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the transaction out of which it arose, or as the security for payment of the debt, is not burdened with the conditions of the agreement and should be held negotiable. (4) These rules should be applied with equal effect whether a bill or note is secured by a mortgage or by any other form of collateral agreement. (5) Notice of the existence or terms of a collateral agreement, of itself, should not prevent the transferee of a bill or note from taking it as a holder in due course.²¹

—Arthur T. Ratcliffe.

CONTRACTS: RIGHTS OF PERSONS NOT A PARTY TO A CONTRACT TO SUE IN MONTANA

The question of the rights of a third party to sue upon what are commonly styled contracts for the benefit of third parties continues to be a subject of litigation in Montana.¹ In a recent Montana case, *Kelley v. Montana Power Company*² which the Court stated involved a contract for the benefit of a third party, the beneficiary failed in a suit against the defendant corporation which the Court treated as the promisee of a contract for the benefit of a third party.³ The Court's dictum is that the beneficiary would have a cause of action under section 7472, R. C. M. 1935 against the promisor.⁴

The foregoing section reads:

“A contract made expressly for the benefit of a third person may be enforced by him at any time before the parties thereto rescind it.”

Under this provision there has been much litigation in Montana as to the liability of the promisor to the beneficiary. The beneficiaries fall by definition into three classes: (1) incidental,

²¹Of course, one who takes a bill or note with notice of the terms of a collateral agreement which disclose an infirmity in the bill or note or a defect in the title of the person negotiating it does not become a holder in due course under the provisions of R. C. M. 1935, §§8459(4), 8461, and 8463, although the bill or note is negotiable in form. However, as pointed out *supra*, note 1, this comment does not deal with cases involving that situation.

¹This note is primarily concerned with the rights of the beneficiary to sue the promisor and not with the various defenses that the promisor may set up in a suit.

²(October 16, 1940) 111 Mont. 118, 106 P. (2d) 339.

³The terms of the contract are not set forth in the case; hence, it is impossible to tell whether it involves a contract for the benefit of a third person about which there may be some question.

⁴See 111 Mont. 118, 122, 106 P. (2d) 339, 340.

(2) creditor, and (3) donee, or as they are often styled, "sole" beneficiaries.⁵

Interestingly enough, although the aforementioned section is taken verbatim from the original Field Code,⁶ it has not resulted in the crystallization of Montana law into the mold of the law of New York at the time of the drafting of the Field Code.⁷

Early decisions in Montana made it clear that the incidental beneficiary—that is, a party to whom no performance is to be rendered but who will gain a benefit incidentally by reason of its performance—will not be able to sue upon the promise.⁸ Later cases have reiterated the view.⁹ The word "expressly" in the code seems designed to cover the situation. The Court has put it in these words in *Martin v. American Surety Co.*:¹⁰

"To entitle a person not a party to a contract between two others, to recover thereunder, the contract must, under 7472 R. C. M. 1921, have been made expressly for his benefit, the fact that it may incidentally benefit him being insufficient to bring him within the terms of the section."

There is no reason, however, to believe that Montana would have reached a different view in the absence of statute.

As to the rights of the beneficiaries of the second type, the creditor beneficiary, the law of Montana follows the doctrine of the cases which Field cited¹¹ in support of his code section, the forerunner of section 7472, R. C. M. 1935, and allows, in

⁵RESTATEMENT, CONTRACTS, No. 133.

⁶FIELD CIVIL CODE (1865), §749. The Field Code was compiled in 1865 by order of the New York Legislature but was never adopted by that state.

⁷The New York cases cited by Field are all cases of creditor beneficiaries (*cases cited infra*). As late as 1903 donee beneficiaries were denied recovery in a direct action against the promisor. *Mahaney v. Carr* (1903) 175 N. Y. 454, 67 N. E. 903. For an excellent summary of the New York law, see *Seaver v. Ransom* (1918) 224 N. Y. 233, 120 N. E. 639, 2 A. L. R. 1187 which is generally cited as placing New York in line with the American rule.

⁸*McDonald v. American National Bank* (1901) 25 Mont. 456, 495, 65 P. 896, 911; *Tatem v. Eglanol Mining Co.* (1912) 45 Mont. 373, 123 P. 877.

⁹*McKeever v. Oregon Mortgage Co.* (1921) 60 Mont. 270, 198 P. 752; *Brockway-Mecklenburg Co. v. Hilderman* (1931) 90 Mont. 317, 2 P. (2d) 1018; *Conley v. United States Fidelity and Guaranty Co.* (1934) 98 Mont. 31, 37 P. (2d) 565, 567.

¹⁰(1925) 74 Mont. 43, 238 P. 877.

¹¹*Scott v. Pilkington*, 15 Abb. 280; *Steman v. Harrison* (1862) 42 Penn. St. 49; *Lawrence v. Fox* (1859) 20 N. Y. 268; *Burr v. Beers* (1861) 178 N. Y. 180, 80 Am. Dec. 327; and *Hoffman v. Schwabe* (1861) 33 Barb. 194 at p. 195 which limited the rule to promises in which the purpose was expressed.

general, a direct suit by the beneficiary against the promisor.¹³ In this respect it is in accord with a large majority of American jurisdictions.¹⁴

Moreover, Montana has not followed the New York court in the peculiar rule which it has laid down, denying the creditor suit upon the promise of a partner to pay the partnership debts upon taking over partnership assets.¹⁴ In *Carlson v. Barker*,¹⁵ in which the point that the plaintiff was not a party to the contract was not raised and the question not discussed, the plaintiff was allowed to recover.

In Montana, however, there is a noteworthy exception to the general theory of recovery in the case of assumption of mortgages. In accord with the great majority of jurisdictions, Montana holds that where a purchaser of mortgaged lands from the mortgagor assumes the payment of the mortgage on such lands, the liability which he assumes will enure to the benefit of the mortgagee who may enforce it in an appropriate action.¹⁶ Many jurisdictions enforce the liability upon the theory that the grantee's promise to pay the debt secured by the mortgage constitutes a contract for the benefit of the mortgagee, and he may enforce the contract by a direct action against the grantee.¹⁷ Although a promise to pay a mortgage debt cannot be distinguished from a promise to pay any other debt, the rule obtains in other jurisdictions, including Montana, that since, as between the parties to the deed, the grantee, by his contract of assumption becomes the principal debtor and the grantor the surety, the mortgagee is entitled to the benefit of the contract, being subrogated to the right of the mortgagor.¹⁸ Professor Williston points out that the use of the word "subrogation" is unfortunate, suggesting analogies which do not exist.¹⁹ As he states:

¹³*Carlson v. Barker*, *infra* note 15; *Western Loan and Savings Co. v. Silver Bow Abstract Co.* (1904) 31 Mont. 449, 78 P. 774; and *Kelley v. Montana Power Co.* *supra* note 2, apparently stating the rule. Further, we find language which recognizes the right of suit and limits it to the creditor beneficiary in *McDonald v. American National Bank* *supra* note 8; also in *Tatem v. Eglanoi Mining Co.* *supra* note 8.

¹⁴For a collection of cases see *Contracts*, 13 C. J. p. 705. Also see WILLISTON, *CONTRACTS* (Rev. ed. 1936) §357, p. 1049.

¹⁵*Merrill v. Green* (1873) 55 N. Y. 270; *Wheat v. Rice* (1884) 97 N. Y. 296; *Corner v. Mackey* (1895) 147 N. Y. 574, 42 N. E. 29; *Edick v. Green* (1885) 38 Hun. 202; *Serviss v. McDonnell* (1887) 107 N. Y. 260, 14 N. E. 314.

¹⁶(1908) 36 Mont. 486, 93 P. 646.

¹⁷For a collection of cases see 21 A. L. R. 440 *et seq.*

¹⁸A collection of cases on this point will be found in 21 A. L. R. 454 *et seq.*

¹⁹For cases on this point consult 21 A. L. R. 451 *et seq.*

²⁰2 WILLISTON, *CONTRACTS* (Rev. ed. 1936) §384, p. 1116.

“In fact, the relief granted is merely the application towards the payment of the debt by a court of equity of the mortgagor’s property, consisting of the promise running to him from the grantee of the mortgaged premises; and whatever terminology is used there is no doubt that this is substantially the meaning of the courts which have followed the early New York decisions.”

With respect to Montana the criticized language has perhaps been instrumental in the results reached in two decisions which seem difficult to sustain on the grounds advanced by the court.²⁰

Professor Williston sums up the probable reason for the different treatment accorded to the promise of the grantee to the mortgagor in these words:

“Perhaps, because the scope of mortgage fell within the scope of equity jurisdiction, the attempt was early made by mortgagees to sue in equity those who had assumed an obligation to pay the mortgage, while no such attempt was made with other debts.”²¹

But there is particular reason in Montana for going back to this older method of reaching the promisor. By the wording of section 9467, R. C. M. 1935,²² there is but one action for the recovery of a debt secured by a mortgage, that is, by foreclosure and in the event of a deficiency on sale, judgment against the debtors personally liable. *Kinyon Investment Co. v. Belmont*²³ held that a deficiency judgment could be obtained against the grantee from the mortgagor who assumed the debt, and, by way of dictum, from the mortgagor also or both. The Court stated the mortgagee would have no action at law as upon a contract made for the special benefit of a third party.²⁴

Whether a direct suit is allowed, or only the so-called “subrogation,” will or should cause a difference in result in some situations. A court allowing a direct suit may, as did the court in *Schneider v. Ferrigno*,²⁵ give the mortgagee a suit against any grantee who has assumed the payment of the mortgage, although in the chain of title one purchaser from the mortgagor hasn’t assumed and agreed to pay, whereas in Montana the mortgagee will not be able to recover from the remote grantee unless all the

²⁰*Shipman v. Terrill* (1929) 84 Mont. 322, 276 P. 21; *United States Building and Loan Association v. Burns* (1931) 90 Mont. 402, 4 P. (2d) 705. These cases will be discussed *infra*.

²¹2 WILLISTON, *CONTRACTS* (Rev. ed. 1936) §384, p. 1115.

²²The section appeared in its original form as §223, p. 90, *BANNACK STAT.*

²³(1923) 69 Mont. 282, 221 P. 286.

²⁴See 69 Mont. at pp. 286, 287, 221 P. 286, 287, 288.

²⁵(1929) 110 Conn. 86, 147 Atl. 303.

intervening grantees have assumed the mortgage.²⁶ In *Murray v. Creese*²⁷ the Court said:

“. . . proof would then be required that he acquired title by deed from the mortgagors containing the assumption of the mortgage debt, or by mesne conveyances through a chain of instruments containing such assumption and his acceptance thereof.”

On the other hand in *Shipman v. Terrill*²⁸ and *United States Building and Loan Association v. Burns*,²⁹ the Montana Court followed those courts which discharge the mortgagor from liability when the mortgagee has made a binding contract with the grantee extending the time of payment of the debt, without noticing that, under its theory of the mortgagee's rights, its basis for giving the surety a defense is entirely gone.³⁰ In jurisdictions where the mortgagee has a direct right against the grantee, some argument can be made that when the mortgagee by contract gives the grantee additional time, he ties up for that period the mortgagor's subrogation to that right, potentially harms him, and, therefore, he should have a defense. That view is widely held³¹ although soundly criticized.³² But where, as in Montana, the mortgagee has no personal right against the grantee and has no power by virtue of his contract with the grantee to tie up or impair the mortgagor's right on the latter's own contract with the grantee, it seems absurd to hold that the surety mortgagor has a defense based either on alteration of the principal's contract or on a collateral contract varying the surety's risk.³³

With respect to a beneficiary of the third type, the donee beneficiary, Montana law is not entirely clear. The right of the beneficiary of an insurance policy to recover has been assumed in a number of Montana cases³⁴ in which the question of the right of a donee beneficiary to sue was not litigated.

²⁶See 2 WILLISTON, CONTRACTS (Rev. ed. 1936) §386A, p. 1122.

²⁷(1927) 80 Mont. 453, 260 P. 1051.

²⁸*Supra*, note 20.

²⁹*Supra*, note 20.

³⁰It is not within the province of this paper to discuss the possible grounds for a defense. For a discussion of the defenses of a surety see Browning, *Suretyship: Defenses of Sureties and Guarantors under R. C. M. 1935, Section 8188 and 8201*, MONT. L. REV. (Spring 1941), p. 155.

³¹For a collection of cases and jurisdictions applying the majority rule, consult 41 A. L. R. p. 282.

³²This view is more fully developed in 2 WILLISTON, CONTRACTS (Rev. ed. 1936) §386, p. 1121.

³³Professor Williston's criticism of such a holding seems entirely sound. 2 WILLISTON, CONTRACTS (Rev. ed. 1936) §386, p. 1122.

³⁴*Knights of Maccabees of the World v. Sackett* (1906) 34 Mont. 357,

In another class of cases; namely where a promise has been made to a parent to confer a benefit on his child, the donee beneficiary has been allowed to win. Thus in *Burns v. Smith*⁸⁵ the plaintiff, in a suit on a promise which he alleged was made to his parent for his benefit, was allowed specific performance of a promise to leave a child's portion. The Court, however, spoke as if the plaintiff were the promisee. In *Wilburn v. Wagner*⁸⁶ the plaintiff alleged a promise to the plaintiff's mother by the defendant's testator to leave a child's portion to the plaintiff in consideration of her marriage to the testator and permission to raise the plaintiff as testator's child. The right of the plaintiff to sue was assumed, and the point that she was a donee beneficiary was apparently not raised. The plaintiff, however, was denied relief on the ground of insufficiency of evidence. And in *Gravelin v. Porier*,⁸⁷ where the plaintiff alleged a promise to the mother by a testator that in consideration of the mother leaving her child (the plaintiff) in the custody of the testator, he would adopt the plaintiff and leave a child's portion to her, the Court affirmed a judgment for the plaintiff. The question of the right of a donee beneficiary was not raised. In its results in this class of cases the law in Montana follows the law of New York which early allowed the donee beneficiary to recover against the promisor when the beneficiary was the child of the promisee.⁸⁸

There is, however, language in some Montana cases limiting the right of the beneficiary to sue to the creditor beneficiary. Thus in *McDonald v. American National Bank*,⁸⁹ the Court said the contract "... must be one whereby the promisor undertakes to pay or discharge some debt or duty which the promisee owes a third party." *Tatem v. Eglanol*,⁹⁰ a case of incidental benefit, repeated this language. The Circuit Court of Appeals of the Ninth Circuit, in *McNaught v. Hoffman*,⁹¹ though pointing out that the Montana view as to rights of third persons for whose

86 P. 423, 115 Am. St. Rep. 532; *Kennedy v. The Grand Fraternity* (1907) 36 Mont. 325, 92 P. 971, 25 L. R. A. (N. S.) 78; *Tuttle v. Pacific Mutual Life Insurance Co.* (1920) 58 Mont. 121, 190 P. 993, 16 A. L. R. 601; *Winkleman v. Minnesota Mutual Life Insurance Co.* (1923) 66 Mont. 451, 213 P. 1104.

⁸⁵(1898) 21 Mont. 251, 53 P. 742, 69 Am. St. Rep. 653.

⁸⁶(1921) 59 Mont. 386, 196 P. 978.

⁸⁷(1926) 77 Mont. 260, 250 P. 823.

⁸⁸*Todd v. Weber* (1884) 95 N. Y. 181, 193, 47 Am. Rep. 20; *Moncrief v. Ely* (1838) 19 Wend. 405; *Birdsall v. Edgerton* (1841) 25 Wend. 619; *Hook v. Pratt* (1879) 78 N. Y. 371; all of which were decided on relationship.

⁸⁹*Supra*, note 8, at p. 495.

⁹⁰*Supra*, note 8, at p. 373.

⁹¹(C. C. A. 1921) 274 F. 918.

benefit contracts have been made is in opposition to the weight of American authority,⁴³ nevertheless felt bound to follow this language as a construction of our statute, and denied the donee beneficiary a recovery.

There is also to be noted the case of *Martin v. American Surety Company*⁴⁴ in which the surety company, which gave bond to the State Highway Commission with the condition that the contractor should "faithfully perform the contract and pay the amounts contracted for materials furnished and labor performed," was held not to be liable to those within this provision who had not been paid. The Court appears to have treated the case as involving an incidental beneficiary and not a donee beneficiary. Prior to the *Martin* case the Montana Supreme Court had held that a surety bond given to the state conditioned that the contractor "shall well and truly pay all and every person furnishing material or performing labor in and about the construction of said roadway" enured to the benefit of those furnishing labor or material.⁴⁵ In *Gary Hay and Grain, Inc. v. Carlson*⁴⁶ where the contract and the bond with the state provided that the "contractor shall promptly make payment for labor and material . . . to all persons supplying such contractor" the Court held that plaintiffs furnishing material had a right to sue the contractor and surety, anything to the contrary in the *Martin* case being overruled. The Court said that the *Martin* case might be upheld on the ground that the contract with the state contained no direct promise to pay for labor and material and that the surety's obligation would not be greater. The Court recognized that the promisee owed no duties to the plaintiffs,⁴⁷ and therefore while it did not discuss the right of a donee beneficiary to recover must have proceeded upon the assumption that the beneficiary may sue unless he is an incidental beneficiary. Subsequent decisions cite this case as controlling.⁴⁸

The effect of these conflicting views can be seen in cases in the federal courts attempting to apply Montana law. For example, in *Federal Surety Company v. Minneapolis Steel and Machinery Company*,⁴⁹ the plaintiff, a materialman, was denied recovery because the Court thought the governing law of the forum, Montana, denied the donee beneficiary a recovery. On

⁴³Citing 6 R. C. L. 884; 13 C. J. 705.

⁴⁴(1925) 74 Mont. 43, 238 P. 877.

⁴⁵*Lanstrum v. Zumwalt* (1925) 73 Mont. 502, 237 P. 205.

⁴⁶(1927) 79 Mont. 111, 255 P. 722.

⁴⁷79 Mont. 111, 124, 125, 255 P. 722, 725, 726.

⁴⁸*H. Earl Clack Co. v. Staunton* (1935) 100 Mont. 26, 44 P. (2d) 1069; *National Surety Co. of New York v. Ulmen* (1933) 68 F. (2d) 330.

⁴⁹(1927) 17 F. (2d) 242.

retrial the district court felt bound by the decision of the circuit court, despite the fact that possibly the law had been changed in Montana by *Gary Hay and Grain, Inc. v. Carlson, supra.*⁴⁹ On appeal⁵⁰ the Court held that the facts came within the rule of the *Martin* case which had not been over-ruled by the *Gary* case because there was a difference between a contract containing a promise that the contractor will pay for labor and material, a direct promise within the terms of the statute, and one from which there can only arise an implied obligation to a third person.⁵¹

Referring again to the *Martin* case, its subsequent developments in the federal courts are worthy of note. In *Cove Irrigation District v. American Surety Co. of New York,*⁵² in which the District sued on behalf of the beneficiary in the *Martin* case, the Court, construing the *Martin* case as denying substantive rights to laborers and materialmen, held that the previous judgment constituted a judicial estoppel for the reason that those who were plaintiffs in the former suit were waging the same claims in the name of the Irrigation District.⁵³ However, in 42 F. (2d) 957 on rehearing, *certiorari denied,*⁵⁴ the Circuit Court reversed itself and allowed recovery under the last sentence of section 9067, R. C. M. 1935.⁵⁵ It treated the promisee as, in substance, a trustee and apparently allowed full damages,⁵⁶ whereas normally the promisee in a donee beneficiary type case would recover only nominal damages.⁵⁷ Resort to the theory by which the Circuit Court of Appeals ultimately permitted a recovery of the same amount that the beneficiary would have recovered in a direct suit in his own name would seem no longer necessary in view of the present status of Montana authority. *National Surety Co. of New York v. Ulmen*⁵⁸ so indicates.

⁴⁹(1927) 22 F. (2d) 712.

⁵⁰(1929) 34 F. (2d) 270.

⁵¹See 34 F. (2d) p. 273 *et seq.* drawing this distinction.

⁵²(1929) 35 F. (2d) 933.

⁵³35 F. (2d) at p. 934.

⁵⁴(1930) 282 U. S. 891, 51 S. Ct. 103, 75 L. Ed. 785.

⁵⁵"Every action must be prosecuted in the name of the real party in interest, except that an executor or administrator, a trustee of an express trust, or a person expressly authorized to sue, without joining with him the person for whose benefit the action is prosecuted. A person for whom, or in whose name, a contract is made for benefit of another, is a trustee of an express trust within the meaning of this section."

⁵⁶See *American Surety Co. of New York v. Cove Irrigation District*, C. C. A. Mont. (1931) 54 F. (2d) 197.

⁵⁷RESTATEMENT, CONTRACTS, §136, comment (b).

For a collection of cases see 2 WILLISTON, CONTRACTS (Rev. ed. 1936) §357, note 7, p. 1048.

⁵⁸*Supra*, note 47.

In summary, this may be ventured in respect to the right of the beneficiary to sue in Montana. The incidental beneficiary has no cause of action against the promisor. The creditor beneficiary is allowed a direct right except in the case of a grantee assuming a mortgage debt. Although there are no general pronouncements by our Court that the donee beneficiary has a direct suit against the promisor, and in spite of the language in early decisions and that of *Martin v. American Surety Co.*, it is believed that the Supreme Court of Montana is substantially committed to the doctrine that the donee beneficiary has a direct suit against the promisor. The donee beneficiary cases passed upon by the Supreme Court have involved "sole" beneficiaries of insurance policies; sub-contractors, laborers and materialmen under provisions of a surety bond; and cases of promises for the benefit of a child. Though there may be historical reason, there is no logical reason for preferring these to other donee beneficiaries. The language of the code is broad enough to permit recovery by any donee beneficiary. In view of the progress already made, the expectation seems warranted that, as occasion arises, other types of donee beneficiaries will be permitted a direct suit, in line with the growth of the law elsewhere in America.

—Carl Burgess.

**CORPORATIONS: LIMITATIONS UPON THE RIGHT OF
A STOCKHOLDER TO BRING A REPRESENTATIVE
SUIT IN MONTANA**

Does the complaining stockholder always have to petition the other stockholders for redress as a condition of his right to bring a derivative suit on behalf of the corporation? Such seems to be the conclusion of a recent A. L. R. Annotation,¹ and at least one Montana case, which goes so far as to say that

¹Annotation in 72 A. L. R. 621 to *Caldwell v. Eubanks* (1930) 326 Mo. 185, 30 S. W. (2d) 976. The annotator apparently concludes that there are only two situations in which application to the stockholders as a body will be excused: one is where the majority stockholders were in league with the wrongdoers, and the other where there is shown lack of time. In support of this proposition he cites every imaginable case on the subject, but it is contended and sought to be shown in this article that his theory is not supported by the better authority, and that it is subject to the same criticism as is herein made of the dictum in *Allen v. Montana Refining Co.* (1924) 71 Mont. 105, 227 P. 582. Rather, it would be more commensurate with sound policy to adhere to the rule as set out in *Continental Securities Co. v. Belmont* (1912) 206 N. Y. 7, 99 N. E. 138, 51 L. R. A. (N. S.) 112 and the exhaustive annotation thereto.