

Managing disputes in Canada and the U.S.: Third-party beneficiary rule

SPEAKERS



Andrew Bernstein



Erica R. S. Goldman

04:06

Video transcript



Andrew Bernstein (00:06): Every law student learns that the default rule is that a contract can only be enforced by the parties to the contract. But how does this play out in the world of commercial disputes? Torys litigators here to tell you all about it. I'm Andrew Bernstein of Torys' Toronto office. And I'm here with my partner, Erica Goldman of Torys New York to talk about the third-party beneficiary rule.

So, Erica, if I enter into a contract with you and it says, Andrew will pay Erica \$100, and Erica will take Andrew's best friend, who's a big Chicago Cubs fan, to a Mets Cubs game, and you don't do it, I can sue to enforce the contract, but my best friend can't.

Erica Goldman (00:44): That's right, Andrew. That's called the third-party beneficiary rule.

Andrew Bernstein (00:48): So, can we talk a little bit about how this comes up in commercial litigation practice? As far as I know, we don't deal with a lot of Mets Cubs cases.

Erica Goldman (00:56): That's right. Well, one place that it comes up often in commercial practice is when you have corporations that are technically the party to a deal but aren't really the force behind the deal. So, if you have a private equity fund or pension fund, for example, and they're selling assets out of a company, that company may not end up being the place where the consideration will ultimately rest.

So, you might well want the underlying fund rather than the corporate seller to be able to enforce the deal.

Andrew Bernstein (01:22): And another place that we saw this recently in Canada was a case called Cineplex and Cineworld, where Cineplex had entered into an arrangement agreement to sell itself to Cineworld. And although the shares were being sold, the shareholders weren't actually party to the agreement. So, when Cineworld breached the contract, it was Cineplex and not the shareholders that had to sue.

Erica Goldman (01:45): That's a really complicated situation. What happened?

Andrew Bernstein (01:47): Well, the judge ordered substantial damages for the loss of synergies Cineplex expected to receive from the merger. But I think that was a surprise to a lot of people and the case settled before it went to the Court of Appeal. So, we're not entirely clear about how that would have played out. But can you tell us a little bit about how you deal with third-party beneficiary issues in the United States and whether it's necessary to do anything special in an agreement in which a third party is intended to benefit?

Erica Goldman (02:14): Sure. So, in the US there are three elements that must be present in any agreement to demonstrate third-party beneficiary status. The first is an intention to benefit the third party must appear from the four corners of that contract. The second is the benefit is intended to satisfy a preexisting obligation to that third party. And finally, there must be a showing that benefiting the third party was a material part of the party's purpose in entering that contract.

What about in Canada, Andrew?

Andrew Bernstein (02:44): So, it's a little trickier. Most provinces recognize that a third-party beneficiary can enforce a contract if it was specifically made for their benefit. But there is enough uncertainty that people use the suspenders and a belt approach.

Erica Goldman (02:58): Are you referring to an iconic Canadian tuxedo trend I've always heard about?

Andrew Bernstein (03:04): So, Erica, now that you're part of Torys, we're going to have to get you your very own Canadian tuxedo. I'm sure you're going to love your Torys jean jacket.

Erica Goldman (03:12): Can't wait.

Andrew Bernstein (03:13): But in this context, the belt is from the rule that we think applies, which is third parties are entitled to enforce agreements that are made for their benefit.

But the suspenders come in the form of a trust technique. So, you say in the agreement that the agreement is, at least in part, for the benefit of the third party. But you also say that the benefit of the agreement is specifically being held in trust for a third party, and that allows there to be, in effect, two owners of the contractual rights.

There's the legal owner who's formally the party to the agreement, and there's the beneficial owner who's the third-party beneficiary. And courts have approved this technique.

Erica Goldman (03:49): That heightened standard would certainly satisfy US courts across jurisdictions, and I think is a wise approach generally to ensure protection for third-party beneficiaries contemplated by the contracting parties.

Contracts are often considered to be between two parties, but in complex deals, third parties may also be stakeholders to the benefits of the deal. To protect the interests of third parties, contracts will include a third-party beneficiary rule.

In this video, Andrew Bernstein and Erica Goldman discuss the fundamentals of the rule, including:

- what rights it provides to third parties

- how it is implemented in Canada and the U.S.

To discuss these issues, please contact the author(s).

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