance and thus can sue Jackson for failing to enforce that provision. Using the information presented in the chapter, answer the following questions.

1. Can Jackson delegate her duty to maintain the buildings to Dunn? Why or why not?

Solution

Jackson can delegate the duty to Dunn because she cannot perform all tasks related to her property, but that does not necessarily relieve her of liability.

1. Who can be held liable for Dunn’s failure to fix the ceiling, Jackson or Dunn? Why?

Solution

Jackson had an obligation to McCall, and thereby his customers, to maintain the building. Her delegation to Dunn will not relieve her of possible liability. If Dunn is in the business of providing such maintenance, by contract, for Jackson, then Dunn could be liable; if Dunn is just an employee of Jackson, then Jackson retains primary liability.

1. Was Faught an intended third-party beneficiary of the lease between Jackson and McCall? Why or why not?

Solution

The purpose of the contract was to have business premises that would be frequented by clients such as Faught. Hence, he is a third-party beneficiary of the relationship and is due protection from such hazards.

1. Suppose that Jackson tells Dan Stryker, a local builder to whom she owes $50,000, that he can collect the rents from the buildings’ tenants until the debt is satisfied. Is this a valid assignment? Why or why not?

Solution

The assignment of income that is owed from other parties to help satisfy a debt is a normal assignment. However, it could not interfere with the rights in the relationship between Jackson and her tenants.

Practice and Review: Debate This

1. As a matter of public policy, personal injury tort claims cannot be assigned. This public policy is wrong and should be changed.

Solution

If it’s not against public policy to allow attorneys to take cases in which, if won, the attorneys obtain contingency fees of, say, one third of the awards, then it should not be against public policy to allow the assignment of personal injury tort claims. Sometimes, individuals do not have the knowledge or the mental state to pursue their own personal injury tort claims. Third parties should be able to undertake the effort necessary, and that is what an assignment of the claims can do.

The public policy against the assignment of personal injury tort claims is based on the notion that others should not be the beneficiaries of someone’s unfortunate situation. If such assignments were legal, unscrupulous individuals and companies would offer money up front—at steep discounts—to pursue individuals’ personal injury tort claims, thereby depriving the injured parties of their full compensation.

Issue Spotters

1. Eagle Company contracts to build a house for Frank. The contract states that “any assignment of this contract renders the contract void.” After Eagle builds the house, but before Frank pays, Eagle assigns its right to payment to Good Credit Company. Can Good Credit enforce the contract against Frank? Why or why not?

Solution

Yes. Generally, if a contract clearly states that a right is not assignable, no assignment will be effective, but there are exceptions. Assignment of the right to receive monetary payment cannot be prohibited.

1. Brian owes Jeff $1,000. Ed tells Brian to give him the $1,000 and he will pay Jeff. Brian gives Ed the $1,000, but Ed never pays Jeff. Can Jeff successfully sue Ed for the $1,000? Why or why not?

Solution

Yes. When one person makes a promise with the intention of benefiting a third person, the third person can sue to enforce it. This is a third-party beneficiary contract. The third party in this problem is an intended beneficiary.

Business Scenarios and Case Problems

1. **Third Party Beneficiaries.** Wilken owes Rivera $2,000. Howie promises Wilken that he will pay Rivera the $2,000 in return for Wilken’s promise to give Howie’s children guitar lessons. Is Rivera an intended beneficiary of the Howie-Wilken contract? Explain. (See *Third Party Beneficiaries.)*

Solution

An intended beneficiary is one who can sue the promisor directly for breach of a contract made for the beneficiary’s benefit. It must be clear from the contract that the parties intended the third party to benefit, the benefit in the agreement must be direct to the third party, and the liability of the promisor must arise from the language of the agreement. In this problem, Rivera is an intended beneficiary: it is clear from the contract that Howie and Wilken intended Rivera to benefit and that the benefit in the agreement is direct to Rivera (Howie is to pay Rivera directly). In this case, Rivera is a *creditor beneficiary* (one who benefits from a contract in which one party promises another party to pay a third party a debt owed by the promisee to the third party).

1. **Assignment.** Aron, a college student, signs a one-year lease agreement that runs from September 1 to August 31. The lease agreement specifies that the lease cannot be assigned without the landlord’s consent. In late May, Aron decides not to go to summer school and assigns the balance of the lease (three months) to a close friend, Erica. The landlord objects to the assignment and denies Erica access to the apartment. Aron claims that Erica is financially sound and should be allowed the full rights and privileges of an assignee. Discuss fully whether the landlord or Aron is correct. (See *Assignments*.)

Solution

As a general rule, any rights flowing from a contract can be assigned. There are, however, exceptions, such as when the contract expressly prohibits or limits assignment. Under the principle of freedom of contract, such prohibitions are enforced—unless they are deemed contrary to public policy. For example, courts have held that a clause prohibiting assignment that restrains the alienation of property is invalid by virtue of being against public policy.

Authorities differ on how a case like Aron’s should be decided. Some courts would enforce the prohibition and hold that Aron’s assignment to Erica is ineffective without the landlord’s consent. Others would permit the assignment to be effective and would limit the landlord’s remedies to the normal contract remedies ensuing from Aron’s breach.

1. **Delegation.** Inez has a specific set of plans to build a sailboat. The plans are detailed, and any boatbuilder can construct the boat. Inez secures bids, and the low bid is made by the Whale of a Boat Corp. Inez contracts with Whale to build the boat for $4,000. Whale then receives unexpected business from elsewhere. To meet the delivery date in the contract with Inez, Whale delegates its obligation to build the boat, without Inez’s consent, to Quick Brothers, a reputable boatbuilder. When the boat is ready for delivery, Inez learns of the delegation and refuses to accept delivery, even though the boat is built to her specifications. Discuss fully whether Inez is obligated to accept and pay for the boat. Would your answer be any different if Inez had not had a specific set of plans but had instead contracted with Whale to design and build a sailboat for $4,000? Explain. (See *Delegations.*)

Solution

The contract to build the boat created a set of duties. Whether these duties can be assigned or delegated without Inez’s consent depends on whether the contractual duties are personal in nature to the performance of the obligor, Whale of a Boat Corp. If the duties are routine (standardized or nonpersonal) and capable of being performed by any firm in the same field, the delegation is permitted and Inez, the obligee, must accept the performance of Quick Brothers. The facts in this case indicate that the building of the boat requires a routine, nonpersonal performance such that any builder could provide. Consequently, the delegation is permitted without Inez’s consent, and she is obligated to accept and pay for the boat as per her contract. If the contract called for Whale to both design and build the boat, however, a strong argument could be made that the contract is personal to Whale, that delegation is therefore not permitted, and that Inez therefore does not have to accept the boat built by Quick Brothers.

1. **Business Case Problem with Sample Answer— Third Party Beneficiary.** David and Sandra Dess contracted with Sirva Relocation, LLC, to assist in selling their home. In their contract, the Desses agreed to disclose all information about the property on which Sirva “and other prospective buyers may rely in deciding whether and on what terms to purchase the Property.” The Kincaids contracted with Sirva to buy the house. After the closing, they discovered dampness in the walls, defective and rotten windows, mold, and other undisclosed problems. Can the Kincaids bring an action against the Desses for breach of their contract with Sirva? Why or why not? [*Kincaid v. Dess,* 48 Kan. App.2d 640, 298 P.3d 358 (2013)] (See *Third Party Beneficiaries*.)   
   **— For a sample answer to Problem 18–4, go to Appendix E.**

Solution

Yes. The Kincaids can bring an action against the Desses for breach of their contract with Sirva. A third person becomes an intended third-party beneficiary of a contract when the original parties to the contract expressly agree that the performance should be rendered to or directly benefit a third person. As the intended beneficiary of a contract, a third party has legal rights and can sue the promisor directly for breach of the contract.

Here, the Desses agreed in their contract with Sirva to disclose all information about their property. They further agreed that Sirva and “other prospective buyers” could rely on the Desses' disclosure in deciding “whether and on what terms to purchase the Property.” The Kincaids were not direct parties to the contract between Sirva and the Desses, but the Kincaids were “other prospective buyers.” Thus, the language of the contract indicated that the Kincaids were intended by Sirva and the Desses to be third party beneficiaries of it. As intended beneficiaries of the contract, the Kincaids could sue the Desses directly for its breach.

In the actual case on which this problem is based, the Kincaids filed a suit in a Kansas state court against the Desses. From a judgment in the Desses’ favor (for lack of privity), the Kincaids appealed. A state intermediate appellate court reversed on the basis of the reasoning stated above and remanded the case for trial.

1. **Third Party Beneficiaries.** Randy Jones is an agent for Farmers Insurance Co. of Arizona. Through Jones, Robert and Marcia Murray obtained auto insurance with Farmers. On Jones’s advice, the Murrays increased the policy’s limits over the minimums required by the state of Arizona, except for uninsured/ underinsured motorist coverage, for which Jones made no recommendation. Later, the Murrays’ seventeen-year-old daughter, Jessyka, was in an accident that involved both an uninsured motorist and an underinsured motorist. She sustained a traumatic brain injury that permanently incapacitated her. Does Jessyka have standing to bring a claim against Jones and Farmers as a third party to her parents’ contract for auto insurance? Explain. [*Lucas Contracting, Inc. v. Altisource Portfolio Solutions, Inc.,* 2016 -Ohio- 474 (Ohio App. 2016)] (See *Third Party Beneficiaries*.)

Solution

Yes. Jessyka has standing to bring a claim against Jones and Farmers as a third party to her parents’ contract for auto insurance. The original parties to a contract can agree that its performance will be rendered to or directly benefit a third person. In that circumstance, the third person is an intended third-party beneficiary of the contract. As an intended beneficiary, the third party has legal rights and can sue the promisor directly for breach of the contract.

In this problem, Jessyka’s parents, Robert and Marcia Murray, obtained auto insurance with Farmers Insurance Co. of Arizona through its agent, Randy Jones. On Jones’s advice, the Murrays increased the policy’s limits over the minimums required by the state of Arizona, except for uninsured/underinsured motorist coverage, for which Jones made no recommendation. Later, the Murrays’ seventeen-year-old daughter Jessyka was in an accident that involved both an uninsured motorist and an underinsured motorist. She sustained a [traumatic brain injury](http://www.westlaw.com/Link/Document/FullText?entityType=disease&entityId=Ic05f562e475411db9765f9243f53508a&originationContext=document&transitionType=DocumentItem&contextData=(sc.Default)&vr=3.0&rs=cblt1.0) that permanently incapacitated her. As a direct beneficiary of the auto policy, Jessyka was clearly a third party intended beneficiary to the insurance transaction between her parents and Farmers, and therefore had standing to file a claim against Farmers based on that contract.

In the actual case on which this problem is based, Jessyka, through her parents, filed a claim in an Arizona state court against Farmers and Jones under the state’s Consumer Fraud Act (CFA). The defendants argued that only the parties to the transaction could bring a claim under the CFA. The court agreed and ruled that Jessyka lacked standing. A state intermediate appellate court reversed, “in view of the broad language and remedial purpose of the CFA, Jessyka’s status as a third-party beneficiary to the transaction, and the persuasive reasoning of other courts that have addressed this or similar issues.”

1. **Third Party Beneficiaries.** The Health Care Providers Self Insurance Trust (the trust) provided workers’ compensation coverage to the employees of its members, including Accredited Aides Plus, Inc. The trust contracted with Program Risk Management, Inc. (PRM), to serve as the program administrator. The contract obligated PRM to reimburse the trust for “claims, losses, and liabilities . . . arising out of” PRM’s acts or omissions. When the trust became insolvent, the state of New York assessed the trust’s employer-members for some of its debts. These employer-members filed a suit against PRM for breach of contract. Were the trust’s employer-members third party beneficiaries of the trust’s contract with PRM? If so, could the employer-members maintain this action against PRM? Explain. [*Accredited Aides Plus, Inc. v. Program Risk Management, Inc*., 147 A.D.3d 122, 46 N.Y.S.3d 246 (N.Y.A.D. 3 Dept. 2017)] (See *Third Party Beneficiaries*.)

Solution

Yes. The members of the trust were third party beneficiaries of the contract with PRM. To establish third-party beneficiary status, there must be a valid contract between two parties and the contract must benefit a third party. To establish *intended* third party beneficiary status, which would enable the third party to bring an action to enforce the contract, the agreement must have been intended to benefit that third party.

In this problem, the Health Care Providers Self Insurance Trust provided workers’ compensation coverage for the employees of its members. The trust contracted with Program Risk Management, Inc. (PRM) to serve as program administrator. The contract obligated PRM to reimburse the trust for “claims, losses, and liabilities . . . arising out of” PRM’s acts or omissions. The employer-members of the trust clearly benefitted from the contract with PRM.

And these employer-members were necessarily *intended* to benefit from the contract, considering that the purpose of the trust was to provide its employer-members’ employees with workers’ compensation insurance. If PRM breached its duties under the contract, as alleged, it deprived the employer-members of their benefit. The employer-members were thus entitled to maintain their action against PRM.

The members of the trust have an ethical duty to pursue this claim on behalf of their stakeholders. These stakeholders include the member corporations, and their owners and employees. The stakeholders also include those who filed claims for workers’ compensation that were unpaid due to the trust’s insolvency. The amount of the trust’s debts and the unpaid claims constitute at least part of the damages that PRM could be ordered to pay.

In the actual case on which this problem is based, the court dismissed the employer-members’ claim for breach on the ground that they were not intended third party beneficiaries of the trust’s contract with PRM. A state intermediate appellate court reversed the dismissal of the claim for breach, holding that the members sufficiently “stated” their status as intended third-party beneficiaries.

1. **Assignments.** State Farm Insurance Co. issued a policy to David Stulberger to insure a Nissan Rogue for collision damage. The policy provided, “No assignment . . . is binding upon us unless approved by us.” When the Nissan was involved in an accident, State Farm agreed that the vehicle should be repaired. M.V.B. Collision, Inc., performed the repairs at a cost of $14,101.80. State Farm offered to pay $9,960.36. Stulberger assigned to M.V.B. the right to pursue State Farm for the difference, or $4,141.44. The assignee filed a suit in a New York state court against the insurer to recoup this amount. The defendant responded with a motion to dismiss, arguing that the plaintiff lacked the capacity to sue because the defendant had not consented to the transfer by Stulberger. Is the assignment valid? Why or why not? [*M.V.B. Collision, Inc. v. State Farm Insurance Co*., 59 Misc.3d 406, 72 N.Y.S.3d 407 (2018)] (See *Assignments*.)

Solution

Yes. The assignment from Stulberger to M.V.B. of the right to pursue State Farm for the difference between the cost of the repair to the insured vehicle and the insurer’s reimbursement offer is valid. The general rule is of course that parties can freely limit the assignment of their contract rights. But there is an exception to this rule based on the public policy against restraints on alienation—a contract cannot prohibit an assignment of the right to receive funds.

Thus, for example, a provision that prohibits the assignment of an insurance policy, or that requires the insurer’s consent to the assignment, is valid until a loss occurs. An added reason for the prohibition of an assignment of an insurance policy is that the transfer would materially increase the risk to the insurer. Once a loss occurs, however, the anti-assignment provision is void. A subsequent assignment is no longer a transfer of risk under the policy, but a transfer of the right to receive payment for the loss. To prohibit a transfer of this right would be to enforce a restraint on alienation.

In this problem, State Farm issued a policy to David Stulberger to cover his auto. The policy barred its assignment without State Farm’s approval. When Stulberger’s car was damaged in an accident, State Farm consented to its repair. M.V.B. Collision did the work for $14,101.80. The insurer offered to reimburse $9,960.36. Stulberger assigned to M.V.B. the right to sue State Farm for the difference. In response to M.V.B.’s suit, State Farm filed a motion to dismiss, arguing that the assignment was invalid. Under the principles stated above, State Farm’s motion should be denied.

In the actual case on which this problem is based, the court denied the motion. “If we permitted an insurer to avoid its contractual obligations by prohibiting all post-loss assignments, we could be granting the insurer a windfall.”

1. **A Question of Ethics—Intended Third Party Beneficiaries.** The Health Care Providers Self Insurance Trust (the trust) provided workers’ compensation coverage to the employees of its members, including Accredited Aides Plus, Inc. The trust contracted with Program Risk Management, Inc. (PRM), to serve as the program administrator. The contract obligated PRM to reimburse the trust for “claims, losses, and liabilities . . . arising out of” PRM’s acts or omissions. When the trust became insolvent, the state of New York assessed the trust’s employer-members for some of its debts. These employer-members filed a suit against PRM for breach of contract. [*Accredited Aides Plus, Inc. v. Program Risk Management, Inc.,* 147 A.D.3d 122, 46 N.Y.S.3d 246 (3 Dept. 2017)] (See *Third Party Beneficiaries*.)
2. Were the trust’s employer-members third party beneficiaries of the trust’s contract with PRM? If so, could the employer-members maintain this action against PRM?

Solution

Yes. The members of the trust were third party beneficiaries of the contract with PRM. To establish third-party beneficiary status, there must be a valid contract between two parties and the contract must benefit a third party. To establish *intended* third party beneficiary status, which would enable the third party to bring an action to enforce the contract, the agreement must have been intended to benefit that third party.

In this problem, the Health Care Providers Self Insurance Trust provided workers’ compensation coverage for the employees of its members. The trust contracted with Program Risk Management, Inc. (PRM) to serve as program administrator. The contract obligated PRM to reimburse the trust for “claims, losses, and liabilities . . . arising out of” PRM’s acts or omissions. The employer-members of the trust clearly benefitted from the contract with PRM.

And these employer-members were necessarily *intended* to benefit from the contract, considering that the purpose of the trust was to provide its employer-members’ employees with workers’ compensation insurance. If PRM breached its duties under the contract, as alleged, it deprived the employer-members of their benefit. The employer-members were thus entitled to maintain their action against PRM.

1. Did the members have an ethical duty to pursue this claim? Explain.

Solution

Yes. The members of the trust have an ethical duty to pursue this claim on behalf of their stakeholders. These stakeholders include the member corporations, and their owners and employees. The stakeholders also include those who filed claims for workers’ compensation that were unpaid due to the trust’s insolvency. The amount of the trust’s debts and the unpaid claims constitute at least part of the damages that PRM could be ordered to pay.

In the actual case on which this problem is based, the court dismissed the employer-members’ claim for breach on the ground that they were not intended third party beneficiaries of the trust’s contract with PRM. A state intermediate appellate court reversed the dismissal of the claim for breach, holding that the members sufficiently “stated” their status as intended third-party beneficiaries.

Critical Thinking and Writing Assignments

1. **Critical Legal Thinking.** If intended third party beneficiaries could not sue the promisor directly to enforce a contract, what would their legal remedy be? (See *Third Party Beneficiaries*.)

Solution

Allowing a third-party beneficiary to sue a promisor directly in effect circumvents the “middle person” (the promisee) and thus reduces the burden on the courts. If a third-party beneficiary could not sue the promisor directly for a breach of the contract, the third party could most likely sue the promisee, who would then sue the promisor.

1. Time**-Limited Group Assignment—Assignment.** The Smiths buy a house. They borrow 80 percent of the purchase price from the local ABC Savings and Loan. Before they make their first payment, ABC transfers the right to receive mortgage payments to Citibank. (See *Assignments.*)
2. The first group will outline what would happen if the Smiths continued to make all their payments to ABC Savings and Loan because ABC never notified them of the assignment.

Solution

Until the obligor has notice of an assignment, the obligor can discharge the obligation by performance to the assignor (the obligee). Performance by the obligor to the assignor (obligee) constitutes a discharge to the assignee. In this problem, the Smiths are not notified of ABC’s assignment of their mortgage payments to Citibank, and they continue to make the payments to ABC. Although the assignment was presumably valid, the Smiths’ payments to ABC can discharge the debt. The failure to notify the Smiths of the assignment causes Citibank to lose its right to collect the payments from the Smiths. (Citibank still has a claim against ABC for the amount, however.)

1. The second group will describe what would happen if the Smiths were notified by ABC of the assignment but continued to make payments to ABC.

Solution

A borrower who obtains a loan may later receive a notice from the lender stating that it has transferred (assigned) its rights to receive payments on the loan to another firm. When it is time to repay the loan, the borrower must make the payments to that other firm. This is common among financial institutions that make mortgage loans. Giving notice of the assignment is not legally necessary to establish its validity—an assignment is effective immediately, whether or not notice is given. But once the obligor receives proper notice, only performance to the assignee can discharge the obligor's obligations. Thus, in this problem, if ABC notified the Smiths of the assignment, but the Smiths continued to make payments on the loan to ABC, their payments to ABC would not discharge the debt, which is of course owed to Citibank.

1. A third group will determine what would happen if the Smiths failed to make any payments on the loan. Which financial institution would have the right to repossess their house?

Solution

A borrower who obtains a loan must make the payments on the loan to discharge it. And once the obligor receives notice of an assignment of those payments, only performance to the assignee can discharge the obligor's obligations. In this problem, assuming that the Smiths were notified of ABC’s assignment of the payments on their loan to Citibank, the assignee would be entitled to enforce the payments in court. The Smiths’ failure to make payments on the loan would give the assignee the right to repossess their house.