



FEES & BURGESS, P.C.
SUPPLY CHAIN MANAGEMENT
MEMO



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**PROTECTING YOURSELF FROM CONTRACTUAL
 LIABILITY TO THIRD-PARTY BENEFICIARIES**

**FEES & BURGESS, P.C.,
 Emphasizes:**

When sitting down at the table to hammer out an agreement, the contracting parties are usually keenly aware of their potential liability to the other contracting party and take steps in negotiating the contract terms to limit, or completely disclaim, those risks. However, there is another important, and sometimes overlooked, source of risk that can generally be disclaimed rather easily if the parties are aware of it and draft their contract to address it. That area of potential risk is a contracting party's liability to third parties that do not actually sign the contract but expect to receive some benefit by its operation. To a limited extent, the law recognizes the right of a third party that is not a signatory to a contract to recover damages based upon the breach of the contract by one of the signing parties, if the contracting parties intended to confer some benefit on the third party.

This kind of potential liability can arise in a number of situations. One possible scenario occurs when someone is selling goods or services to a customer that will then be used by someone else. If the seller fails to perform, the buyer and the buyer's customer are both left without the goods/services they anticipated. This might apply to a construction subcontractor that is technically providing goods or services to a general contractor that are then provided to the property owner. This could also include a seller of goods that are purchased by a customer who will then turn around and sell them to someone else, particularly when the seller knows that this is the intent and knows who the anticipated end user will be. A second feasible scenario might occur when a buyer is purchasing goods or services from a seller that uses subcontractors or second-tier suppliers. In that situation, if the buyer backs out of the deal, the seller and its suppliers/subcontractors might all look to the buyer to compensate them for the damages they may have suffered now that they no longer have a buyer.

Under Alabama law, for a third-party beneficiary to recover for breach of contract, the plaintiff must prove the following: (1) that the contracting parties intended, when they entered the contract, to bestow a direct, as opposed to an incidental, benefit upon a third party, (2) that the plaintiff was the intended third-party beneficiary of the contract, and (3) that the contract was breached. The intention of the contracting parties, as disclosed by the writing, if any, and the surrounding circumstances known to the parties, determines the rights of the alleged third-party beneficiary. Courts must look to the surrounding circumstances of the transaction only when the contract is unclear as to whether the contracting parties intentionally conferred upon a third person a direct benefit. A court's inquiry may stop when it determines from the face of the contract that the parties did not intend to confer upon the third person a direct benefit.

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**PROTECTING YOURSELF FROM CONTRACTUAL
LIABILITY TO THIRD-PARTY BENEFICIARIES***(cont'd from page 1)*

Problems with third-party beneficiary liability generally arise when the parties to the contract fail to clearly state their intentions concerning third parties in the contract itself. This opens the door for outside parties, who were expecting to receive some benefit from the transaction, to assert claims against the breaching party when the deal does not go through as expected. While these situations may not ultimately result in a court granting a judgment in favor of the third party, it can still result in significant legal expenses and other costs associated with defending the claim. As the discussion above demonstrates, the fastest way to cut off any such argument is for the parties to clearly express their intentions concerning third parties in the contract itself. If the parties use a solid disclaimer of any intent to benefit third parties, under Alabama law, a court will defer to the expressed intentions of the parties in the contract and not waste the parties' time and resources trying to wade through a sea of facts concerning the circumstances surrounding the contract.

Below is an example of a contract clause that might be used to disclaim any intent by the parties' to benefit non-signatories to their contract:

No Third -Party Beneficiaries. *It is expressly understood and agreed that this Agreement is entered into solely for the mutual benefit of the parties herein and that no benefits, rights, duties, or obligations are intended by this Agreement as to third parties not a signatory hereto.*

Clauses such as these are not appropriate in every contract. There may be circumstances when the parties do intend for a third party to receive some benefit from the contract, and would prefer not to use a blanket disclaimer like the one above. For instance, it is fairly common for a party purchasing goods for resale to include language in the contract expressly allowing the purchaser's customer to enforce any warranty offered by the seller. If that is the parties' intention, they may want to have a general disclaimer, as above, but expressly exclude the warranty provision from the disclaimer. The same kind of issue might arise if there is an indemnification provision in the contract under which the parties want third parties, like their respective employees or subsidiaries, to be able to force the other contracting party to indemnify and defend them if the third parties are sued or otherwise damaged as a result of the potential indemnifying party's acts or omissions. Once again, if the intention is to confer upon such third parties the right to seek indemnification or defense from one of the contracting parties pursuant to the agreement, there needs to be a carve-out in the third-party-beneficiary disclaimer relating to that benefit.

Given that most contracting parties are agreeable to some form of disclaimer regarding liability to third parties, and since the potential ramifications of failing to include such a disclaimer can be significant, this is an issue that should always be considered and addressed in drafting commercial contracts.



Calendar of Events

September 1, 2010– Huntsville, Alabama, Holiday Inn Research Park

Employment Law Survival Training for Managers: 10 Key Areas of Legal and Practical Knowledge

This daylong program, presented by Jeffrey Roth, Allen Anderson, and Leah Green, is a must for training managers and supervisors to recognize and deal with challenging employee issues that arise daily in the workplace. Attendees will learn key aspects of critical issues and how to work with existing company policies to address and resolve them.

The 10 key areas covered in the program will include:

- The Employment Relationship
- Company Policies/Handbook/Code of Conduct
- Equal Employment Opportunity
- Medical Issues in the Workplace
- Hiring/Promotion
- Wages/Hours/Compensation
- Labor Relations/Union Free
- Occupational Safety and Health Act of 1970
- Conflict Management/Grievances
- Discipline/Termination

This highly interactive program includes discussion of real-life scenarios encountered by supervisors, and how, and how not, to respond to each scenario or crisis. This program is designed to help managers and supervisors from small and large businesses recognize high risk situations and minimize, or eliminate, those risks.

*Ask about group discounts.



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