New York Law Journal
Real Estate Trends
WWW.NYLJ.COM
An ALM Publication
VOLUME 257—NO. 118
WEDNESDAY, JUNE 21, 2017

CONSTRUCTION LAW

Ensuring Third-Party Beneficiary Status to Owners

By **Kenneth M. Block**
And **Joshua M. Levy**

One of the more common questions asked in the construction contracting arena is whether an owner of a construction project can enforce the terms of a subcontract or its architect's consulting agreement with engineers directly against the subcontractor or engineers as a third-party beneficiary. The answer is "yes," but (as with all things legal), with some caveats.

Subcontractors

In most cases, the owner of a construction project is a third-party beneficiary of any subcontracts formed to carry out the construction work. *Logan-Baldwin v. L.S.M. General Contractors*, 94 A.D.3d 1466, 1469 (4th Dept. 2012). Under contract law, claimants may assert third-party beneficiary rights if they can demonstrate: (1) a valid contract exists; (2) the contract was intended to benefit them; and (3) the benefit they were to receive was more than incidental. Id. The second prong of the third-party beneficiary test is what often raises a factual issue and, in the context of construction, New York courts have been inconsistent on this issue.

For example, the Second Department held in *Key Intl. Mfg. v. Morse/Diesel,* 142 A.D.2d 448, 455 (2d Dept. 1988) that, in the context of construction, "it is almost inconceivable that those…who render their services in connection with a major construction project would not contemplate that the performance of their contractual obligations would ultimately benefit the owner…" However, the same department, four years later, held in *Board of Manager of the Riverview at College Point v. Schorr Bros.,* 182 A.D.2d. 664 (2d Dept. 1992), that owners of condominium units could not sue a general contractor with whom they did not have privity. (While a condominium unit owner may be more removed from the contracting process than an owner—e.g., the sponsor of the condominium—the rationale of *Key Intl.* should seemingly apply, and did apply as discussed below regarding architects.)

What is consistent in New York rulings is that the evaluation of what makes an owner a third-party beneficiary to a subcontract is fact dependent. In order to swing the facts in their favor, owners would best be served by having their general contractors include language in all subcontracts explicitly naming the owner as a third-party beneficiary. (Such language, however, should be qualified by precluding the sub-contractor from asserting third-party status against the owner.) While absent such a provision New York courts may still find in favor of an owner, the presence of such a provision provides an additional factor upon which a court may find third-party beneficiary status. *Logan-Baldwin,* supra at 1470.

If an explicit third-party beneficiary statement is unobtainable, owners should, at a minimum, require approval over subcontracts to ensure they do not contain statements explicitly denying third-party beneficiary status to the owner. As held by the First Department (albeit in a condominium action brought by the board of managers against the general

KENNETH M. BLOCK *and* JOSHUA M. LEVY *are members of Tannenbaum Helpern Syracuse & Hirschtritt.* DANIEL SOSO, *an associate at the firm, contributed to the preparation of this article.*

contractor of the project), a clause in a contract expressly disclaiming any third-party beneficiaries would foreclose an owner from asserting a claim under the contract. *Board of Managers of the Alexandria Condominium v. Broadway/72nd Associates,* 285 A.D.2d 422 (1st Dept. 2001).

Architects and Engineers

Just as with trade subcontracts, New York courts have vacillated on the third-party beneficiary status between owners and design consultants depending on the specific set of facts. For instance, the First Department upheld an owner's (here a condominium board of managers) third-party beneficiary status in *Board of Managers of the Astor Terrace Condominium v. Schuman, Lichtenstein, Claman & Efron*, 183 A.D.2d 488, 489 (1st Dept. 1992), finding that the board, acting on behalf of the unit owners, was the intended beneficiary of the contracts between the sponsor and the architect. However, in *Kerusa v. W10Z/515 Real Estate Ltd.,* 50 A.D.3d 503, 504 (1st Dept. 2008), the court held that the owner of a condominium unit was not a third-party beneficiary as the unit owner had "no contractual or other relationship with the…architect, mechanical engineer or structural engineer on the project and is, at best, only an incidental, rather than an intended, beneficiary of the contracts…"

An alternative approach to asserting claims in contract against design professionals is a suit in tort, where direct privity is not necessary. In one such case, *Ossining Union Free School District v. Anderson LaRocca Anderson*, 73 N.Y.2d 417 (1989), the Court of Appeals held that a school district's negligent representation claim against an engineer with which it did not have a contract could survive summary judgment despite a lack of actual privity. The school district contended that because a sub-consultant to its architect negligently prepared a structural analysis report, the district unnecessarily closed its high school annex, suffering monetary damage. The sub-consultant contended that since the harm was only monetary, the "economic loss rule applied" (a rule barring tort claims for pecuniary loss absent privity of contract) and could not be asserted in the absence of a contract. The court, however, held that the relationship between the parties was a functional equivalent of contractual privity and allowed the claim to proceed.

> What is consistent in New York rulings is that the evaluation of what makes an owner a third-party beneficiary to a subcontract is fact dependent.

The test the *Ossining* court used arose from *Credit Alliance Corp. v. Andersen & Co.*, 65 N.Y.2d 536, 551. The *Credit Alliance* test evaluates three criteria to determine the presence of functional privity: (1) awareness that the defendant's work would be used for a particular purpose; (2) reliance on the part of the party bringing the claim; and (3) conduct by the defendants connecting them to claimant and demonstrating their knowledge of the claimant's reliance. In *Ossining*, the court was swayed by certain key facts including that the school district's contract with the architect contemplated the hiring of consultants and that the sub-consultant sent its bill directly to the school district.

What *Ossining* suggests is that in addition to the precautions owners should take regarding subcontracts generally, owners should draft agreements with architects and design professionals requiring the inclusion of express third-party beneficiary status to the owner.

Conclusion

While it would seem evident that owners are third-party beneficiaries of the work of subcontractors and sub-consultants, caution should be taken by owner's counsel to ensure this status by requiring express language to this effect in subcontracts and consulting agreements. In doing so, however, it should be made clear that the subcontractor or sub-consultant is not a third-party beneficiary to the owner's contract with the general contractor or architect, thereby precluding a direct right of action by the subcontractor or sub-consultant against the owner.