CALIFORNIA'S NEW DEFINITION OF THIRD-PARTY BENEFICIARY

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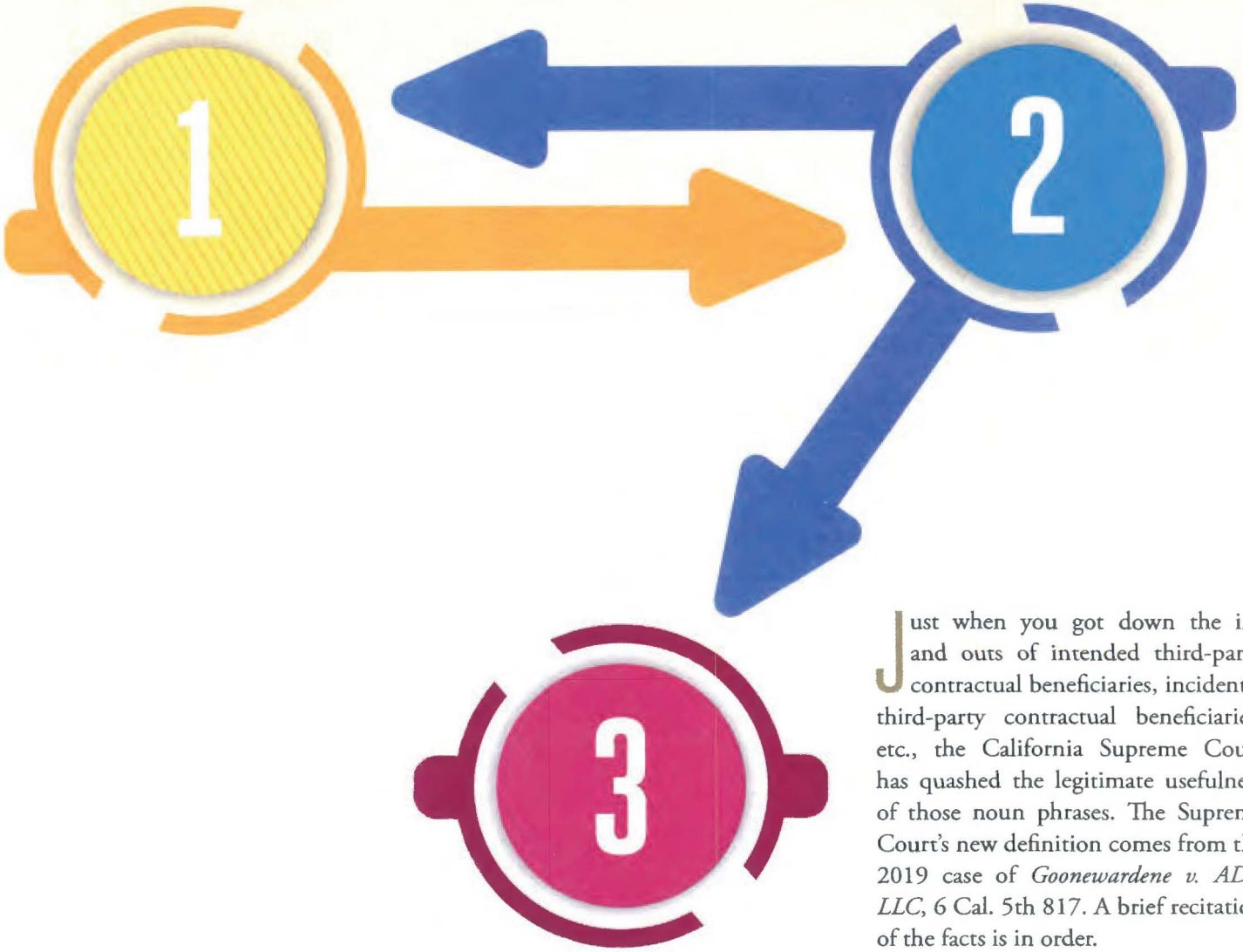

Just when you got down the ins and outs of intended third-party contractual beneficiaries, incidental third-party contractual beneficiaries, etc., the California Supreme Court has quashed the legitimate usefulness of those noun phrases. The Supreme Court's new definition comes from the 2019 case of *Goonewardene v. ADP, LLC*, 6 Cal. 5th 817. A brief recitation of the facts is in order.

Plaintiff Sharmalee Goonewardene was an employee of Altour International, Inc. *Goonewardene*, 6 Cal. 5th at 822. Altour and ADP entered into an unwritten contract whereby ADP would handle Altour's payroll tasks. *Id.* at 823-24. Ms. Goonewardene sued ADP, alleging that ADP did not obey the Labor Code in the administration of the Altour payroll and theorizing that she was a third-party beneficiary to the Altour/ADP contract. *Id.* at 825-26. After a bevy of procedural maneuvers, the case ended up in the California Supreme Court in the posture of denial of a demurrer. *Id.* Thus, all that was pleaded had to be taken as true.

The centerpiece of the California Supreme Court's decision was a new definition of a valid third-party beneficiary to a contract. This is that definition. A person who is not a party to the subject contract may enforce that contract against a contracting party:

> only if the third party establishes not only (1) that it is likely to benefit from the contract, but also (2) that a motivating purpose of the contracting parties is to provide a benefit to the third party, and further (3) that permitting the third party to bring its own breach of contract action against a contracting party is consistent with the objectives of the contract and the reasonable expectations of the contracting parties. All three elements must be satisfied to permit the third party action to go forward.

Id. at 821. This is a very workable definition—the kind of definition that one reads and says to oneself, "yeah, that's it."

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Before getting into the substantive wording of each of the three *Goonewardene* elements, it is valuable to note that a survey of appellate cases shows that, since the publication of *Goonewardene*, few courts of appeal have published a discussion about donee, creditor, or incidental beneficiaries. The word "donee" appears in *Baiul-Farina v. Crown Media*, No. B279653, 2019 Cal. App. Unpub. LEXIS 5563 at 46-47 (Aug. 21, 2019), but the Supreme Court ordered the case not published; and "incidental" appears in at *Wexler v. California Fair Plan*, 63 Cal. App. 5th 55, 64 (2021) in a brief mention of what a valid third-party beneficiary is not. So, the *Goonewardene* rule appears all-encompassing.

Element (1): "that [the third-party] is likely to benefit from the contract." The word "likely" appears to have not been found in any or many iterations of the old definition of a valid third-party beneficiary to a contract. Thus, it should be examined, as it may be outcome-determinative.

"Under the plain meaning rule, courts give the words of the contract or statute their usual and ordinary meaning. [Citation.]" *Gravillis v. Coldwell Banker Residential Brokerage Co.*, 143 Cal. App. 4th 761, 774-75 (2006), citing *Valencia v. Smyth*, 185 Cal. App. 4th 153, 162 (2010). "[T]he 'ordinary' sense of a word is to be found in its dictionary definition." *Scott v. Continental Ins. Co.*, 44 Cal. App. 4th 24, 29-30 (1996). "Likely" means "probable." *Webster's Third New Int'l Dictionary* at 1310. So, if there's an issue as to whether the third party is likely to benefit from the contract, the practitioner should think "probably," and go from there. One should use care, because some post-*Goonewardene* appellate opinions leave the word "likely" out of element (1). Perhaps "likely" is not an issue in such opinions. That is the case in *Hernandez v. Meridian Management Services, LLC*, 87 Cal. App. 5th 1214, 1222 (2023) (reviewing the *Goonewardene* rule, without quotation marks, and omitting the word "likely").

Another reason for various omissions of the word "likely" might be that, in *Goonewardene* (6 Cal. 5th at 830), the California Supreme Court recaps its "past decisions." That recap is

not the new rule; it is what the *Goonewardene* court said is "a review of this court's [prior] third-party beneficiary decisions." The casual reader might think that the recap is the new rule because it has some similarity to that new rule. The casual reader would be incorrect. The new rule contains the "likely" language in element (1) (*Goonewardene*, 6 Cal. 5th at 830), and is recited at the beginning of this article.

Element (2): "that a motivating purpose of the contracting parties is to provide a benefit to the third party." The "motivating purpose" phraseology was at least partially guided by a scholarly article penned by U.C. Berkley School of Law's Professor Melvin Eisenberg. *Goonewardene*, 6 Cal. 5th at 830 (citing Eisenberg, *Third Party Beneficiaries*, 92 Colum. L. Rev. 1358, 1378 (Oct. 1992)). The court thought that word "intent" was problematic as it has an "ambiguous and potentially confusing nature." Thus, all forms of the word "intent" are purposely absent from the new rule. "[T]his opinion uses the term 'motivating purpose' in its iteration of this element to clarify that the contracting parties must have a motivating purpose to benefit the third party, and not simply knowledge that a benefit to the third party may follow from the contract." *Goonewardene*, 6 Cal. 5th at 830.

The California Supreme Court emphasized that it was using the phrase "motivating purpose" to clarify its past "intent-to-benefit" jurisprudence. "To avoid any possible confusion . . . we emphasize that our intent-to-benefit case law remains pertinent in applying this element of the third party beneficiary doctrine." *Id.* at 830. This is an important emphasis because Professor Eisenberg's article dug deeply into the word "intent," finding it "deeply ambiguous along at least three axes." His analysis thoroughly supports his opinion. Without modifying terms, "intent" is indeed an ambiguous word. *Id.* California has generally dealt with this ambiguity by using modifiers (e.g., general intent, specific intent, objective intent, subjective intents). By explaining that the California Supreme Court's "intent-to-benefit" Supreme Court third-party opinions remain intact, the new nomenclature has left undisturbed years of case law.

A question adjacent to element (2) remains: Will courts and lawyers use Professor Eisenberg's now-California-Supreme-Court-codified opinion that the term "intent" is "ambiguous and potentially confusing [in] nature" in other areas of the law?

A portion of the Court's element (2) ruling should make the practitioner wary and at the same time add a strong arrow to his/her litigation quiver. The subject *Goonewardene* complaint alleged that the Altour/ADP contract was, "for the benefit of Altour and its employees." *Id.* at 824. Recall that the Altour/ADP contract was unwritten. The court noted that third-party rights may issue from an oral contract just as well as from a written contract; however, the court said that "the alleged benefit that the unwritten contract between Altour and ADP allegedly conferred upon Altour's employees are too vague and conclusory to support" the maintenance of a third-party action. The alleged benefit to the employees was made on information and belief, and it was bald. There wasn't anything in the subject complaint about what benefit was to be conferred on Altour's employees. *Id.* at 832-33.

Element (3): "that permitting the third party to bring its own breach of contract action against a contracting party is consistent with the objectives of the contract and the reasonable expectations of the contracting parties."

"With regard to the third element, we observe that academic commentators have pointed out that the parties to a contract are typically focused on the terms of performance of the contract rather than on the remedies that will be available in the event of a failure of performance." *Id.* at 830. The court observed that its cases, "have not required a showing that the contracting parties actually considered the third-party enforcement question as a prerequisite to the applicability of the third-party beneficiary doctrine." *Id.* at 830. Thus, the court fashioned element (3) to not focus on whether the contracting parties intended for a third-party to have the right to contractual enforcement,

> but rather upon whether, taking into account the language of the contract and all of the relevant circumstances under which the contract was entered into, permitting the third party to bring the proposed breach of contract action would be 'consistent with the objectives of the contract and the reasonable expectations of the contracting parties.'

Id.

As to that portion of element (3) which requires a third-party contractual action to meet "the reasonable expectations of the contracting parties," Ms. Goonewardene's suit against ADP is a prime exemplar of the ills that this rule is meant to prevent. Recall that her employer, Altour, was still around and vulnerable to liability for any Labor Code misdeeds. Recall that the allegations of a benefit to Ms. Goonewardene was very general—the contract was "for the benefit of Altour and its employees"—and that was pleaded on information and belief. The court observed that the typical contract between an employer and a payroll company doesn't benefit the employee; it benefits the employer. "Altour [was] available and . . . fully capable of pursuing a breach of contract action against ADP if, by failing to comply with its contractual responsibilities, ADP render[ed] Altour liable for any" Labor Code violations. The court observed, "permitting an employee to sue ADP for an alleged breach of its contractual obligations to Altour is not necessary to effectuate the objectives of the contract." *Id.* at 836.

The new definition of a valid third-party beneficiary to a contract is concise, deeply rooted in scholarship and California law, and very workable.

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