

The Law Reform Commission's Privity of Contract Sub-committee today (3 June) released a consultation paper on proposals to reform the doctrine of privity of contract.

The privity doctrine has two aspects. As a general rule, a person cannot acquire and enforce rights under a contract to which he is not a party; and a person who is not party to a contract cannot be made liable under it.

While the second aspect is generally regarded as just and sensible, the first aspect has been subject to widespread criticism by the courts, academics and law reform bodies in a number of common law jurisdictions. An example of the consequences of the first aspect of the doctrine arises, for instance, where A and B enter into an agreement whereby A will pay C a sum of money. If A subsequently fails to pay C, C cannot enforce the contract against A because he is not a party to the contract.

The main concern of the consultation paper is therefore with this first aspect of the doctrine. In the sub-committee's opinion, the doctrine frustrates contracting parties' intention to benefit third parties, and the doctrine is unduly complex, uncertain and artificial.

The sub-committee recommends that the doctrine should be reformed (but not completely abolished), by means of a detailed legislative scheme which would provide a comprehensive, systematic and coherent solution. It also recommends that all the major issues arising from their proposed statutory exception should be dealt with in the new legislation, including:

- How should a third party be designated?
- Under what circumstances should a third party have the right to enforce a contract to which he is not party?
- How should the balance between the contracting parties' freedom to vary or rescind the contract and the third party's interests be struck?
- Should the courts have the discretion to authorise variation or cancellation of the contract by the contracting parties?
- What defences, set-offs and counterclaims should be available to the contracting party who has promised to confer benefits on the third party in an action brought by the latter to enforce the promise against the former?

The effect of the reform on everyday life can best be illustrated by some practical examples.

- *Contracts to pay money to a third party* -- A and B enter into an agreement under which A agrees to pay a sum of money to C. Both parties fully intend that C should take the benefit of A's promise. If A defaults, C cannot sue A under the existing law because of the privity doctrine. C, however, would be able to claim against A under the sub-committee's proposals.
- *Retail contracts* -- B makes it clear to A, a retailer, when purchasing a genuine painting by a famous artist that it is to be delivered to C as a birthday gift. If the painting delivered is only a replica, only B can sue A for the breach under the existing law. Under the sub-committee's proposals, C would also be able to enforce the promise made by A.
- *Insurance contracts* -- B is a sub-contractor of A. B takes out an insurance policy with an insurer (C) to cover his and A's liability to employees' compensation. A is not joined as a party. One of B's employees is injured in the course of employment because of the negligence of one of A's employees. A pays the required compensation to B's employee. Under the existing law, A would have difficulties in seeking indemnity from C, since A is not a party to the insurance contract even though the parties intend to benefit him. In contrast, A would be able

to seek indemnity from C under the sub-committee's proposals.

Mr Benjamin Yu SC, Chairman of the sub-committee, said, "What we propose is a general and wide-ranging statutory exception to the privity doctrine." He stressed that the underlying principle of the reform was to respect contracting parties' freedom of contract and, where appropriate, to give effect to their intention to benefit a third party. "If the parties prefer, they will be able to make it clear in their contract that the proposed legislation is not to apply to their contract," Mr Yu said.

The sub-committee emphasises that the recommendations in the Consultation Paper are intended to facilitate discussion and do not represent the sub-committee's final conclusions. Mr Yu said that the sub-committee would welcome views, comments and suggestions on any issues discussed in the Consultation Paper.

Copies of the Consultation Paper are available on request from the Secretariat of the Law Reform Commission at 20/F Harcourt House, 39 Gloucester Road, Wanchai, Hong Kong. They are also available on the Internet at <[www.info.gov.hk/hkreform](http://www.info.gov.hk/hkreform)>.

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