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Contracts for the Benefit of Third Persons: When the Right of the Beneficiary Becomes Indefeasible

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CONTRACTS FOR THE BENEFIT OF THIRD PERSONS: WHEN THE RIGHT OF THE BENEFICIARY BECOMES INDEFEASIBLE

IN GENERAL, the law of Colorado regarding contracts for the benefit of third parties follows the rules of the majority of American courts.[1] But in one important instance the Colorado law is contrary to the weight of American authority. That instance concerns the question as to when the right of the beneficiary becomes indefeasible so that the parties to the contract cannot rescind it or alter its terms without his consent.

In order to understand in just what way the Colorado law is unusual it will be necessary to make a short analysis of the difference between a donee or sole beneficiary and a creditor beneficiary. First let us consider the former.

One is a donee or sole beneficiary if it appears from the terms of the contract and surrounding circumstances that the purpose of the promisee is to make him a gift or to confer upon him the right against the promisor to some performance not due from the promisee to the beneficiary.[2] The chief purpose of such a contract is to confer a benefit by way of a gift. Now since the beneficiary has been given a right which the courts have decided to enforce, it is clear that such right should not be taken from him without his consent unless the parties have reserved the power to do so. The only possible question is as to when the right of the donee vests—is it at the time the contract is made or not until he assents to it? Since the gift is a benefit to him there seems no reason why assent should not be presumed. Thus, on this basis, most courts hold that the right of the donee becomes indefeasible as soon as the contract is made.[3]

This argument, however, is not suited to the case of the creditor beneficiary. A creditor beneficiary is one to whom the promisee owes a duty which will be satisfied by performance by the promisor.[4] In this type of case the promisee has no intention to make a gift. He has made a bargain for the

[1]For an excellent summary of the Colorado law on the whole question, see *Contractual Rights of Persons Not Parties to the Contract in Colorado*, 3 Rocky Mountain Law Review 175 (1930).

[2]American Law Institute Restatement of Contracts, Sec. 133.

[3]1 Williston on Contracts 740, Restatement of Contracts, Sec. 142.

[4]Restatement of Contracts, Sec. 133.

purpose of relieving himself from a liability, pecuniary or otherwise, and it is himself and not the beneficiary whom he intends to benefit. He has increased his own assets by arranging that his debt shall be paid by another. Thus the right of the creditor beneficiary is not original as is that of the donee beneficiary, but derivative; and when this debtor ceases to have a right, his right, too, is cut off. He loses nothing by an alteration or rescission of the contract.[5] But since the courts have given him a right to sue at law on the promise, his right must become indefeasible at some time. This is generally held to be when he brings suit or materially changes his position in reliance on the promise, or when the rescission of the contract would be a fraud upon him as creditor of the promisee.[6]

Thus we have seen that the right of the sole beneficiary should, and in most jurisdictions does, vest at a much earlier time than that of the creditor beneficiary, being based on different theoretical grounds. But, nevertheless, in Colorado the two seem to be treated in precisely the same way.[7]

As far as the donee beneficiary is concerned the Colorado cases conform to the weight of authority, uniformly holding that unless the power to do so is reserved, the promisee cannot alter or release the duty of the promisor to the beneficiary without the consent of the latter. In *Love vs. Clune*, 24 Colorado 227, 50 Pac. 34 (1897), it was held that an attempt to change the beneficiary of a life insurance policy where the power to make such change was not reserved was ineffectual to cut off the rights of the person first named as beneficiary. This case concerns the policy of a fraternal benefit organization, the Locomotive Engineers Mutual Life and Accident Association. In many jurisdictions the power to change the beneficiary in a policy of a fraternal organization exists without express words.[8] But in Colorado even in such a policy the reservation must be express, under this holding. *Pittinger vs. Pittinger*, 28 Colo. 300, 64 Pac. 195 (1901), is to the same effect.

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[5]This is the analysis given in 1 Williston on Contracts 744.
[6]Restatement of Contracts, Sec. 143.
[7]See Rocky Mountain Law Review, cited supra, page 178.
[8]Restatement of Contract, Comment to Sec. 143.

It should be further noted that in this state the reservation of a power to change the beneficiary does not of itself divest the beneficiary of his interest, but that it becomes vested at the moment the contract is formed, subject to a condition subsequent. *Hill vs. Capitol Life Insurance Co.*, 91 Colo. 551, 14 Pac. 2d 1006 (1932). Here the insured, not wishing to pay a note he had given as payment of the first premium, arranged for a cancellation of the policy. This was done without the consent of the beneficiary. On the death of the insured the beneficiary sued for the value of the policy and was given judgment, the court holding that the interest of the beneficiary was vested and could not be cut off without her consent even though the reservation had been made. The insured could have achieved the desired result simply by making his estate the beneficiary and then cancelling the policy. On principle there would seem no reason for demanding this roundabout route, but the case is in accord with earlier cases holding that a power to change a beneficiary must be exercised in strict accordance with the terms of the reservation. See *Muller vs. Penn Mutual Life Insurance Co.*, 62 Colo. 96, 160 Pac. 188 (1916). Prof. W. R. Vance contends that when the power to change the beneficiary is reserved the sound view and the weight of authority are that the beneficiary has no vested interest but only an expectancy. 31 Yale Law Journal 343.

Colorado, then, enforces strictly the usual rule that a donee beneficiary has a vested interest as soon as the contract is made. Let us now see whether our law accords with the weight of authority as regards a creditor beneficiary.

There are only two decided cases on this precise point. These are in accord neither with the usual rule nor with each other. In *Starbird vs. Cranston*, 24 Colo. 20, 48 Pac. 652 (1897), a grantee of lands promised to pay a mortgage which the grantor had assumed. The grantor and grantee then made arrangements rescinding the promise, but the mortgagee was allowed to recover from the grantee. The court held that the creditor beneficiary has an indefeasible right to performance as soon as the contract is made, and the promisor and promisee have no power to discharge or vary the contract without the consent of the beneficiary. *The International*

Trust Co. vs. The Keefe Manufacturing and Investment Co., 40 Colo. 440, 91 Pac. 915 (1907), lays down a slightly different rule. Here a materialman sued the surety on a contractor's bond which had been given to the owner. The court said, without distinguishing between a donee and a creditor beneficiary, that the promisor and promisee could not vary the terms of the bond after the beneficiary had "accepted" it. It is not entirely clear what the court means by "accept," but apparently the word is used as synonymous with "assent." If this interpretation is correct then the case gives more power to the promisor and promisee than the *Starbird* case, *supra*, but less than the general rule. The rule as laid down here was dictum, however, for the bond was conditional and the condition had not been satisfied.

In conclusion, then, it may be said that Colorado, in common with many other jurisdictions. fails to distinguish between cases of donee and creditor beneficiaries. Theoretically, a distinction can and should be made, but perhaps it is better that there be a single rule covering all types of cases, or, if distinctions are to be drawn, that they be on practical and equitable grounds rather than for theoretical reasons, as is frequently done in giving insurance beneficiaries the greatest possible rights. GEORGE S. GRAHAM, Class of 1936.

FOR COLORADO: A CRIMINAL CODE?

> We may think the law is the same if we refuse to change the formulas. The identity is verbal only. The formula no longer has the same correspondence with reality.—BENJAMIN N. CARDOZO *in Paradoxes of Legal Science.*

AS OLD as laws and lawyers is public dissatisfaction with both—a dissatisfaction pervasive, ubiquitous, and without analogy in any other area of endeavor. Stage and platform echo with the perennial theme of the law's delay and the lawyer's vested interest in the evils of the status quo, and the same theme fills many books and more editorials.

Criminal justice, in which the public as such is most obviously concerned. is the most commonly and fiercely assailed object of all.