

THE LAW REFORM COMMISSION OF HONG KONG

REPORT

PRIVITY OF CONTRACT

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September 2005

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CONTENTS

<i>Chapter</i>	<i>Page</i>
Preface	1
Terms of reference	1
The Sub-committee	1
Meetings	2
What is “privity of contract”?	2
Criticisms of the privity doctrine and reform in other jurisdictions	2
The consultation process	3
Layout of this report	3
1. The current law in Hong Kong	5
The doctrine of privity	5
(i) <i>Contracts to pay money to a third party</i>	6
(ii) <i>Contracts to purchase real property</i>	6
(iii) <i>Insurance contracts</i>	7
Legal principles which have the effect of allowing third parties to enforce rights	7
<i>Common law</i>	8
<i>Statutory provisions</i>	9
How the Hong Kong courts have received judicial developments in other common law jurisdictions	11
<i>Canada</i>	11
<i>Australia</i>	12
<i>Hong Kong courts</i>	13
2. Should the privity doctrine be reformed?	15
Arguments against reforming the privity doctrine	15

Chapter	Page
<i>Third party should not be able to sue in the absence of consideration</i>	15
<i>Contracts are personal transactions</i>	16
<i>Undesirable to subject promisor to two actions</i>	16
<i>Unjust that the third party can sue on the contract but cannot be sued</i>	17
<i>Limits freedom of the contracting parties to rescind or vary and exposes them to a wide range of possible third party plaintiffs</i>	17
Arguments for reforming the privity doctrine	18
<i>Frustrating parties' intention to benefit third parties</i>	18
<i>The privity doctrine is unduly complex, uncertain and artificial</i>	18
<i>The person who has suffered the loss cannot sue, while the person who has suffered no loss can sue</i>	20
<i>The injustice to a third party who has relied on the promise</i>	21
<i>Widespread and continuous criticism of the doctrine, and abrogation of the doctrine in other jurisdictions</i>	21
Conclusion	22
3. Options for reform of the privity doctrine	26
<i>Option 1 – Judicial development of circumvention of the privity doctrine</i>	26
<i>Option 2 – Legislative exceptions to the privity doctrine to be made in specific instances</i>	27
<i>Option 3 – Adopting a general provision that no third party should be denied enforcement of a contract made for his benefit on the grounds of lack of privity</i>	28
<i>Option 4 – Reform by means of a detailed legislative scheme</i>	28
Conclusion	29
4. The elements of the new legislative scheme	32
Who is a third party?	33
<i>Australia</i>	33
<i>Canada</i>	34
<i>England and Wales</i>	34
<i>New Zealand</i>	35
<i>Singapore</i>	35
<i>Options and conclusions</i>	36
What is the test of enforceability?	38
<i>Australia</i>	39
<i>Canada</i>	39
<i>England and Wales</i>	40
<i>New Zealand</i>	41
<i>Singapore</i>	43
<i>Options and conclusion</i>	43
Can the contracting parties vary or rescind the contract?	53
<i>Australia</i>	53
<i>England and Wales</i>	54

Chapter	Page
<i>New Zealand</i>	55
<i>Singapore</i>	55
<i>Options and conclusions</i>	56
Can the parties vary or rescind the contract after crystallisation, or lay down their own crystallisation test?	60
<i>Canada</i>	61
<i>England and Wales</i>	61
<i>New Zealand</i>	61
<i>Singapore</i>	61
<i>Options and conclusions</i>	62
Should there be any judicial discretion to authorise variation or cancellation?	65
<i>England and Wales</i>	65
<i>New Zealand</i>	66
<i>Singapore</i>	66
<i>Options and conclusions</i>	66
Should consideration be an issue?	69
<i>Australia</i>	69
<i>England and Wales</i>	69
<i>New Zealand</i>	70
<i>Singapore</i>	71
<i>Options and conclusion</i>	71
What defences, set-offs and counterclaims should be available to promisors?	72
<i>Australia</i>	72
<i>Canada</i>	72
<i>England and Wales</i>	72
<i>New Zealand</i>	73
<i>Singapore</i>	74
<i>Options and conclusion</i>	74
How should overlapping claims against promisors be dealt with?	78
<i>Promisor's duty owed both to the promisee and the third party</i>	78
<i>Discharge of promisor by performing obligation to the third party</i>	82
<i>Avoidance of double liability</i>	83
Should arbitration clauses and exclusive jurisdiction clauses be binding on third parties?	86
<i>England and Wales</i>	86
<i>Singapore</i>	87
<i>Options and conclusions</i>	87
What should the scope of the present reform be?	93
<i>Preservation of existing rights of third parties</i>	93
<i>Areas to which the recommended legislation should not apply</i>	97
<i>Miscellaneous issues</i>	107
5. Summary of recommendations	110

<i>Chapter</i>	<i>Page</i>
Annex 1	114
List of those who responded to the consultation paper	
Annex 2	115
Comparison table of the rules on reforming the privity doctrine	
Annex 3	124
Legislation in other jurisdictions	

Preface

Terms of reference

1. In December 2002, the Secretary for Justice and the Chief Justice directed the Law Reform Commission:

"To examine the doctrine of privity of contract and its exceptions, and the justifications for and against its retention, and to make such recommendations for reform as appropriate."

The Sub-committee

2. In the same month, the Law Reform Commission appointed a sub-committee under the chairmanship of Mr Benjamin Yu, SC, to consider the subject and to make proposals to the Commission for reform. The members of the Sub-committee reflected a range of backgrounds and expertise. All were appointed in their personal capacity, rather than formally representing the particular organisations to which they belong. The membership of the Sub-committee was:

Mr Benjamin Yu, SC, JP (Chairman)	Senior Counsel
Mr Anthony Chow, SBS, JP	Partner Peter C Wong, Chow & Chow
Mr Simon Chui	Legal Counsel Consumer Council
Mr Baptista Lai	Barrister-at-Law
Mr Christopher Potts	Partner Crump & Co
The Hon Mr Justice Reyes	Judge Court of First Instance
Mr Peter Schelling	Managing Director & CEO Zurich Insurance Group (HK)
Ms Isabelle Tsang	Legal Counsel Bank of China (HK) Ltd

Ms Jessica Young

Assistant Professor
Department of Professional Legal Education
Faculty of Law
The University of Hong Kong

Mr Byron Leung

Secretary

Meetings

3. The Sub-committee began its work on 29 January 2003 and between then and the publication of this report held a total of nineteen meetings.

What is "privity of contract"?

4. The doctrine of privity of contract ("the doctrine of privity") holds that a contract cannot confer rights or impose obligations on any persons other than the parties to the contract. The doctrine of privity is also known as the "third party rule". The doctrine has two aspects: as a general rule,

- (a) a person cannot acquire and enforce rights under a contract to which he is not a party; and
- (b) a person who is not party to a contract cannot be made liable under it.

The second aspect is generally regarded as just and sensible. However, the first aspect, that a third party cannot acquire rights under a contract to which he is not privy, has been criticised. The main concern of this report is therefore with this first aspect of the rule, and references to the doctrine of privity or the "third party rule" are to this.

Criticisms of the privity doctrine and reform in other jurisdictions

5. The privity doctrine has long been criticised as artificial and contrary to the parties' intention to benefit a third party. As a result, the courts have sometimes needed recourse to devices such as agency and trust to allow a third party to enforce a right conferred on him. Furthermore, legislation has made incremental inroads to the doctrine in specific cases. These legal principles at common law and in statutes circumvent the privity doctrine in some cases, but not generally.¹ It is no surprise that law reform bodies in various common law jurisdictions have critically examined the

¹ These legal principles are discussed in Chapter 1.

doctrine and recommended its reform.² In Australia (Western Australia and Queensland), Canada (New Brunswick), England, New Zealand and Singapore the privity doctrine has eventually been abrogated by legislation.³

6. The questions which fall to be considered are whether the anomalies of the privity doctrine are serious enough to warrant its reform and, if so, whether *ad hoc* reforms, either by the courts on their own initiative or by legislation, are adequate in the modern Hong Kong context, or whether an issue of this magnitude calls for comprehensive legislative reform.

The consultation process

7. The Sub-committee published a consultation paper on *Privity of Contract* (the "consultation paper") in June 2004, with a consultation period until the end of August 2004. The Sub-committee received responses to the consultation paper from those listed at Annex 1. We are grateful to all those who responded to the consultation paper.

8. The recommendations in the consultation paper were in general supported by the majority of respondents. Nevertheless, some respondents did have specific comments and reservations on both the recommendations and the issues discussed in the consultation paper. Apart from written comments, the Hong Kong Construction Association Ltd also met the Sub-committee and presented the consolidated views of the Association itself, the Hong Kong Federation of Electrical & Mechanical Contractors, the Hong Kong Institute of Surveyors, the Hong Kong Institute of Architects and the Association of Consulting Engineers. We will deal with the various comments and reservations in the following chapters.

Layout of this report

9. This report is the result of careful consideration of the initial recommendations in the consultation paper in the light of the responses we received. Chapter 1 of this report further examines the doctrine of privity as well as the common law and statutory principles which have the effect of circumventing the doctrine. Chapter 2 discusses the arguments for and against reforming the doctrine, while Chapter 3 examines a number of options

² Such as the Queensland Law Reform Commission, *Report on a Bill to Consolidate, Amend and Reform the Law Relating to Conveyancing, Property, and Contract and to Terminate the Application of Certain Imperial Statutes* (1973); the Law Commission (England), *Privity of Contracts: Contracts for the Benefit of Third Parties* (1996); the New Zealand Contracts and Commercial Law Committee, *Report on Privity of Contract* (1981); and Law and Revision Division, Attorney General Chambers (Singapore), *Report on the Proposed Contracts (Rights of Third Parties) Bill 2001: Law Reform Commission of Nova Scotia, Report on Privity of Contract (Third Party Rights)* (2004).

³ See the Western Australian Property Law Act 1969 (Western Australia), the Queensland Property Law Act 1974 (Queensland), the Law of Property Act 2000 (the Northern Territory), the Law Reform Act 1993 (New Brunswick), the Contracts (Rights of Third Parties) Act 1999 (England), the Contracts (Privity) Act 1982 (New Zealand), and the Contracts (Right of Third Parties) Act 2001 (Singapore).

for reform and concludes in favour of recommending reform by means of a detailed legislative scheme. Chapter 4 examines the legislative schemes in other major common law jurisdictions and considers various options before making our provisional recommendations for a legislative scheme for Hong Kong. Chapter 5 summarises all our recommendations.

Chapter 1

The current law in Hong Kong

The doctrine of privity

1.1 In this chapter, we further explain the doctrine of privity and illustrate its effect with some real-life examples. We then examine common law and statutory principles which have the effect of circumventing the doctrine and allowing a third party to enforce a *jus quaesitum* (a right conferred on him by the contractual parties). The last part of the chapter looks at judicial developments in other common law jurisdictions and discusses how those developments have been received by the Hong Kong courts.

1.2 As explained in the Preface, the doctrine of privity has two aspects. The first aspect, which is the crux of our present discussion, is that, as a general rule, a person cannot acquire and enforce rights under a contract to which he is not a party. The doctrine of privity at common law is generally considered to have been established in *Tweddle v Atkinson*.¹ The court in that case held that, in the words of Wightman J, "*no stranger to the consideration could take advantage of a contract though made for his benefit.*"² That is to say, a third party to a contract, not having provided consideration himself, cannot enforce the contract even if it has been entered into for his benefit. The rule was affirmed in *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd*³ when the House of Lords accepted that it was a fundamental principle of law that only a party to a contract who had provided consideration could sue on it.⁴ This "consideration" rule is related to the doctrine of privity and is regarded as a possible explanation for the doctrine.⁵

1.3 When considering the effect of the privity doctrine, account needs to be taken of the remedy rule: the need to prove loss in an action for breach of contract. When a plaintiff sues for breach of contract, he must prove that he has suffered actual loss as a result of the alleged breach.

¹ (1861) 1 B & S 393. *Kepong Prospecting Ltd v Schmidt* [1968] AC 810, a decision of the Privy Council on appeal from Malaysia, seems to support the view that the doctrine of privity is distinct from the rule that consideration must move from the promisee. G Treitel, *The Law of Contract*, Sweet and Maxwell, 11th Edition, 2003, at 587.

² (1861) 1 B & S 393, at 397.

³ [1915] AC 847.

⁴ The existence of the doctrine of privity was, however, later doubted by Denning LJ in *Smith and Snipes Hall Farm Ltd v River Douglas Catchment Board* [1949] 2 KB 500 in 1949 and *Drive Yourself Hire Co (London) Ltd v Strutt* [1954] 1 QB 250 in 1954. See also G Treitel, *The Law of Contract* (cited above), at 588. However, the House of Lords (with Lord Denning dissenting) once again affirmed the existence of the doctrine of privity in 1961 in *Sruttons Ltd v Midland Silicones Ltd* [1962] AC 446.

⁵ G Treitel, *The Law of Contract* (cited above), at pages 588. Chapter 2 will discuss whether the rationale is valid, and will also critically discuss other possible reasons for supporting the privity doctrine.

Otherwise, he will only be entitled to nominal damages. This, when combined with the privity doctrine, could lead to unjust results in some circumstances. For example, suppose a contract is entered into between a parent company and a contractor for the benefit of a subsidiary company. If the subsidiary company subsequently suffers loss as a result of the contractor's breach, the subsidiary company cannot sue the contractor because it is not a party to the contract. The parent company, even though it is a party to the contract, will only recover nominal damages because it has suffered no actual loss. Hence it is not a viable option for a promisee (the parent company) to sue the promisor (the contractor). The decision of *Alfred McAlpine Construction Ltd v Panatown*⁶ is a good example of the rule that a person can only recover nominal damages unless he has suffered actual loss.

1.4 The effect of the first aspect of the doctrine of privity on everyday life can best be illustrated by some real-life examples.

(i) Contracts to pay money to a third party

1.5 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 because of the doctrine of privity. It does not help for B to sue A for damages since B would be unlikely to have suffered any damage himself. Sometimes, the Court may be able to prevent an injustice to C if B is prepared to sue A for specific performance and the Court is prepared to make an order compelling A to perform his promise.

(ii) Contracts to purchase real property

1.6 A property developer enters into a building contract with a contractor under which the contractor promises to use good workmanship and sound materials. The contractor warrants that he would make good any defects in the building within a stated period of, say, twelve months. Shortly before completion of the building, the developer sells individual units to purchasers. If a purchaser of a unit discovers a defect in his flat, he has no direct recourse against the building contractor. This is still the case even though the developer may have obtained the building contractor's warranties specifically for the benefit of purchasers, since purchasers are not "privity" to the building contract. In practice, a developer may withhold part of the payment to the building contractor to ensure that the building contractor honours its promise. The developer may also contract with the purchaser that the developer would exercise its best endeavours to enforce all defects and maintenance obligations under all contracts relating to the construction of the development.⁷ Nevertheless, a purchaser may find himself in a poor

⁶ [2001] 1 AC 518.

⁷ R5C(2)-(5) of the Solicitors' Practice Rules (Cap 159); Circular No 04-53 (PA) of the Law Society of Hong Kong and Circular Memorandum No.40A of the Legal Advisory and Conveyancing Office <<http://www.info.gov.hk/landsd/download/html/40a.html>> (last visit on 27 June 2005).

bargaining position because his only direct recourse, if any, is against the developer. Even that would depend upon the terms of his contract with the developer and on whether the developer is still around to honour its promise. In certain circumstances⁸, the contract between a developer and the purchasers may provide that where the developer is wound up, all warranties and guarantees under all contracts relating to the construction of the development would be assigned by the developer to the owners' corporation incorporated under the Building Management Ordinance (Cap 344) or, if no such corporation exists, to the manager of the development for the time being to be held in trust for purchasers of the units in the development. This recourse against the contractor is indirect, however, and an individual purchaser may encounter difficulties in compelling the owners' corporation or the manager of the development to sue the contractor.

(iii) Insurance contracts

1.7 B is a sub-contractor of A. B takes out an insurance policy to cover his and A's liability to employees' compensation with an insurer (C), without joining A as a party. An employee of B is injured in the course of employment because of the negligence of A's employee. A pays the required compensation to B's employee. A, however, will 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.

Legal principles which have the effect of allowing third parties to enforce rights

1.8 As illustrated in the above examples, strict adherence to the privity doctrine can prove artificial and contrary to the parties' intention, and can lead to injustice and inconvenience. There are, however, circumstances in which the doctrine does not apply, either because of supervening principles of common law or because of specific statutory provisions which allow a third party to enforce a right conferred on him by the contracting parties. The following paragraphs will first explain the principles at common law, followed by those in statutes. The merits and limits of employing these common law and statutory principles as options for reforming the privity doctrine are discussed under "Option 1" and "Option 2" respectively in Chapter 3 where other possible options for reform are also considered.

⁸ R5C(2)-(5) of the Solicitors' Practice Rules (Cap 159); Circular no 04-53 (PA) of the Law Society of Hong Kong and Circular Memorandum No.40A of the Legal Advisory and Conveyancing Office <<http://www.info.gov.hk/landsd/download/html/40a.html>> (last visit on 27 June 2005).

Common law

(i) Covenants concerning land

1.9 Covenants in a lease can benefit third parties who later acquire an interest in the property. Hence, a person may be able to enforce a covenant affecting land made by his predecessor in title even though he was not a party to the covenant, and a covenant may be enforced against someone acquiring land with notice that it is burdened with a covenant.⁹

(ii) Trusts

1.10 A trust is an equitable obligation to hold property on behalf of a beneficiary. A chose in action may be the subject matter of a trust. For example, if A makes a promise to B to pay a sum of money to C, a trust of that promise can be construed as created by B in equity in favour of C. In that case, B would be the trustee while C would be the beneficiary under the trust. If this agreement is construed by the court as a properly constituted trust, C can, in his capacity as beneficiary, sue A to enforce the promise. Though C is not a party to the promise made by A to B, C could nonetheless enforce the promise in equity.

1.11 However, the use of this trust device to circumvent the doctrine of privity has its restrictions. A promisee (ie B in the example quoted above) is not a trustee for a third party unless he manifests an intention to create a trust.¹⁰ Where the word "trust" or "trustee" is not used, there may be difficulties in determining whether or not there is the requisite intention to create a trust. Moreover, there must be an intention to benefit the third party. If the promisee intends the promise to be for his own benefit, there will not be any trust created in favour of the third party.¹¹ The main difficulty of using the trust device is that the court has confined its usage within narrow limits. The trust device has so far been applied only to promises to pay money or to transfer property.¹² According to Sir Guenter Treitel, the trust device has therefore been treated as an exception to the doctrine of privity but is of limited and uncertain scope.¹³

(iii) Tort of negligence

1.12 A contract between A and B may, in addition to creating contractual obligations between the parties, impose on B a duty of care towards a third party, C, under the law of tort. Breach of a duty of care on the part of B may render him liable to C for negligence.¹⁴

⁹ *Tulk v Moxhay* (1848) 2 Ph 774.

¹⁰ *Swain v Law Society* [1983] 1 AC 598, at 620.

¹¹ G Treitel: *The Law of Contract* (cited above), at 648.

¹² G Treitel: *The Law of Contract* (cited above), at 650.

¹³ G Treitel: *The Law of Contract* (cited above), at 650

¹⁴ *Donoghue v Stevenson* [1932] AC 562.

(iv) *Collateral contracts*

1.13 A contract between two parties may be accompanied by a collateral contract between one of them and a third party. For instance, A may enter into a contract of repair with B which specifies the use of the paint manufactured by C because of its special quality. If the paint supplied does not have that quality, A cannot sue C on the contract of sale of the paint to B because A is not privy to the contract.¹⁵ The Court may, however, resort to the device of a collateral contract between A and C under which C would be held to have warranted to A the quality of the paint in consideration of A's agreement with B to buy the paint.

(v) *Assignment*

1.14 A person who is entitled to the benefit of a contract may transfer the benefit to another person who is not a party to the contract. This process is known as assignment, and the consent of the party liable under the contract is not needed. An assignment may be seen as a circumvention of the privity doctrine because the person bearing the burden of the contract becomes liable to a person with whom he had no contractual relationship and whom he may not have intended to benefit.

(vi) *Agency*

1.15 Agency is the relationship between two persons, by agreement or otherwise, where one (the agent) may act on behalf of the other (the principal). One consequence is that the principal acquires rights and incurs liabilities under the contract made by the agent on his behalf with third parties, even though the principal is not a party to the contract. Agency is sometimes looked upon as only an apparent exception to the doctrine of privity because in an agency the agent is only the instrument of the principal, who is the real contracting party.¹⁶ This view may be true if the agent acts within his actual authority, but where, for example, the principal's identity is not disclosed, an established agency is a clear exception to the doctrine of privity.¹⁷

Statutory provisions

(i) *Conveyancing and Property Ordinance (Cap 219)*

1.16 Section 41 of Cap 219 provides that a covenant is enforceable not only by the parties but also by the covenantee's successors in title, assigns, lessees and mortgagees. Section 26 of Cap 219 provides:

¹⁵ *Shanklin Pier Ltd v Detel Products Ltd* [1951] 2 KB 854.

¹⁶ G Treitel, *The Law of Contract*, (cited above), at 645.

¹⁷ According to Sir Guenter Treitel, other scenarios are where an agent acts without actual but within his "usual" authority and in certain cases of agency of necessity. G Treitel, *The Law of Contract*, (cited above), at 646.

"[a] person may take an immediate or other interest granted to him in land or the benefit of any condition, right of entry, covenant or agreement granted to him over or in respect of land, although he may not be named as a party to the instrument."

(ii) *Third Parties (Rights against Insurers) Ordinance (Cap 273)*

1.17 Under Cap 273, a third party may in specified circumstances step into the shoes of the insured and enforce his rights under the policy by suing the insurance company directly. According to section 2, where a person who is insured against liabilities to third parties under a contract of insurance becomes bankrupt, makes a composition or an arrangement with his creditors, or is wound up, his rights under the contract of insurance are transferred to the third party to whom the liability was incurred. In other words, the third party has a direct cause of action against the insurer.

(iii) *Marine Insurance Ordinance (Cap 329)*

1.18 A person with a limited interest in property may insure and recover its full value, holding any amount above his own interest on account for others similarly interested. Section 14(2) of Cap 329 provides that:

"A mortgagee, consignee or other person having an interest in the subject-matter insured may insure on behalf and for the benefit of other persons interested as well as for his own benefit."

(iv) *Bills of Exchange Ordinance (Cap 19)*

1.19 A bill of exchange is defined in section 3(1) of Cap 19 as:

"an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to, or to the order of, a specified person or to bearer."

Under section 38(a), a holder of a bill of exchange may sue on the bill in his own name. A holder of a bill of exchange means a payee or an indorsee of a bill who is in possession of the bill, or a bearer of the bill (section 2).

(v) *Bills of Lading and Analogous Shipping Documents Ordinance (Cap 440)*

1.20 Where goods sold are to be delivered by sea, the seller will enter into a contract of carriage with the carrier, which is evidenced by a bill of lading. The goods are then consigned to the buyer, to whom the bill of lading is endorsed. At common law, a buyer of goods carried by sea cannot sue the carrier on the contract of carriage because there is no privity between them. However, under section 4(1) of Cap 440 a lawful holder of a bill of

lading has "all rights of suit under the contract of carriage as if he had been a party to that contract". In other words, the buyer can sue the carrier direct, notwithstanding that he was not a party to the contract of carriage.¹⁸

How the Hong Kong courts have received judicial developments in other common law jurisdictions

1.21 There have been recent judicial developments in Canada and Australia relaxing the strict doctrine of privity. Although these overseas judicial developments are not binding on courts in Hong Kong, the fact that they represent the judicial opinion of the superior courts in other major common law jurisdictions may have some impact on local judicial thinking. In the following paragraphs, we first explain these overseas judicial developments, and then discuss how the Hong Kong courts have received them.

Canada

1.22 Two recent judgments of the Supreme Court of Canada have modified the law relating to privity: *London Drugs Ltd v Kuehne & Nagel International Ltd*¹⁹ and *Fraser River Pile & Dredge Ltd v Can-Dive Services Ltd*²⁰. In the *Fraser River* case, a third party beneficiary sought to rely on a contractual provision so as to defend against an action brought by one of the contractual parties (the insurer). The court held that the third party beneficiary was entitled to rely on the waiver of subrogation clause whereby the insurer expressly waived any right of subrogation against the third party beneficiary. Iacobucci J emphasised that in appropriate circumstances the courts should not abdicate their judicial duty to decide on incremental changes to the common law which were necessary to address emerging needs and values in society.²¹ In the *London Drugs Ltd* case, employees of a warehouseman sought to rely on the limitation of liability clause in the contract between their employer and the client (the bailor) when the employees were sued by the bailor. The Supreme Court held that the privity rule could be relaxed where the parties to the contract had, expressly or by implication, intended the relevant provision to confer a benefit on the third parties (the employees), and the action taken out by the third parties came within the scope of the agreement between the initial parties. The employees fulfilled these two conditions, and thus could benefit from the

¹⁸ At common law, where a carrier delivers the goods to a buyer, an implied contract may arise from the carrier's attornment to the buyer and the buyer's acceptance of the goods, to the effect that the goods were delivered in the same apparent good order and condition as when received by the carrier. This device enables a third party to sue the carrier on an implied contract having similar (but not necessarily identical) terms to those in the bill of lading. See *Brandt v. Liverpool* [1924] 1 KB 275.

¹⁹ (1992) 97 DLR (4th) 261

²⁰ [2000] 1 Lloyd's Rep 199

²¹ [2000] 1 Lloyd's Rep 199, at 208 (para 44). "[T]he Courts may... ,bound by both common sense and commercial reality, ... determine whether the doctrine of privity... should be relaxed in the given circumstances" (See *The Canadian Encyclopedic Digest: Ontario*, 3rd Edition, at Title 32 Contracts, para 58.1).

limitation clause, despite the privity doctrine. The court recognised a limited exception to the doctrine in the circumstances of the case so as to conform to "commercial reality and justice".²²

Australia

1.23 The decision of the High Court of Australia in *Trident General Insurance Co Ltd v McNiece Bros Proprietary*²³ has relaxed the strictness of the doctrine. The importance of this case is its implications for the privity doctrine in Australia generally.²⁴ In this case, the respondent (McNiece) was the principal contractor for construction work being carried out at the limestone crushing plant of a company which took out a public liability insurance policy with the appellants (Trident) covering itself and all contractors and sub-contractors. A person injured at the construction site recovered damages from McNiece, which in turn brought an action against Trident to seek indemnity for the amount of damages paid. The High Court of Australia held that McNiece was entitled to seek indemnity from Trident even though McNiece was not a party to the insurance contract.

1.24 In the High Court of Australia, three of the Justices criticised the doctrine of privity. Mason CJ and Wilson J (who delivered their judgment jointly) were of the view that there was "*much substance*" in the criticisms directed at the doctrine of privity.²⁵ Toohey J considered that:

"the law which precludes him [ie a non-party assured] from doing so [ie suing the insurer] is based on shaky foundations and, in its widest form, lacks support both in logic or in jurisprudence".²⁶

1.25 Mason CJ, Toohey and Wilson JJ decided the case on the basis of a specific abrogation of the privity rule in relation to insurance contracts. Mason CJ and Wilson J put forward their arguments as follows:

"In the ultimate analysis the limited question we have to decide is whether the old rules [of privity] apply to a policy of insurance. The injustice which would flow from such a result arises not only from its failure to give effect to the expressed intention of the person who takes out the insurance but also from the common intention of the parties and the circumstances that others, aware of the existence of the policy, will order their affairs accordingly ... In the nature of things the likelihood of some degree of reliance on the part of the third party in the case of a benefit to be provided for him under an insurance policy is so

²² S Waddams, *The Law of Contracts*, 4th Edition, 1999, Canada Law Book Inc, at 202.
²³ [1987-1988] 165 CLR 107

²⁴ Carter and Harland, *Contract Law in Australia*, 4th Edition, 2002, Butterworths, at 352.

²⁵ [1987-1988] 165 CLR 107, 118.

²⁶ [1987-1988] 165 CLR 107, 168.

tangible that the common law should be shaped with that likelihood in mind."²⁷

Hong Kong courts

1.26 The *Trident* case was considered in *B + B Construction Ltd v Sun Alliance and London Insurance Plc*,²⁸ the facts of which were similar to those of the *Trident* case. Pak Kee, a sub-contractor, took out an insurance policy with an insurer (the defendant), and the "insured" was described in the contract as "Pak Kee and his contractors". An employee of Pak Kee was injured because of the negligence of an employee of the principal contractor (the plaintiff), which was then held liable to pay damages for negligence and to reimburse Pak Kee for employee's compensation. The plaintiff brought an action against the defendant as the insurer for an indemnity. Since the defendant did not take the point that the plaintiff was not a party to the insurance contract, the Hong Kong Court of Appeal proceeded on the footing that the plaintiff's claim, if otherwise good, was enforceable in the usual way. Hence, at issue was whether the scope of the indemnity extended to the plaintiff.²⁹ Godfrey VP (with whom Ribeiro JA agreed) nonetheless stated incidentally:

*"[the court is] aware of the judicial abrogation of the rule effected in Australia by the decision of the High Court (split 4 to 3) in [the Trident case], a case the facts of which bear many similarities to our own. ...But here, in Hong Kong, the law remains as magisterially stated by Viscount Haldane LC in Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd [1915] AC 847 at 853: '... only a person who is a party a contract can sue on it. Our law knows nothing of a jus quaesitum tertio...' "*³⁰

1.27 No Hong Kong case can be found in which the *Fraser River* case has been considered. The Privy Council in *Re the Mahkutai*³¹ mentioned both the *Trident* case and the *London Drugs Ltd* case. Lord Goff of Chieveley of the Privy Council stated in an *obiter dictum*:

"the time may well come when, in an appropriate case, it will fall to be considered whether the courts should take what may legitimately be perceived to be the final, and perhaps inevitable, step in this development, and recognize in these cases a fully-fledged exception to the doctrine of privity of contract, thus escaping from all the technicalities with which courts are now faced in English law. It is not far from their Lordships' minds that, if the English courts were minded to take that step, they

²⁷ [1987-1988] 165 CLR 107, 123-4.

²⁸ [2000] 2 HKC 295.

²⁹ [2000] 2 HKC 295, at 301 I to 302 D. The plaintiff lost and appealed to the Court of Final Appeal ([2001] 3 HKC 127) which also decided on the scope of the indemnity, without even mentioning the privity doctrine.

³⁰ [2000] 2 HKC 295, at 301B to 301F.

³¹ [1996] 2 HKC 1.

would be following in the footsteps of the Supreme Court of Canada (see [the London Drugs Ltd case]) and, in a different context, the High Court of Australia (see [the Trident case]). Their Lordships have given consideration to the question whether they should face up to this question in the present appeal. However, they have come to the conclusion that it would not be appropriate for them to do so, first, because they have not heard argument specifically directed towards this fundamental question, and second because, as will become clear in due course, they are satisfied that the appeal must in any event be dismissed."

The Privy Council here raised the possibility of "a fully-fledged exception" to the privity doctrine. Nevertheless, as Godfrey VP reiterated in the *B + B* case, the privity doctrine is still part of the Hong Kong law.

Chapter 2

Should the privity doctrine be reformed?

2.1 We examined in the last chapter the current law on the privity doctrine. This chapter examines the arguments for and against reforming the doctrine, and sets out the reasons for our conclusion that the doctrine should be reformed. In identifying the arguments for and against reform, we have been greatly assisted by the detailed examination of those arguments in the consultation paper on privity of contract published in 1991 by the Law Commission in England and Wales (the "Law Commission"), and we make extensive reference to that paper in this chapter.¹

Arguments against reforming the privity doctrine

Third party should not be able to sue in the absence of consideration

2.2 The idea that a contract requires consideration leads naturally to the view that a stranger to a contract cannot take advantage of its terms because he has not provided consideration. To put matters another way, since a promisee must provide consideration, it would be unreasonable to place a third party who has not provided consideration in a better position than a promisee who has not provided consideration.² In commenting on the Sub-committee's consultation paper, the Hong Kong Federation of Insurers also subscribed to this view.

2.3 In the Law Commission's opinion, whilst the privity doctrine determines the question of who may enforce a contract, the doctrine of consideration decides which promises may be enforced.³ There is a bargain (a valid contract) if consideration has been given, since the promisor's promise has been "paid for", albeit by the promisee and not the third party. The fact that there has been consideration means that the third party can potentially acquire rights under the contract. This contrasts with the case where the promisee has given no consideration: in that case, there is no valid contract. We agree with the Law Commission that the "consideration" rule should not be confused with the privity doctrine. It is thus unconvincing to seek to justify the privity doctrine on the basis of a lack of consideration moving from the third party.

¹ Law Commission, *Consultation Paper on Privity of contract: Contracts for the Benefits of Third Parties*, (1991), WP No 121.

² Law Commission Consultation Paper No 121 (cited above), at para 4.3(v).

³ Law Commission Consultation Paper No 121 (cited above), at para 4.4(v).

Contracts are personal transactions

2.4 Another argument is that the ambit of a contract should extend only to those who agree on its terms and scope (ie, the contracting parties), rather than any third party beneficiary. Contracts are seen as personal transactions affecting only the parties to them. This is based on the notion that contracts need an element of consent which is provided by making an offer or an acceptance. Since a third party has, by definition, made neither an offer nor an acceptance, and so has not consented, he should not obtain any contractual rights.⁴ The Hong Kong Federation of Insurers observed in response to the Sub-committee's consultation paper that it was against the parties' intention to allow a third party to claim on their contract, and the third party could have been joined as a party to the contract so as to be able to enforce the contract.

2.5 The Law Commission, however, argued that the purpose of requiring consent was to protect personal autonomy, and a third party's autonomy would not be undermined when the issue concerned the giving of benefits to (but not imposing burdens on) him.⁵ In addition, where both parties have agreed to benefit a third party, allowing the third party to enforce the agreement gives effect to their intention and, if anything, promotes the autonomy of the parties to the contract rather than the reverse. Sir Guenter Treitel observes that the privity doctrine can scarcely be justified by saying that a contract is a personal relationship affecting only the parties to it; for this amounts to a restatement of the doctrine rather than a reason for it.⁶ We understand that contracts are personal in nature. Nonetheless, if the parties intend to benefit a third party, their wishes as stipulated in the contract should be respected. The law should give effect to the parties' intention.

Undesirable to subject promisor to two actions

2.6 If a third party can enforce the promise, the promisor will be liable to be sued by both the promisee and the third party. It could be argued that it is undesirable for a promisor to be liable to actions from both the promisee and the third party.⁷

2.7 The Law Commission considered that this concern could be addressed. Once a promisee or a third party has enforced the promise made by the promisor, the promisor's liability would disappear and the promisor would not be liable to anyone else.⁸ Experience in other jurisdictions shows that it is possible to devise a rule which protects a promisor from double liability. So, for instance, under the Contracts (Rights of Third Parties) Act 1999 in England, where a promisee has recovered substantial damages representing the third party's loss, the third party will not

⁴ Law Commission Consultation Paper No 121 (cited above), at para 4.4(ii).

⁵ Law Commission Consultation Paper No 121 (cited above), at para 4.4(ii).

⁶ G Treitel, *The Law of Contract*, (cited above), at 588.

⁷ Law Commission Consultation Paper No 121 (cited above), at para 4.3(iii).

⁸ Law Commission Consultation Paper No 121 (cited above), at para 4.4(iii).

be entitled to an award duplicating that sum.⁹ Chapter 4 will further explore this issue of double liability.

Unjust that the third party can sue on the contract but cannot be sued

2.8 One argument in favour of the privity doctrine is that it avoids the unjust result that a person could be treated as a party to a contract for the purpose of suing upon it when he could not be sued.¹⁰

2.9 However, the fact that the third party can sue, but not be sued, should not be seen as an impediment to enforceability of a contract since unilateral contracts¹¹ in which only one person is obliged to perform are enforceable under the law of contract.¹² Moreover, although the third party is immune from reciprocal action by the promisor, the promisor may protect his interests by taking action against the promisee.¹³ We must also emphasise that it is up to the parties to decide whether to confer a benefit on a third party, and what benefit is to be conferred. If their intention is to benefit a third party when they are fully aware that the third party cannot be sued, they should have the freedom to do so.

Limits freedom of the contracting parties to rescind or vary and exposes them to a wide range of possible third party plaintiffs

2.10 Clearly, if third parties are able to enforce contracts made for their benefit, the freedom of the contracting parties to rescind or vary such contracts is affected, and promisors may be subject to a wide range of possible third party plaintiffs.¹⁴ However, experience in other jurisdictions suggests that it is possible to strike an appropriate balance between the interests of contracting parties in maintaining freedom to rescind or vary their contract and the interests of third parties in maintaining enforceable rights. For instance, under the Contracts (Rights of Third Parties) Act 1999 in England, the contracting parties may vary or cancel the contract until the third party has communicated his assent to the promise, or has relied on it.¹⁵

2.11 Similarly, a sufficiently circumscribed test of who is a third party beneficiary could narrow the range of third party plaintiffs and avoid a flood of

⁹ Contracts (Rights of Third Parties) Act 1999 (England), section 5, and Contracts (Rights of Third Parties) Act 2001 (Singapore), section 6. See also Law Commission, *Report on Privity of contract: Contracts for the Benefits of Third Parties*, (1996), (Law Com No 242), at para 11.21.

¹⁰ Law Commission Consultation Paper No 121 (cited above), at para 4.3(iv).

¹¹ A unilateral contract may arise when one party promises to pay the other a sum of money if the other will do (or forbear from doing) something without making any promise to that effect. The contract is described as unilateral because the promisee has not made any counter-promise in favour of the promisor.

¹² G Treitel, *The Law of Contract* (cited above), at 588.

¹³ Law Commission Consultation Paper No 121 (cited above), at para 4.4(iv).

¹⁴ Law Commission Consultation Paper No 121 (cited above), at paras 4.3(vi) and (vii).

¹⁵ Contracts (Rights of Third Parties) Act 1999, sections 2(1) and 2(2)

litigation.¹⁶ We understand that these issues must be addressed, but they should not preclude reform. Chapter 4 will explore them in greater detail.

Arguments for reforming the privity doctrine

2.12 Apart from setting out the arguments against reforming the privity doctrine, the Law Commission also comprehensively presented the case for reforming the doctrine in its 1996 report. In the following paragraphs, we will discuss those arguments with examples to better illustrate the anomalies of the doctrine before concluding that the doctrine should be reformed.

Frustrating parties' intention to benefit third parties

2.13 The foremost criticism of the privity doctrine is its failure to give effect to the expressed intention of the parties. The privity doctrine prevents effect from being given to the contracting parties' intention to benefit a third party. The failure of the law to afford a remedy to third parties in such cases frustrates the parties' intentions.¹⁷ We find it difficult to justify why, in situations where a contract is expressly made for the benefit of a third party, the third party should not be able to enforce that benefit.

2.14 The facts of the case of *Tweddle v Atkinson*¹⁸ well illustrate how the privity doctrine can impede the contracting parties' intention. In that case, the plaintiff's father and his would-be father-in-law agreed to pay the plaintiff £100 and £200 in contemplation of his intended marriage. The marriage took place, but the father-in-law failed to pay the £200 as agreed and subsequently died. The plaintiff sued the executor of his father-in-law's estate. It was held that the plaintiff could not succeed, as he had not provided consideration for the agreement between his father and father-in-law. The agreement in question was made by the contracting parties with the intention of benefiting the plaintiff, but the manifest intention of the contract was frustrated by the privity doctrine.

The privity doctrine is unduly complex, uncertain and artificial

2.15 One of the main criticisms of the doctrine is that the law relating to it is unduly complex. Over time, the courts have circumvented the privity doctrine to mitigate its harshness. The effect has been to increase the law's complexity and artificiality, and to raise doubts as to whether a third party in a particular case can circumvent the doctrine. We fully endorse the view that the existing law is complex, uncertain and artificial. The need to circumvent the doctrine demonstrates that the doctrine causes injustice in particular

¹⁶ Law Commission Consultation Paper No 121 (cited above), at paras 4.4(vi) and (vii); See also Law Commission Report No 242 (cited above), at paras 8.1 to 8.18.

¹⁷ Law Commission Report No 242 (cited above), at para 3.1.

¹⁸ (1861) 1 B & S 393.

cases. It also casts doubt on the coherency of the doctrine. It is clear from the extensive litigation that the problems associated with the privity doctrine have not yet been resolved.¹⁹

2.16 The Privy Council's approach to the case of *New Zealand Shipping Co Ltd v A M Satterthwaite & Co Ltd (The Eurymedon)*²⁰ demonstrates the unnecessary complexities which can arise in seeking to circumvent the doctrine and give effect to the contracting parties' intention.

2.17 In that case, a drilling machine was shipped from Liverpool to New Zealand. The bill of lading contained a clause exempting the carrier from liability after one year. Another clause extended this immunity to the carrier's servants, agents and independent contractors. Stevedores negligently damaged the machine. The consignee sued the stevedores more than a year later. The stevedores sought to rely on the exclusion clause in the bill of lading. For the stevedores to be able to claim the protection of the exclusion clause, four conditions laid down by Lord Reid in the earlier case of *Scruttons Ltd v Midland Silicones Ltd* had to be satisfied.

2.18 The first three of the four conditions were satisfied. The main problem lay in finding the consideration by the stevedores for the exclusion clause in a contract to which they were not a party. The Privy Council found in favour of the stevedores by proceeding in the following way:

*"... the bill of lading brought into existence a bargain initially unilateral but capable of becoming mutual, between the shipper and the appellant [ie the stevedores], made through the carrier as agent. This became a full contract when the appellant performed services by discharging the goods. The performance of these services for the benefit of the shipper was the consideration for the agreement by the shipper that the appellant should have the benefit of the exemptions and limitations contained in the bill of lading."*²¹

2.19 *The Eurymedon* demonstrates that, with considerable ingenuity and inconvenience, it is possible in some circumstances to get round the privity doctrine. That result, however, was only achieved at the end of protracted and expensive litigation. The solution used in *The Eurymedon* was criticised as too technical by Lord Goff of Chieveley in *Re The Mahkutai*:

"Though these solutions are now perceived to be generally effective for their purpose, their technical nature is all too apparent; and the time may well come when, in an appropriate case, ... the courts should... recognise... a fully-fledged exception to the doctrine of privity of contract, thus escaping

¹⁹ Law Commission Report No 242 (cited above), at para 3.5.

²⁰ [1975] AC 154 (PC).

²¹ [1975] AC 154, at 167-168 (PC).

*from all the technicalities with which courts are now faced in English law."*²²

The person who has suffered the loss cannot sue, while the person who has suffered no loss can sue

2.20 As pointed out by the Law Commission, the doctrine produces the perverse and unjust result that the person who has suffered the loss of the intended benefit (ie the third party) cannot sue, while the person who has suffered no loss (ie the promisee) can sue.²³ The absurdity of the doctrine's effect is illustrated by the case of *Beswick v Beswick*.²⁴ In that case, an uncle transferred his business to his nephew in return for a promise from the nephew to pay a weekly sum to the uncle's widow after the uncle's death. The House of Lords held that the widow could not maintain a successful action in her personal capacity, as she had not been a party to the promise between the uncle and his nephew. She was, however, held to be able to sue for the loss to her husband's estate in her capacity as administratrix. Nevertheless, she could only recover nominal damages because the uncle (and hence his estate) had suffered no loss from the nephew's breach of promise. The widow, in her personal capacity, who had suffered actual loss of the intended benefit of the promise, could not sue, while the estate, which had suffered no loss, had that right to sue. Their Lordships took the view that it would be unjust to award nominal damages in the present situation and therefore ordered specific performance of the nephew's promise.

2.21 In commenting on the Sub-committee's consultation paper, the Hong Kong Federation of Insurers observed that apart from damages based on loss, there could be other remedies, such as specific performance or other equitable remedies, which did not require the proof of loss. In the context of an insurance contract, a policyholder who has not suffered any loss may seek specific performance to enforce the insurer's promise to benefit beneficiaries. We must, however, point out that equitable remedies are at the courts' discretion. The House of Lords was able to achieve fairness by ordering specific performance in *Beswick v Beswick*. Such a remedy may not be available in every case, however. It could not be used, for instance, where the contract is not supported by valuable consideration or is one for personal service. Moreover, the widow as administratrix in the *Beswick* case of course had no problem with bringing an action against the promisor for her own good. In other cases, even if specific performance or substantial damages could be obtained, the promisee may not be able, or wish, to sue for one reason or another, such as the stress and strain of litigation and its cost, sickness or being overseas.²⁵ The Hong Kong Federation of Insurers also observed that in a typical life insurance contract, a trust was usually expressly created in favour of the beneficiary who could then enforce his equitable interest against the policyholder. Thus, the combined effect of the remedy

²² [1996] AC 650, at 664-5.

²³ Law Commission Report No 242 (cited above), at para 3.3.

²⁴ [1968] AC 58.

²⁵ Law Commission Report No 242 (cited above), at para 3.4.

rule and the privity doctrine will not necessarily create unjust results. While this may be true for life insurance contracts, the present reform concerns contracts in general. We believe that in many situations, third parties may be left without a remedy.

The injustice to a third party who has relied on the promise

2.22 The Law Commission highlighted the injustice to a third party who had, in relying on the promisor's promise, regulated his affairs in the expectation that he would benefit from the promise.²⁶ That injustice would be particularly acute where a third party regulates his affairs to his own detriment.

Illustration

A and B agree that A is to pay a sum of money to C. C gives his car to D, in the expectation of using the money from A to buy himself a new one. If A does not keep his promise, C may be left with no remedies even though he has relied on the promise to his own detriment.

Widespread and continuous criticism of the doctrine, and abrogation of the doctrine in other jurisdictions

2.23 The privity doctrine has been the subject of considerable judicial criticism over the years. Professor Jack Beatson has stated that no other doctrine of English contract law has been subjected to more criticism by the senior judiciary than the privity doctrine.²⁷ Steyn LJ pointed out that:

"there [was] no doctrinal, logical, or policy reason why the law should deny effectiveness to a contract for the benefit of a third party where that [was] the expressed intention of the parties."²⁸

The House of Lords has also made repeated demands for reform of the doctrine. For example, Lord Scarman hoped that the House of Lords would reconsider *Tweddle v Atkinson* and other cases which stood guard over the unjust rule.²⁹ Professor Andrew Burrows has also observed,

"Lord Denning in various cases tried unsuccessfully to bring about reform judicially. And Lords Reid, Scarman, Diplock and, more recently, Lord Goff and Lord Steyn have all in their judgments criticized the privity doctrine and called for its reform."³⁰

²⁶ Law Commission Report No 242 (cited above), at para 3.2.

²⁷ Jack Beatson, "Reforming the law of Contracts for the Benefit of Third Parties: A Second Bite at the Cherry" (1992) 45 CLP 1, at 2,

²⁸ *Darlington Borough Council v Wiltshier Northern Ltd* [1995] 1 WLR 68, at 76.

²⁹ *Woodar Investment Ltd v Wimpey Construction* [1980] 1 WLR 277, at 300. See also Lord Reid in *Bewick v Bewick* [1968] AC 58, at 72; Lord Diplock in *Swain v Law Society* [1983] 1 AC 598, at 611

³⁰ Andrew Burrows, "The Contracts (Rights of Third Parties) Act 1999 and Its Implications for Commercial Contracts", [2000] LMCLQ 540, at 540.

2.24 Sir Roy Goode has said that a strong case can be made out for relaxing, if not entirely abandoning, the privity rule.³¹ In addition, various law reform bodies in the common law world have critically examined the privity doctrine and recommended its reform.³² In Australia (the Northern Territory, Western Australia and Queensland), England, New Zealand and Singapore the doctrine has eventually been abrogated by legislation.³³ In Europe, the legal systems of many non-common law jurisdictions also recognise and enforce third parties' rights, including Austria, Belgium, France, Germany, Greece, Italy, Luxembourg, the Netherlands, Portugal, and Spain.³⁴ The extent of the criticism, and the fact that reform has been adopted in so many jurisdictions, clearly indicate that the privity doctrine is fundamentally flawed.

Conclusion

2.25 After careful deliberations, we have decided that there is a need to reform the privity doctrine. We note that one member of the Subcommittee was not convinced that a case for reform has been made out. (He made clear, however, that if the privity doctrine were to be reformed, the recommendations made in this report should be the way forward.)

2.26 In that member's opinion, the doctrine is a cornerstone of the common law and has worked well for over one hundred and fifty years. Although there have been calls from various quarters for the doctrine to be changed by statute, many jurisdictions remain unconvinced. For instance, while some states in Australia have reformed the doctrine, most states (including New South Wales, Victoria and the Australian Capital Territory) have not. Furthermore, there is no evidence that the abolition of the doctrine will benefit consumers. The effects of change should be ascertained in those jurisdictions where the doctrine has been reformed.

2.27 The dissenting member also highlights the specific problem in the construction industry. Generally speaking, a number of different contractors are involved in any building project, and the purchaser of a flat may not be able to tell which of those contractors should be held responsible for a particular defect. This would compound the cost and complexity of any legal action brought by the purchaser. Reform of the privity doctrine may also bring injustice to a contractor if an unscrupulous developer winds up its shelf company to avoid liabilities and does not pay its contractors for their

³¹ R Goode, *Commercial Law*, 2nd Edition, 1995, Penguin Books, at 108.

³² Such as the Queensland Law Reform Commission, *Report on a Bill to Consolidate, Amend and Reform the Law Relating to Conveyancing, Property, and Contract and to Terminate the Application of Certain Imperial Statutes (1973)*; Law Commission Report No 242 (cited above); the New Zealand Contracts and Commercial Law Committee, *Report on Privity of Contract (1981)*; and Law and Revision Division, Attorney General Chambers (Singapore), *Report on the Proposed Contracts (Rights of Third Parties) Bill 2001*.

³³ See the Western Australian Property Law Act 1969 (Western Australia); the Queensland Property Law Act 1974 (Queensland); the Law of Property Act 2000 (the Northern Territory); the Contracts (Rights of Third Parties) Act 1999 (England); the Contracts (Privity) Act 1982 (New Zealand); and the Contracts (Right of Third Parties) Act 2001 (Singapore).

³⁴ Law Commission Report No 242 (cited above), at para 3.8.

work. In this case, a contractor is not only unpaid for his work, but may also become involved in a legal action concerning work which may or may not be found to be defective. If the abolition of the privity doctrine is designed to shift the risk of buying a flat from the purchaser to the contractor, the contractor is not the best party to take the risk and would become a victim in such circumstances. Furthermore, the type of claim which can be made by a purchaser may be different from the type which can be made by a developer, thus further increasing a contractor's risk. This does not seem fair.

2.28 We do not share this Sub-committee member's concerns. Whether the developer remains in existence or not should not affect the contractor's duty to consumers to make good any defects due to its poor workmanship. By paying the purchase price, a consumer pays the contractor indirectly (through the developer) for the construction work up to a specified standard. It would seem unfair to the consumer if the main contractor were not to assume any responsibility for defects or sub-standard materials used in the development. There is no valid reason why the consumer should not be given the benefits of any warranty given by the contractor to the developer. All in all, we do not accept the arguments against reform which have already been dealt with one by one in the preceding paragraphs. Although certain issues require careful thought, this should not stand in the way of what is in our opinion a convincing case for reform. None of the issues raised are insurmountable and Chapter 4 will consider ways to address these concerns.

2.29 While acknowledging the anomalies of the privity doctrine, the Commissioner of Insurance highlighted a social policy issue in his response to the Sub-committee's consultation paper. If a sub-contractor takes out an insurance policy to cover his and the main contractor's liability for employees' compensation, the main contractor would have little incentive to improve risk management, as he would be able to seek indemnity from the sub-contractor's insurer for damage caused by his own employees. Instead, the pressure would be on the sub-contractor to minimise such risks, but he would have no control over the main contractor's employees. In response to the Commissioner's concern, we would point out that main contractors have a statutory obligation to take out insurance cover for employees' compensation.³⁵

2.30 The British Chamber of Commerce, the Consumer Council, Clement Shum of Lingnan University, the Housing, Planning and Lands Bureau, the Law Society of Hong Kong and Stephenson, Harwood & Lo shared the view that the privity doctrine was anomalous. They supported the relaxation of the privity doctrine to the extent that third parties should be able to enforce contracts which conferred benefits on them. The Hong Kong Society of Accountants also shared their concern that strict adherence to the privity doctrine would frustrate the contracting parties' intention to benefit third parties. The Hong Kong Association of Banks believed that our proposal would enhance the flexibility of the law of contract, even though they would

³⁵ Section 40(1B) of the Employee's Compensation Ordinance (Cap 282).

not want third parties to acquire rights to sue banks. Some consultees were of the view that the privity doctrine was so anomalous that it should be abolished in its entirety. We emphasise that the spirit of the present reform is to respect the contracting parties' freedom of contract. In some cases, contracting parties may wish to confer a benefit on a third party, without enabling him to enforce that benefit. We think that the total abolition of the doctrine would deprive contracting parties of this choice.

2.31 In contrast, the Hong Kong Federation of Women Lawyers and the Chinese General Chamber of Commerce expressed reservations at relaxing the privity doctrine. The Hong Kong Federation of Insurers was of the opinion that there was no need to reform the privity doctrine, since contracting parties were free to assign contractual rights to third parties under the existing law so as to benefit third parties. For example, under a standard life insurance contract, an assignee of the contractual benefit can enforce his rights in court. We think, however, that our proposed reform would avoid the need for a promisee and the third party to sign a separate contract of assignment. Furthermore, the promisor's assent is not essential for an assignment. From the promisor's point of view, our proposed reform would enable a promisor to ascertain the third party's identity before deciding whether to confer a benefit on the third party. Finally, the Law Commission observed that there was a thin divide between (i) making a contract for the benefit of a third party; and (ii) making a contract for the benefit of a third party and, immediately thereafter, assigning that benefit to the third party. If an immediate assignment is valid, there can hardly be fundamental objections to allowing the third party to sue without an assignment.³⁶

2.32 The Federation of Insurers also believed that there were no anomalies in the privity doctrine. The doctrine worked well in Hong Kong and its reform was not to anyone's benefit. Abrogation of the doctrine in other jurisdictions was not an acceptable reason for Hong Kong to change such a fundamental rule in the law of contract.

2.33 We have carefully considered the responses made to the consultation paper. Despite the reservations expressed in some quarters, we find the arguments in favour of reform compelling, and consider that there should be a simple and clear mechanism whereby a third party can generally enforce a benefit intended to be conferred on him. In other words, if the parties to a contract wish to confer a benefit on a third party, they should have the freedom to do so, and their wishes should be respected and given legal effect. The fact that the privity doctrine prevents effect from being given to the contracting parties' intention runs counter to the underlying theory of contract, and presents a range of practical difficulties which we have described in this chapter and Chapter 1. Sir Guenter Treitel has pointed out that none of the reasons for the privity doctrine take account of "the inconvenience that can result from its practical operation".³⁷ We would emphasise, however, that we favour reform of the doctrine, rather than its

³⁶ Law Commission Report No 242 (cited above), at para 2.17.

³⁷ G Treitel, *The Law of Contract* (quoted above), at 588.

outright abolition. Our intention is to provide a fair mechanism for the enforcement of third party rights.

Recommendation 1

We recommend reform of the general rule that only the parties to a contract may enforce rights thereunder, but not the complete abolition of the rule.

Chapter 3

Options for reform of the privity doctrine

3.1 Chapter 2 recommended reforming the privity doctrine. In this Chapter we consider four possible reform options, which are all (except the first) founded upon a legislative scheme.¹ The options are:

- (1) Leaving matters to the courts to circumvent the doctrine in deserving cases.
- (2) Providing legislative exceptions to the doctrine in specific instances.
- (3) Adopting a general provision that no third party be denied enforcement of a contract made for his benefit on the grounds of lack of privity.
- (4) Reforming the law by means of a detailed legislative scheme.

Option 1 – Judicial development of circumvention of the privity doctrine

3.2 The courts have, over the years, adopted various devices in mitigating the harshness of the privity doctrine. The first option is to leave matters to the courts.² The principal advantage of this option is that the courts are able to develop exceptions to meet particular injustices caused by the privity rule in specific cases. The remedy can be tailored to meet the specific needs of the particular case coming before the court. By contrast, a legislative scheme cannot be expected to achieve the same degree of flexibility. Any shortcomings in the legislation identified later could only be remedied by further legislative amendments, involving additional time and costs. In responding to our consultation paper, one consultee suggested that the hardship caused by the privity doctrine could be addressed by employing various common law devices, such as equitable estoppel, part performance, *quantum meruit*, duty of care, exception to the rule in *Foss v Harbottle*³, etc.

¹ Reforming the "remedy" rule which prevents the promisee from recovering the third party's loss is another possibility. The Law Commission also considered it as an option. However, reform of the "remedy" rule would have its own repercussions on the law of contract and goes beyond our terms of reference. In any event, as pointed out by the Law Commission, this method in itself would not be adequate, as the promisee may be unwilling or unable to recover the third party's loss for one reason or another.

² See the discussion in Chapter 1.

³ (1843) 2 Hare 461.

3.3 However, there are distinct problems with judicial reform of the privity rule. The courts act incrementally and can only act when a suitable opportunity arises. It is impossible to predict when a case will arise which gives the courts the opportunity to "reform". Even with the right case, the judicial process from the first instance stage to that of the final appeal can be lengthy. A further disadvantage of judicial reform is the uncertainty that it would generate. In *Re The Mahkutai*, for example, Lord Goff of Chieveley described how the pendulum of judicial opinion had swung backwards and forwards in its approach to the privity doctrine in cases involving carriage of goods by sea:

*" [O]pinion has fluctuated about the desirability of recognising some form of modification of, or exception to, the strict doctrine of privity of contract to accommodate... commercial expectations that the benefit of certain terms of the contract of carriage should be made available to parties involved in the adventure who are not parties to the contract. ... At first there appears to have been a readiness on the part of judges to recognise [third parties'] claims. ... Opinion, however, hardened against them in the middle of the century as the pendulum swung back in the direction of orthodoxy in Midland Silicones Ltd v Scruttons Ltd [1962] AC 446; but in more recent years it has swung back again to recognition of their commercial desirability... ."*⁴

Option 2 – Legislative exceptions to the privity doctrine to be made in specific instances

3.4 Some existing statutory provisions have the effect of getting round the privity doctrine and enabling third parties to enforce their rights.⁵ Under this option, reform is effected by legislation to create further specific exceptions to the privity doctrine in appropriate circumstances.

3.5 One advantage of this option is that the needs of specific situations can be directly addressed in detail. A further advantage is that a policy intent to confer an enforceable right to a third party in a particular situation can be expressly addressed in the legislation.⁶

3.6 The principal shortcoming of this option, however, is that it does not address the underlying anomalies of the doctrine. Instead of dealing directly with a rule which is fundamentally flawed, this option would not only leave those anomalies unsolved, but would also add further complexity to the existing rule.

⁴ [1996] AC 650, at 658D-G (PC).

⁵ Chapter 1 has discussed some examples of these statutory provisions under the heading "Statutory provisions".

⁶ Law Commission Consultation Paper No 121 (cited above), at para 5.2.

Option 3 – Adopting a general provision that no third party should be denied enforcement of a contract made for his benefit on the grounds of lack of privity

3.7 Under this option, there would be a general legislative provision to the effect that a contract for the benefit of a third party should not be unenforceable by him for lack of privity. This was the approach preferred by the Ontario Law Reform Commission in its report published in 1987.⁷

3.8 The Ontario Law Reform Commission favoured this approach rather than a detailed legislative scheme for several reasons.⁸ Firstly, it was thought that the courts should have some flexibility in dealing with the variety of issues which would undoubtedly arise under any reform, such as the designation of third party beneficiaries, etc. A detailed legislative scheme would restrict the discretion of the courts in dealing with the special circumstances of the cases before them. Secondly, anomalies would arise if the same piece of legislation were to apply to widely differing circumstances. Third party beneficiary cases could arise in a range of different contexts (for example, contracts to pay money to relatives, contracts extending defences in bills of lading to stevedores, etc). A single piece of legislation was thought unlikely to deal with all these cases satisfactorily. Thirdly, the problem of defining the class of beneficiaries entitled to sue and the question of variation and rescission were regarded as particularly intractable.

3.9 The advantage of this broad-brush option is that it is simple to implement. It is, however, by no means easy to apply, since many important questions about the detailed application of the general provision remain to be settled by the courts.⁹ In the meantime, it would be difficult for a lawyer to advise his client on whether the third party concerned can enforce the contract, or even whether that person is a third party beneficiary under the contract in the first place. As pointed out by the Law Commission, to leave these questions to the courts with no legislative guidance could be said to be an abdication of responsibility.¹⁰ These questions are too fundamental and numerous to lend themselves to the generalised approach adopted under this option.

Option 4 – Reform by means of a detailed legislative scheme

3.10 Under this option, the overall policy would be determined and provision would be made for various matters, including the designation of third party beneficiaries, when a third party can enforce a contract made for his benefit, the rights of contracting parties to vary or discharge the contract, and promisors' defences.

⁷ Ontario Law Reform Commission, *Report on Amendment of the Law of Contract*, (Toronto 1987).

⁸ Law Commission Consultation Paper No 121 (cited above), at para 5.4.

⁹ The questions include the designation of third party beneficiaries and whether the contractual parties can vary or rescind the contract.

¹⁰ Law Commission Consultation Paper No 121 (cited above), at para 5.5.

3.11 The two main advantages of this option are certainty and clarity. Many of the difficulties accompanying reform of the privity doctrine could be addressed and dealt with in the legislation. Some court decisions and statutory provisions may, on an *ad hoc* basis, have the effect of circumventing the privity doctrine with little thought for the overall development of the law. Some of these statutory and common law rules are artificial and subject to limits not related to wider policy considerations. A comprehensive legislative scheme could establish a coherent body of rules which are clear and certain, and provide for the overall development of this area of the law. A comprehensive legislative scheme would provide the courts with clear guidelines for determining the cases coming before them. This would be of particular benefit in the commercial world, enabling businesses to clearly identify their legal position and to make informed decisions accordingly.

3.12 A major shortcoming of a detailed legislative approach is its inflexibility. Circumstances may arise which were not foreseen by the draftsman or the legislature, but the legislative provisions cannot be ignored. The courts must apply the statute as they find it, no matter how hard the particular circumstances may seem. Under a detailed statutory scheme, the courts may have insufficient flexibility to be able to do justice in deserving cases. In addition, any defects in the legislation can only be remedied by legislative amendments, with the delay and complications associated with that process.

Conclusion

3.13 Having weighed the advantages and disadvantages of each of the above options for reform, we have come to the conclusion that reform should proceed by means of a detailed legislative scheme. We are aware that options 1 and 2 have the advantage of being flexible and can address the needs of specific circumstances. Their principal shortcoming, however, is that both are only piecemeal in nature, and do not deal with the privity doctrine within a comprehensive, systematic and coherent scheme. The problem is even more acute in option 1 where the courts would only be able to act when a suitable case arises. For option 2, the creation of specific statutory exceptions will inevitably complicate an area of law which is already generally regarded as technical, artificial and complex. Option 3 may be simple to implement, but it is not viable since it leaves too many fundamental questions unanswered and would create considerable uncertainty in its operation.

3.14 We understand there are concerns that a detailed legislative scheme may tie judges' hands, and would lack the flexibility of the other options in allowing specific circumstances to be catered for. Cogent though these arguments may sound, we are firmly of the view that a detailed legislative scheme can strike a sensible balance between giving adequate guidance to judges and allowing them flexibility in deserving cases. A wholesale reform of the privity doctrine would provide certainty, clarity and a coherent body of law, which is not available under the other options. We

note that this is also the approach adopted in a number of other jurisdictions, including Australia, England, New Brunswick, New Zealand and Singapore. Neil Andrews is of the view that the Law Commission was right to adopt a detailed scheme which is "*attractive in many respects...[and reveals] the power of legislative precision*".¹¹ In his opinion, the "*tools of common law technique cannot match it*".¹² Professor Jack Beatson shares this view:

*"[A]bolition of the privity rule... throws up a number of difficult problems that cannot be isolated. This makes it particularly difficult to develop on a case by case basis without undue loss of certainty and without making choices of policy rather than of principle".*¹³

Iacobucci J summarised it well in *Fraser River Pile & Dredge Ltd v Can-Dive Services Ltd*:

*"[P]rivacy of contract is an established doctrine of contract law, and should not be lightly discarded through the process of judicial decree. Wholesale abolition of the doctrine would result in complex repercussions that exceed the ability of the Courts to anticipate and address. It is by now a well-established principle that the Courts will not undertake judicial reform of this magnitude, recognizing instead that the legislature is better placed to appreciate and accommodate the economic and policy issues involved in introducing sweeping legal reforms. ... That being said, the corollary principle is equally compelling, which is that in appropriate circumstances, the Courts must not abdicate their judicial duty to decide on incremental changes to the common law necessary to address emerging needs and values in society. ..."*¹⁴

3.15 The British Chamber of Commerce, the Hong Kong Bar Association, Clement Shum of Lingnan University, the Hong Kong Federation of Women Lawyers, the Hong Kong Society of Accountants and Stephenson, Harwood & Lo agreed that a detailed legislative scheme was the best way to reform the privity doctrine. Some consultees, including the Commerce and Industry Bureau, suggested that contracting parties should not be able to contract out of the recommended legislation. The spirit of our proposed reform is to respect the contracting parties' freedom of contract, however, and we believe that contracting parties should therefore have the freedom to contract out of the terms of the recommended legislation if they choose to do so.

3.16 The Law Society of Hong Kong queried whether the proposed reform would affect the rule discussed in Chapter 1 that a person can only

¹¹ Andrews, "Strangers to Justice No Longer: The Reversal of the Privity Rule under the Contracts (Rights of Third Parties) Act 1999" [2001] CLJ 353, at 356.

¹² Andrews, (cited above),

¹³ Beatson, "Reforming the Law of Contracts for the Benefit of Third Parties: A Second Bite at the Cherry", (1992) 45 CLP 1, 18.

¹⁴ [2000] 1 Lloyds Rep 199, at paras 43-44.

recover nominal damages unless he has suffered actual loss, and the exception to that rule.¹⁵ We stress that the recommended legislation would exist alongside this rule and its exception, and would not affect them. The Hong Kong Federation of Insurers commented that the proposed reform was contrary to the principle of freedom of contract and would create uncertainties and arguments in ascertaining the contracting parties' intention. We reiterate that the spirit of the reform is to respect the parties' wishes, and the recommendations proposed in the next chapter are intended to minimise uncertainties as far as possible.

Recommendation 2

We recommend that a clear and straightforward legislative scheme (the "recommended legislation") be enacted whereby, subject to the manifest intentions of the parties to an agreement, the parties can confer legally enforceable rights or benefits on a third party under that agreement.

¹⁵

Alfred McAlpine Construction Ltd v Panatown [2001] 1 AC 518; and *Albazero* [1977] AC 774.

Chapter 4

The elements of the new legislative scheme

4.1 In the last chapter, we recommended that the privity doctrine should be reformed by a detailed legislative scheme. In this chapter, we identify the main elements of the proposed scheme. We do this by considering a number of key issues, and how those issues have been addressed in other common law jurisdictions.¹ The various issues to be considered in this chapter are:

- (i) Who is a third party?
- (ii) What is the test of enforceability?
- (iii) Can the contracting parties vary or rescind the contract?
- (iv) Can the parties vary or rescind the contract after crystallisation, or lay down their own crystallisation test?
- (v) Should there be any judicial discretion to authorise variation or cancellation?
- (vi) Should consideration be an issue?
- (vii) What defences, set-offs and counterclaims should be available to promisors?
- (viii) How should overlapping claims against promisors be dealt with?
- (ix) Should arbitration clauses and exclusive jurisdiction clauses be binding on third parties?
- (x) What should the scope of the present reform be?

For convenience, we use the following abbreviations in this Chapter when referring to the legislation in other jurisdictions:

- the Property Law Act 1974, Queensland – "the 1974 Act (Qld)"
- the Law of Property Act 2000, the Northern Territory – "the 2000 Act (NT)"
- the Property Law Act 1969, Western Australia – "the 1969 Act (WA)"
- the Law Reform Act 1993, New Brunswick – "the 1993 Act (NB)"
- the Contracts (Rights of Third Parties) Act 1999, England and Wales – "the 1999 Act (E & W)"

¹ The common law jurisdictions discussed in this chapter are Australia (the Northern Territory, Queensland and Western Australia), Canada (New Brunswick), England and Wales, New Zealand and Singapore. Annex 2 provides a comparison table of the relevant provisions in these jurisdictions, while Annex 3 sets out these provisions.

- the Contracts (Privity) Act 1982, New Zealand – "the 1982 Act (NZ)"
- the Contracts (Rights of Third Parties) Act 2001 (Cap 53B), Singapore – "the 2001 Act (Sg)"

Who is a third party?

4.2 There are two issues involved: (1) how a third party can be designated; and (2) whether a third party must have been in existence when the contract was made. As to the first issue, a third party can be expressly identified by:

1. name (eg "Mr John Doe");
2. class (eg "stevedores", "subsequent owners"); or
3. description (eg "person living at 123 King's Road", or "A's nominee").

Australia

4.3 In Australia, the parliaments of the Northern Territory, Queensland and Western Australia have reformed the privity rule. The reform in Queensland was made following the report of that State's Law Reform Commission.² The main statutory provision is section 55 of the Property Law Act 1974, which is almost identical to section 56 of the Law of Property Act 2000 in the Northern Territory. Under both Acts, "beneficiary" (ie a third party) means:

"a person other than the promisor and promisee, and includes a person who, at the time of acceptance is identified and in existence, although that person may not have been identified or in existence at the time when the promise was given."

It seems that a third party need not be identified by name. In the opinion of the New Zealand Contracts and Commercial Law Reform Committee, the provisions preserve the promise for the benefit of a person identified by description but not yet having that status (for example, a future spouse of the promisee).³

4.4 Section 11(2) and (3) of the Property Law Act 1969 (Western Australia) implements the recommendations of the English Law Revision Committee.⁴ This section applies where a contract *"expressly in its terms purports to confer a benefit directly on a person who is not named as a party to the contract."* This seems to imply that only the person named can

² *Report on a Property Law Bill*, QLRC16.

³ *Report on Privity of Contract* (1981), at para 7.2(f).

⁴ Law Revision Committee, Sixth Interim Report, *Statute of Frauds and the Doctrine of Consideration*, (1937) Cmd 5449.

enforce the contract.⁵ It does not appear to allow enforcement by those who are non-existent at the time the contract is made.⁶

Canada

4.5 The Law Reform Branch of the New Brunswick Department of Justice recommended reforming the privity rule through legislation, in the form of "*a relatively modest amendment that address[d] the most glaring deficiency in the existing law*".⁷ The Law Reform Branch's recommendations resulted in section 4 of the Law Reform Act 1993. Section 4(1) provides as follows:

"A person who is not a party to a contract but who is identified by or under the contract as being intended to receive some performance or forbearance under it may, unless the contract provides otherwise, enforce that performance or forbearance by a claim for damages or otherwise."

Any person, not being a party to a contract, who is identified by or under the contract as being benefited is to be regarded as a third party. Section 4, however, does not specify the means by which a third party is to be identified.

England and Wales

4.6 Calls for legislative reform were made as long ago as 1937 by the English Law Revision Committee,⁸ whose report did not lead to any reform in England and Wales at that time. In 1991, the Law Commission put forward for discussion in a consultation paper proposals for reforming the privity rule, and recommended in its final report in 1996 a detailed legislative scheme to reform the doctrine.⁹ The English Contracts (Rights of Third Parties) Act 1999 was passed to implement the report. Under section 1(3) of the 1999 Act (E & W), a third party must be "*expressly identified in the contract by name, as a member of a class or answering a particular description but need not be in existence when the contract is entered into*". After discussing the New Zealand position (which is explained in the following paragraphs), the Law Commission emphasised that in their view there would be sufficient identification by description if a third party was referred to as "B's nominee".¹⁰ In *Kharegat and others v Deloitte & Touche LLP*,¹¹ the claimants, partners of Deloitte & Touche LLP ("Deloitte"), gave notice to leave Deloitte and join KPMG. Deloitte argued that this amounted to a breach of

⁵ This was criticised by the New Zealand Contracts and Commercial Law Reform Committee as being too restrictive. (*Report on Privity of Contract* (1981), at para 7.2(f)).

⁶ This was the subject of criticism by the New Zealand Contracts and Commercial Law Reform Committee (*Privity of Contract* (1981), at para 7.1(a)).

⁷ New Brunswick, Office of the Attorney General, Law Reform Branch, *Commentary on the "Law Reform Act (1993)*, at para 3.

⁸ Law Revision Committee, Sixth Interim Report, *Statute of Frauds and the Doctrine of Consideration*, (1937) Cmd 5449.

⁹ Law Commission Report No 242 (cited above).

¹⁰ Law Commission Report No 242 (cited above), at para 8.3.

¹¹ [2004] EWHC 1767(QB).

the notice provisions and restrictive covenants in the partnership agreement. By relying on an opt-out agreement by which the "entire group" could "after 12 months" leave Deloitte, the claimants contended that they were not bound by the notice provisions and restrictive covenants. One of the issues was whether Mr Oldcorn, a third party to the opt-out agreement, could rely on the agreement. Simon J decided that Mr Oldcorn fell within the description "entire group" in the opt-out agreement for the purposes of section 1(3) of the 1999 Act.

New Zealand

4.7 In its 1981 Report, the New Zealand Contracts and Commercial Law Committee made various proposals for the reform of the privity doctrine.¹² The Contracts (Privity) Act 1982 implements these proposals. Just like the English provisions, section 4 of the 1982 Act (NZ) allows a third party to be "*designated by name, description, or reference to a class*". Designation requires a degree of specification or identification by which the beneficiary is to be identified.¹³ Words like "nominee" were not regarded as sufficient.¹⁴ Tipping J in *Rattrays Wholesale Ltd v Meredyth-Youth & A'Court Ltd*¹⁵, however, held that "X's nominee" was a person designated by description for the purpose of section 4. That section should be given a "fair, large and liberal interpretation". This wide view is supported by academics who regard it as "*both commercially convenient and... [consistent] with the purpose of the 1982 Act*".¹⁶ Section 4 does not require a third party to be in existence at the time when the contract is made. Thus a promise for the benefit of a company yet to be incorporated¹⁷ or a child yet to be born may fall within the section.¹⁸

Singapore

4.8 The Contracts (Rights of Third Parties) Act 2001 (Cap 53B) implements a report of the Law and Revision Division of the Attorney-General's Chambers¹⁹, and is broadly similar to the 1999 Act (E & W). In

¹² New Zealand Contracts and Commercial Law Reform Committee, *Report on Privity of Contract* (1981).

¹³ *The Laws of New Zealand*, Contract, para 262. In *Allison v KPMG Peat Marwick* [2000] 1 NZLR 560, the auditor, being sued by the purchaser of a company, could not rely on the compromise agreement between the vendor and purchaser since the auditor was not designated by name, description or reference to a class as required by section 4.

¹⁴ A "nominee" was held to be a sufficient identification by description under section 4 in *Coldicutt v Webb & Keays* (Unreported, High Court, 17 May 1985, A50/84). This approach was, however, rejected by the Court of Appeal in *McElwee v Beer* (Unreported, High Court, 19 Feb 1987, A45.85), and *Field v Fitton* [1988] 1 NZLR 482. Nonetheless, both the New Zealand Law Commission in its report *Contracts Statutes Review* (report no 2, 1993) and the Law Commission in its report (No 242, 1996) endorsed the approach in the "*Coldicutt*" case.

¹⁵ [1997] 2 NZLR 363, at 381. He stated that the Court of Appeal's discussion in the *Field v Fitton* was not part of the ratio and hence did not bind him.

¹⁶ Burrows, Finn & Todd, *Law of Contract in New Zealand*, 2nd Edition 2002, at 525.

¹⁷ *Speedy v Nylex New Zealand Ltd* (High Court, Auckland, CL 29/87, 3 Feb 1989).

¹⁸ *The Laws of New Zealand*, Contract, at para 262.

¹⁹ Law and Revision Division, Attorney-General's Chambers, Singapore, *Report on the Proposed Contracts (Rights of Third Parties) Bill 2001*, at para 3.1.2.

relation to the designation and existence of a third party, the Singaporean provisions are identical to their English counterparts.

Options and conclusions

4.9 There are at least three possible options in relation to the designation of a third party: (a) only a third party named in the contract can enforce it (as in Western Australia); (b) a third party can be designated by name, description, or reference to a class (as in England, New Zealand and Singapore); and (c) the mode of designation can be left unspecified, as in the provisions in New Brunswick, the Northern Territory and Queensland which simply adopt the keyword "identified" without specifying the means by which a third party can be identified.

4.10 In our opinion, it would be too restrictive to identify a third party by name alone. This is the criticism which the New Zealand Contracts and Commercial Law Reform Committee levelled at the Western Australian provision. We agree with the Law Commission, which rejected a requirement for an express designation by name only because that would prevent rights from being conferred upon a third party who could only be identified by class or description.²⁰ This would mean, for example, that an employer and contractor would not be able to provide in a construction contract for rights to be conferred on future occupiers of the premises under construction. The third party cannot, however, be identified by implication. It would give rise to unacceptable uncertainty if third party rights were conferred on someone whose identity was to be implied from the mind of the parties to the contract. We therefore recommend that a third party can be expressly designated either by name, as a member of a class or as answering a particular description. The British Chamber of Commerce expressly endorsed this recommendation. The Hong Kong Federation of Insurers commented that identification by name alone might not adequately identify the person to be benefited, and suggested adopting additional ways of identification in conjunction with the beneficiary's name. There are two distinct issues here, however. The first is fixing the threshold for identification of a third party, and should be addressed in the legislation. The second issue, with which the Federation is concerned, is determining whether a person has reached that threshold. The second issue is a matter for the courts, rather than the legislation. We believe that identifying a third party by name is the appropriate threshold. It would then be up to the third party to prove that he is the person named.

4.11 The Consumer Council was concerned that in consumer transactions third parties might find it difficult to invoke the recommended legislation because of the requirement of identification by name, as a member of a class or as answering a particular description. The Council observed that in most consumer transactions the intention to confer a benefit on a third party might not be manifested at the time of contracting. Hence, the

²⁰ Law Commission Report No 242 (cited above), at para 8.2.

intended beneficiary may not be properly identified. We believe that one possible answer is to educate consumers about the importance of identifying any third party beneficiary in the contract if they wish the third party to be able to enforce the contract directly.

4.12 As to the question of whether a third party must be in existence at the time of the contract, the provisions in England, New Zealand and Singapore expressly exclude such a requirement. The provisions in the Northern Territory and Queensland have similar effect, while those in New Brunswick are silent on this issue. The alternative would be to follow the approach in Western Australia which appears to require a third party to be in existence at the time the contract is made.

4.13 We note that the New Zealand Contracts and Commercial Law Reform Committee criticised the provision in Western Australia as being too restrictive. There is, however, the concern that the potential range of third parties may be unduly widened if those not yet in existence at the time of contracting are included. Furthermore, it may be unfair to the contracting parties, as they may not be aware of their potential liability to a third party who is not yet in existence. It will also restrict the parties' right to vary their contract subsequently. However, we do not consider these to be convincing arguments against the inclusion of a third party not yet in existence. The contracting parties may still be unaware of a third party even if he was in existence at the time of contracting. As regards the restriction on the parties' variation rights, it is a question of determining what particular act by a third party can stop the contracting parties from varying their contract. This will be dealt with as a separate issue later in this chapter.

4.14 The Hong Kong Bar Association commented that conferring benefits on third parties not yet in existence at the time of contracting would make some inroads into the rule against perpetuities. Under the existing law, benefits can be conferred on a class of third parties (including those not yet in existence) by way of a trust, but the trust would be void if the future interests created by the trust do not vest or take effect within the perpetuity period. The Bar Association was concerned that if the recommended legislation allowed benefits to be conferred on third parties not yet in existence, this might allow evasion of the rule against perpetuities. We are of the view that allowing the conferment of benefits on third parties not yet in existence would not violate the rule against perpetuities because, in contrast to the position under a trust, no property rights will be tied up under a contract.

4.15 We therefore see no good reason why a benefit should not be conferred on a third party who is not yet in existence at the time of contracting. This is especially true when, as highlighted in the explanatory notes to the 1999 Act (E & W) (the "Explanatory Notes"), such an approach would enable the parties to give enforceable rights to, for example, an unborn child, a future spouse or a company that has not yet been incorporated.²¹ A third party

²¹ *Explanatory Notes to Contracts (Rights of Third Parties) Act 1999* (England), at para 8. The Explanatory Notes, issued by the Lord Chancellor's Department in order to assist the reader in understanding the Act, do not form part of the Act and have not been endorsed by Parliament.

should, however, be capable of being ascertained with certainty at the time when the promisor's duty to perform arises, or when a liability against which the contractual provision seeks to protect the third party is incurred. We agree with the Law Commission that the normal principle is that to be valid a contract, or contractual provision, must be sufficiently certain.²² A related issue is the position of pre-incorporation contracts. There should be a differentiation between a contract on behalf of a company (the third party) and that for the benefit of a company.²³ The present reform is about the latter type of contract, and does not involve a third party becoming a party to the contract. Hence, the present reform does not derogate from the rule that a company which is not incorporated at the time when a contract is made on its behalf cannot enforce the contract. No specific rules are thus needed in the recommended legislation.

4.16 The Law Commission in England also concluded that a joint promisee who had not provided consideration should not be regarded as a third party for the purpose of the present reform.²⁴ We agree with its conclusion. One consultee, in responding to the Sub-committee's Consultation Paper, argued that the issue should be dealt with by the legislature. However, in our view, the issue is somewhat peripheral to the focus of the reform and we prefer to leave matters for the courts to determine the most appropriate remedies for the promisee on a case-by-case basis.

Recommendation 3

We recommend that a third party should be expressly identified by name, as a member of a class or as answering a particular description. It should be possible to confer rights on a third party who was not in existence at the time of contracting.

What is the test of enforceability?

4.17 A core issue of a detailed legislative scheme is to define the limits within which a third party can enforce a contract to which he is not a party.

They are not, and are not meant to be, a comprehensive description of the Act. Nonetheless, they are still of referential value, especially when there are few cases on the Act. Mr Justice Colman referred to the Explanatory Notes and said: "*Although these Notes clearly do not have the force of law, they occupy a position in relation to the Act similar to that of the statement by a minister introducing a bill. The courts are entitled to construe the wording of the Act on the assumption that, if the precise meaning of the words used is in doubt, when Parliament enacted those words it did so with some regard to the ministerial explanation.*" (*Nisshin Shipping Co Ltd v Cleaves & Co Ltd*, [2003] EWHC 2602, at para 37)

²²

Law Commission Report No 242 (cited above), at para 8.17.

²³

Law Commission Report No 242 (cited above), at para 8.9.

²⁴

Law Commission Report No 242 (cited above), at para 6.9.

Australia

4.18 In the Northern Territory and Queensland, a promisor who promises to do something for the benefit of a beneficiary will be subject to a duty enforceable by the beneficiary.²⁵ Under section 56(6) of the 2000 Act (NT) and section 55(6) of the 1974 Act (Qld), a promise means a promise (in writing in the Northern Territory) that:

- (a) is or appears to be intended to be legally binding; and
- (b) creates or appears to be intended to create a duty enforceable by a beneficiary.

Mason CJ and Wilson J said, as *obiter dicta*, in *Trident General Insurance Co Ltd v McNiece Bros Proprietary Ltd*²⁶ that for the Queensland provision to apply, the parties' intention that the third party should be able to enforce the contractual term for his benefit was required.

4.19 In Western Australia, a third party can enforce a contract where the "contract expressly in its term purports to confer a benefit directly on" him under section 11(2) of the 1969 Act (WA). In *Westralian Farmers v Southern Meat*²⁷, Westralian Farmers were livestock agents acting for the vendor in the sale of cattle to Southern Meat Packers. Under the contract of sale, Southern Meat Packers were to make payment for the cattle direct to Westralian Farmers (who were not parties to the contract), rather than the vendor, so as to protect Westralian Farmers for their fees. Southern Meat Packers paid the vendor direct and Westralian Farmers sued. The Supreme Court of Western Australia held that the contract term regarding payment did directly confer a benefit on Westralian Farmers within the meaning of section 11(2). Consequently, they could enforce that aspect of the contract even though they were not a party to it. Moreover, in the *Trident General Insurance* case²⁸ Mason CJ, Wilson J and Brennan J said, as *obiter dicta*, that an express intention to benefit a third party was required in the contract under this section.

Canada

4.20 According to section 4(1) of the 1993 Act (NB), a person who is identified by or under the contract as being intended to receive some

²⁵ Section 55(1) of the 1974 Act (Qld) and section 56(1) of the 2000 Act (NT).

²⁶ (1988) 165 CLR 107, at 123, 117-118 per Mason CJ and Wilson J.

²⁷ [1981] WAR 241. A more recent example can be found in *Jones v Barlett* (2000) 176 ALR 137. Jones was injured when he carelessly put his knee through a glass door in a house his parents were renting from the respondents. He sued the respondents for breach of a statutory implied term of contract by failing to have the glass replaced with thicker glass that complied with modern safety standards. Gleeson CJ (at 145) held that Jones was not a party to the lease and nothing in the lease purported to confer a right, interest or benefit upon Jones. There was nothing to which section 11 could attach.

²⁸ (1988) 165 CLR 107, at 123 per Mason CJ and Wilson J and at 134 per Brennan J.

performance or forbearance under it may enforce that performance or forbearance, unless the contract provides otherwise.

England and Wales

4.21 Under section 1(1) of the 1999 Act (E & W), a third party may enforce a contract term if (a) "the contract expressly provides that he may" do so, or (b) "the term purports to confer a benefit on him". According to subsection (2), however, a third party will not acquire any rights under the second limb "if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party". The first limb is relatively straightforward and would apply where a contract contains phrases like "C shall have the right to enforce the contract (or terms 3 and 4 of the contract)" or "C shall have the right to sue".²⁹ Less clear-cut is the second limb which consists of a rebuttable presumption. The test "the term purports to confer a benefit on [a third party]" will be satisfied where a third party is to receive a benefit from the promisor directly, but not a consequential or incidental benefit stemming from a promisor's performance.³⁰ This presumption can be rebutted by the contracting parties where on a proper objective construction of the contract, because of an express term to this effect or other inconsistent terms, it appears that the parties did not intend the third party to have the right to enforce. Mr Justice Colman noted that subsection (2) did not provide that subsection 1(b) was disapplied unless on a proper construction of the contract it appeared that the parties intended that the benefit should be enforceable by the third party.³¹ Instead, it provides that subsection 1(b) is disapplied if, on a proper construction, it appears that the parties did not intend third party enforcement. Hence he held that if the contract was neutral on the question, subsection (2) did not disapply subsection 1(b).

4.22 *Laemthong International Lines Co Ltd v Artis and others*³² illustrates how the courts would apply sections 1(1) and 2. The claimants in the case were the owners of the vessel *Laemthong Glory*. The first defendants were the charterers and the second defendants were the receivers of the cargo shipped on board the vessel pursuant to the charterparty. The receivers agreed in their letter of indemnity to indemnify the charterers, their servants and agents in respect of any liability, loss, damage or expense resulting from delivering the cargo according to the receivers' request. The question was whether the owners, as third parties to the receivers' letter of indemnity, were entitled to proceed directly against the receivers by virtue of the 1999 Act. At the trial of certain preliminary issues,

²⁹ Andrew Burrows, "The Contracts (Rights of Third Parties) Act 1999 and Its Implications for Commercial Contracts", [2000] LMCLQ 540, at 544. Law Commission Report No 242 (cited above), at para 7.10.

³⁰ Andrew Burrows, "The Contracts (Rights of Third Parties) Act 1999 and Its Implications for Commercial Contracts", [2000] LMCLQ 540, at 544.

³¹ *Nisshin Shipping Co Ltd v Cleaves & Co Ltd*, [2003] EWHC 2602, at para 23.

³² [2005] EWCA Civ 519. In *Atlas Ltd and others v Brightview Ltd and others* [2004] EWHC 1058 (Ch), the court decided that the investment agreement purported to confer a benefit on the nominee company, a third party to the agreement, within the meaning of section 1(1)(b) of the 1999 Act.

the judge held that the owners were entitled to enforce the letter of indemnity against the receivers. The receivers appealed. The Court of Appeal dismissed the appeal and held that the receivers' letter of indemnity purported to confer a benefit upon the owners under section 1(1)(b) since they were the charterers' agents in delivering the cargo and, on a proper construction, the receivers' letter of indemnity was intended to be enforceable by the owners.

4.23 A third party's right of enforcement under the Act can be used both as a sword and a shield. It is a sword because the Act enables him to sue on a term for his benefit, while according to section 1(6) it is also a shield since the Act allows him to rely on an exclusion or limitation clause in the contract when he is sued by the promisor. In both limbs, the reference is to a contract term but not the contract in its entirety. In other words, a third party can enforce the contract as a whole or just one or more specific terms, depending on the parties' intention.

New Zealand

4.24 Under section 4 of the 1982 Act (NZ), where a promise in a deed or contract confers or purports to confer a benefit on a third party, the promisor is under an obligation to perform the promise and the third party can enforce it. This section does not apply if, on a proper construction of the deed or contract, the promise is not intended to create an obligation enforceable by the third party. There are several elements in this provision.

4.25 The promise must be contained in a deed or contract between the promisor and promisee. It was held in *Morton-Jones v RB & JR Knight Ltd*³³ that a solicitor's letter purporting to designate a third party as the beneficiary of an existing agreement did not fall within section 4. In *Gartside v Sheffield Young & Ellis*³⁴, the testatrix died before the will was finalised, and the legatee sued as a third party beneficiary of an implied term in the contract between the testatrix and her solicitor that the solicitor would draw up and present the will to the testatrix for execution promptly. Richardson J dismissed the claim since the contract did not include any provision for the benefit of a third party. The benefit to the legatee, which arose only when the contract was properly carried out, was not conferred by the contract itself.

4.26 The term "benefit" is defined in section 2 as including:

- "(a) Any advantage; and*
- (b) Any immunity; and*
- (c) Any limitation or other qualification of— (i) An obligation to which a person (other than a party to the deed or contract) is or may be subject; or (ii) A right to which a person (other than a party to the deed or contract) is or may be entitled; and*

³³ [1992] 3 NZLR 582.
³⁴ [1983] NZLR 37.

- (d) *Any extension or other improvement of a right or rights to which a person (other than a party to the deed or contract) is or may be entitled".*

The term "advantage" is relatively straightforward and means something positive conferred by the contract. The benefit may be money, property or some other form of financial advantage. The Court of Appeal held that section 4 applied to an agreement between a union and a hospital giving redundant employees priority of appointment to vacancies in other hospitals.³⁵ The section was also applied in *New Zealand Guardian Trust Co Ltd v Peat Marwick*, a case where the third party was a trustee.³⁶ In this case, the trustee for holders of debenture stock issued by X Co sued the auditor of the company, claiming that under the audit contract between the company and the auditor, the auditor was required to research and report to the shareholders and the trustee, and that the audit contract conferred a benefit under section 4. The court held that the case fell within the section despite the trustee's representative capacity, and the benefit was the advantage in receiving the auditor's advice so that the trustee could perform its duties properly.

4.27 The term "immunity" means that a third party can have the benefit of an exclusion clause in the contract when he is sued by the promisor. A benefit can also be a release from liability: "*limitation or other qualification of an obligation to which a person [other than a party] is or may be subject*".

4.28 Just like its English counterpart discussed above, the application of section 4 is subject to the contrary intention of the parties upon a proper construction of the deed or contract. Indeed, the second limb of the English provision was modelled on section 4. In *Malyon v NZ Methodist Trust Association*,³⁷ there was such a contrary intention. A lessor of land sued the guarantor of the obligations of the assignee/lessee of the land. The guarantor covenanted in the deed of assignment with the vendor/assignor of the lease, not with the lessor. The court held that the lessor could not enforce the guarantee under section 4. The guarantee was to provide security to the vendor/assignor against the failure of the assignee to pay rent which would lead to a claim by the lessor against the assignor. The proviso to section 4 applied since there was no intention to create an obligation enforceable by the lessor. In *Saunders & Co v Bank of New Zealand*³⁸, a solicitor was appointed by the District Law Society (DLS) under a statute to investigate the affairs of a law firm. One of the issues was whether the contract between the solicitor and DLS conferred a benefit on the firm under investigation. The court held that the statutory appointment was a regulatory matter and did not confer a benefit on the firm under section 4. In any event, on a proper construction of the contract, the contract was not intended to create an obligation enforceable at the suit of the firm under investigation.

³⁵ *Wellington AHA v Wellington Hotel, Hospital, Restaurant and Related Trades Union* [1992] 3 NZLR 658.

³⁶ (1991) 5 NZCLC 67.

³⁷ [1993] 1 NZLR, 137.

³⁸ [2002] 2 NZLR, 270.

To find otherwise would compromise the statutory investigative power and would put the investigator in a position of conflict which was difficult to resolve.

Singapore

4.29 The tests in section 2(1) and (2) of the 2001 Act (Sg), and section 2(6) are identical to those in England, and the earlier discussion of the English provisions is equally applicable to Singapore.

Options and conclusion

4.30 There appear to be at least five options available to Hong Kong. A third party can enforce the contract if:

1. The contract expressly in its terms purports to confer a benefit directly on a third party (as in Western Australia) (option 1).
2. The parties intend a third party to receive the benefit of the promise and also intend to create a legal obligation enforceable by him (following the tests in the Northern Territory and Queensland) (option 2).
3. The parties intend a third party to receive the benefit of the promise, provided that on a proper construction of the contract the promise is intended to create an obligation enforceable by the third party (as in New Zealand) (option 3).
4. Either (a) the contract expressly provides that a third party may enforce a contract term, or (b) a term purports to confer a benefit on the third party, unless the promise is not intended to create an obligation enforceable by the third party (the "alternative" approach, as in England) (option 4).
5. The parties intend a third party to receive some performance or forbearance, unless the contract provides that the third party cannot enforce that performance or forbearance (as in New Brunswick) (option 5).

4.31 Before making its final recommendation which resulted in the present section 1(1) and (2) of the 1999 Act (E & W), the Law Commission had considered other possible tests. These four tests were that a third party might enforce a contract:

- (a) where the parties intend that he should receive the benefit of the promised performance, regardless of whether they intend him to have an enforceable right of action or not (option 6);

- (b) where to do so would effectuate the intentions of the parties and either the performance of the promise satisfies a monetary obligation of the promisee to him or it is the intention of the promisee to confer a gift on him (option 7);
- (c) on which he justifiably and reasonably relies, regardless of the intentions of the parties (option 8); or
- (d) which actually confers a benefit on him, regardless of the purpose of the contract or the intention of the parties (option 9).

4.32 In responding to the Sub-committee's consultation paper, one consultee expressly supported option 9. We are of the view that if the parties have expressly provided that the third party can enforce a contractual term, he should be able to do so. The parties' intention should be respected and given effect to, and the test of enforceability should enshrine their intention. To this end, we can rule out options 1, 5, 6, 8 and 9 which are not consistent with this view. Options 8 and 9 also have the added disadvantage that they are too wide in scope and would, contrary to the parties' intention, potentially enable a wide range of persons to sue as third parties. The problems of option 8 can be illustrated by the example of a person who purchases a house on the understanding that a new motorway is to be built. If the motorway is not built on time, under option 8 the person can sue the builder for his losses, such as additional travelling costs. Another example can exemplify the shortcomings of options 1, 6 and 9. Where a contract to build a new road expressly purports to confer a benefit on nearby residents, or the parties to the contract intend that the residents should receive the benefit, or the contract actually confers a benefit on the residents, those residents can enforce the contract under options 1, 6 and 9 if the road is not built on time or at all.

4.33 We are also of the opinion that if the parties have intended that a third party can enforce a promise, it should not be necessary to further require that the third party is an intended beneficiary of the promise. A third party need not be a beneficiary under the contract to have a right to enforce it. For instance, where the parties confer on C (as a trustee) a right to enforce a promise in the contract which would benefit D, C should have the right to enforce the promise even though C is not the beneficiary of the promise. One common problem of options 2, 3 and 7 is that they require the parties to intend a third party to benefit from the promise and also intend to create a legal obligation enforceable by him. It seems that the only option which allows a third party to enforce a contract if the contract so provides is the first limb of option 4, and hence we recommend its adoption.

4.34 It would, however, be too restrictive if a third party could enforce a contract only where the contract had expressly so provided. We notice that, with the exception of option 8, all the options require either that the contract purports to confer, or that the parties intend to confer, a benefit on the third party. We agree with the Law Commission that a test which gives effect to the parties' intentions in the light of the contract and the surrounding circumstances can lead to uncertainty.³⁹ The second limb in option 4, as

³⁹ Law Commission Report No 242 (cited above), at para 7.5.

recommended by the Law Commission and modelled on the New Zealand provision, adopts a presumption in favour of a third party's right to enforce a contractual term which purports to confer a benefit on him. The presumption can be rebutted where, on a proper construction of the contract, it appears that the parties did not intend the term to be enforceable by the third party. Professor Andrew Burrows has explained the basis of the presumption thus:

*"if you ask yourself, 'When is it that parties are likely to have intended to confer rights on a third party to enforce a term, albeit that they have not expressly conferred that right', the answer will be: 'Where the term purports to confer a benefit on an expressly identified third party.' That then sets up the presumption."*⁴⁰

4.35 Academics in general endorse the presumption, regarding it as striking a balance between the aims of effecting the parties' intentions and the avoidance of uncertainty. It also enshrines the notion of "freedom of contract". Nonetheless, some academics have expressed reservations. The first concern is what amounts to "purports to confer a benefit" and where the line should be drawn.⁴¹ Both Professor Burrows and Sir Guenter Treitel are of the view that the presumption is only triggered where a third party is to receive a benefit from the promisor directly, and this must not be just a consequential or incidental benefit stemming from the promisor's performance.⁴² If A contracts with B to cut B's hedge adjoining C's land, performance by A might benefit C but the term does not purport to confer a benefit on C. By the same token, a solicitor's contractual obligation to use reasonable care in drawing up a will would not, *vis-a-vis* the beneficiaries of the will, fall within the presumption because the term does not purport to confer a benefit on those beneficiaries. The benefit to them derives from the testator, not from the solicitor, whose role is only to enable his client to confer a benefit on the beneficiaries.⁴³ This was also the conclusion of the New Zealand court in *Gartside v Sheffield Young & Ellis* on similar facts discussed above.⁴⁴

4.36 Another concern is the manner in which the presumption can be rebutted. One consultee suggested in response to the Sub-committee's consultation paper that only an express term could rebut the presumption. We think this suggestion too restrictive, however. The same consultee also suggested adopting a purposive and objective approach to interpreting the contract. It seems that the contract should be looked at as a whole, and the presumption can be rebutted if there is an express term to the effect that the parties did not intend the third party to have the right to enforce, or there are other inconsistent terms in the contract.⁴⁵ Professor Robert Merkin is of the

⁴⁰ Andrew Burrows, "The Contracts (Rights of Third Parties) Act 1999 and Its Implications for Commercial Contracts", [2000] LMCLQ 540, at 544.

⁴¹ Catherine MacMillan, "A Birthday Present for Lord Denning: The Contracts (Rights of Third Parties) Act 1999", (2000) 63 MLR 721, at 724.

⁴² Andrew Burrows, "The Contracts (Rights of Third Parties) Act 1999 and Its Implications for Commercial Contracts", [2000] LMCLQ 540, at 544.

⁴³ This example is based on *White v Jones* [1995] 2 AC 207 which was ruled out of the scope of presumption by the Law Commission Report No 242 (cited above), at paras 7.19-7.24.

⁴⁴ [1983] NZLR 37.

⁴⁵ Andrew Burrows, "The Contracts (Rights of Third Parties) Act 1999 and Its Implications for

opinion that on a strict reading of section 1(2), extrinsic evidence is to be disregarded, but he also thinks that the 1999 Act as a whole does not have that effect, nor was it the Law Commission's intention.⁴⁶ No general principle can be derived from the New Zealand cases on this issue. Professor Andrew Burrows observes that the normal objective approach to contractual interpretation should be applied, and classic cases on what is admissible in relation to interpretation of a contract therefore apply.⁴⁷ We think that the extent to which surrounding circumstances can be taken into account would best be left to the courts to decide. We therefore recommend adopting the second limb of option 4. Nonetheless, the words "it appears that" in section 1(2) of the 1999 Act (E & W) obscure the meaning of the provision. We believe that those three words are unnecessary. Otherwise, the court would only look for what appears to be, but not the parties' actual, intention and this would lower the threshold. We emphasise that the test should remain an objective one, and we believe that the words "on a proper construction" should already put this beyond doubt. A third party will have the right to enforce the contract so long as he falls within either of the two limbs. We believe that the recommended two-limb test recognises the parties' freedom of contract in the sense that they can decide when a third party should be able to sue on their contract. We also agree with section 1(6) of the 1999 Act (E & W) that a reference to the third party enforcing a contractual term should include a reference to his availing of an exclusion or limitation clause contained in the contract. The definition of the term "benefit" in section 2 of the 1982 Act (NZ) and the word "forbearance" in section 4(1) of the 1993 Act (NB) have the same effect. The Hong Kong Association of Banks suggested in response to the Sub-committee's consultation paper that both limbs of option 4 should be subject to rebuttal so that contracting parties could have the freedom to exclude the application of the recommended legislation altogether. We do not think it sensible to make the first limb subject to rebuttal, however. If a contract already expressly provides that a third party can enforce a contractual term, it would seem illogical to say that, on a proper construction, the parties do not intend the term to be enforceable by the third party.

4.37 The Commissioner of Insurance observed that the recommended legislation would too easily deem a person to be a third party.

Commercial Contracts", [2000] LMCLQ 540, at 544. See also Andrew Tettenborn in Merkin's *Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999*, LLP, 2000, at para 7.45. Catherine MacMillan, "A Birthday Present for Lord Denning: The Contracts (Rights of Third Parties) Act 1999", (2000) 63 MLR 721, at 725.

⁴⁶ R Merkin, *Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999*, LLP, 2000, at para 5.29.

⁴⁷ Andrew Burrows, "The Contracts (Rights of Third Parties) Act 1999 and Its Implications for Commercial Contracts", [2000] LMCLQ 540, at 545. In *Reardon Smith Line Ltd v. Yngvar Hansen-Tangen (The Diana Prosperity)* [1976] 1 WLR 989 (at 995-996), Lord Wilberforce said: "No contracts are made in a vacuum; there is always a setting in which they have to be placed. The nature of what it is legitimate to have regard to is usually described as 'the surrounding circumstances' but this phrase is imprecise: it can be illustrated but hardly defined." More recently, Lord Hoffmann in *Investors Compensation Scheme Ltd v. West Bromwich Building Soc* [1998] 1 WLR 896 (at 912-913), said: "The background was famously referred to by Lord Wilberforce as the 'matrix of fact'... it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man. [But] the law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent."

The Commissioner was particularly concerned about the schemes administered by the Motor Insurers' Bureau of Hong Kong and the Employees Compensation Insurer Insolvency Bureau which provide some redress for road accident victims and their families, and employees and their families respectively. The Commissioner's concern was that under the recommended legislation, these persons might, as third parties, be able to enforce against insurers the underlying contracts between the Bureaus and insurers under these schemes. In response, we would emphasise that contracting parties can rely on the second limb of the above recommendation to prove that, on a proper construction of the contract, they did not intend the third party to have the right to enforce their contract. Instead, the third party should seek redress from the Bureau. In addition, under Recommendation 3, contracting parties can confine third parties to certain designated classes or descriptions. In any event, contracting parties can contract out of the recommended legislation.

4.38 *A more lenient test for consumers* Another issue is whether there should be a more lenient test of enforceability for consumers. None of the jurisdictions discussed in this report have provided for such a test. In view of some consultees' feedback that the proposed reform should go further in protecting consumers by having a more lenient test of enforceability for consumers, the Law Commission considered the issue in its report. The consultees' suggested tests were in effect options 8 and 9 discussed above. The Law Commission rejected the suggestion on the grounds that the specific issue of consumer protection could not be addressed through a general reform of the law of contract such as was under consideration.⁴⁸

4.39 We are not aware, however, of any initiative in Hong Kong to enact comprehensive consumer protection legislation in the near future. In addition, the two-limb test recommended above may not cover all situations involving consumer third parties. For example, a contract between a property developer and a main contractor instructing the latter to use specific materials in the construction of a block of flats ultimately destined for retail to consumers may not be regarded by the Court as purporting to confer a benefit on third parties under the second limb. Similarly, it is doubtful whether a contract between a retailer and a manufacturer for the purchase of the manufacturer's goods could be said without more to constitute an agreement which purported to confer a benefit on third party consumers who subsequently deal with the retailer. A third example is where goods are sold to a buyer who, unbeknown to the retail seller, intends to make a gift of the goods to a consumer third party. In any event, none of the ultimate consumers just considered are expressly identified by name or description, or as members of a class, in the original transactions between promisor and promisee as required in Recommendation 3. In such circumstances, it is worth considering whether our recommended legislation should include measures for consumer protection.

⁴⁸ Law Commission Report No 242 (cited above), at para 7.54.

4.40 In their response to the Sub-committee's consultation paper, the Consumer Council foresaw that the recommended legislation would be excluded from application in most consumer transactions, and consumer third parties would not be able to invoke the legislation. Consumers' problems would be exacerbated by the lack of comprehensive consumer protection legislation in Hong Kong to enable them to seek redress. The Council advocated a more lenient enforceability test for consumers, and specifically favoured options 8 and 9. The British Chamber of Commerce also supported the application of a separate test for consumers.

4.41 Having considered the issue and the consultees' responses, we are not convinced that we should formulate a more lenient test for consumers alongside the two-limb test in our recommended legislation for the reasons set out below. First, in our opinion, relaxation of the strict privity rule would of itself result in a major change of Hong Kong contract law. It would be prudent first to see how the law takes effect as a matter of practice before considering whether refinements, including special rules to cater for consumers, should be enacted.

4.42 Secondly, the two-limb test which we recommend is intended to respect the parties' freedom to contract. A more lenient test for consumers may enable a consumer to enforce a promise made by the promisor even when it is contrary to the promisor's wishes. Such a test would thus deviate from the principle of freedom of contract. While such a deviation may be justifiable in certain cases, the balance to be struck between the private interests of contracting parties and those of consumers is insufficiently clear cut in every case to enable simple universally applicable rules to be articulated.

4.43 Thirdly, a more lenient test for consumers may not be able to achieve its intended result. Promisors may simply be discouraged from entering into agreements for the benefit of third parties or they may contract out of the more lenient test (or even the entire recommended legislation) where their wishes may be ignored. Promisors may find the consequences of entering into contracts to benefit a third party too onerous.

4.44 Fourthly, not all of the cases involving consumer third parties are deserving of sympathetic treatment. Where, as in the third example mentioned above, a buyer does not tell a retailer that he is buying goods in order to make a present of them to a consumer third party, we do not see any anomaly if the consumer cannot sue the retailer directly under the two-limb test.⁴⁹ The British Chamber of Commerce commented that the analysis was

⁴⁹ Professor Jack Beatson is of the view that the position would be different if the buyer makes it clear to the retailer when purchasing the goods that it is a gift and the retailer agrees to deliver it to the consumer third party. In such circumstances, the contracting parties can be said to purport to confer a benefit on the third party, under the two-limb test, who is also identified by name. J Beatson, *Anson's Law of Contract*, 28th Edition, 2002, at 434. One of our Sub-committee members argues that there are no good policy reasons to exclude the former case from the two-limb test while Professor Beatson's modified case falls within the test. The majority of the Sub-committee, however, believes that it is not an anomaly to exclude the former case from the test.

not compatible with the concept of strict liability. However, we do not think that the issue is one of strict liability. It is a matter for the contracting parties to decide as to whether they wish to confer a benefit on the third party. Without knowing the buyer's intention to benefit the consumer, the retailer did not have the chance to refuse to deal with the buyer on the basis of his liability to the consumer. It is reasonable for a promisor, such as the retailer in this example, to wish to limit his exposure to third party liability (for example, in light of the terms of his liability insurance). In such a case, it would be anomalous if an unexpected liability to an unknown third party were forced upon him.

4.45 Finally, in the discrete situation of property developer and contractor, we are hopeful that, without the need for special consumer rules, market forces would cause contractors of their own accord to agree that certain building specifications may be enforceable against them by consumer third parties. Thus, for example, the fact that a contractor has expressly agreed to be liable to an ultimate buyer of a flat if the flat does not meet the specifications, could, we believe, well be perceived as a major selling point for a property development. To a consumer choosing between a flat in development A or development B (with only one of them offering a right to enforce building covenants against the building contractor), such a right could be a factor in his choice. The Government, as the sole supplier of land in Hong Kong and a major employer in construction development, may, together with major property developers and building contractors in Hong Kong, take the lead in adopting a code of practice and standard forms of contract whereby building contractors agree to certain of their covenants being enforceable by consumers.⁵⁰ In this way, even without special rules for consumers, we are optimistic that the new law could help foster a commercial environment from which consumers can substantially benefit. Some consultees, including the British Chamber of Commerce, thought that that was unrealistically idealistic. We remain of the view, however, that both the government and consumer organisations can help foster a more consumer-friendly environment by educating the public as to their new rights under the recommended legislation, and by encouraging property developers and contractors to take the consumers' interests more seriously.

Recommendation 4

We recommend that a third party should be able to enforce a contractual term if:

- (a) the contract expressly provides that he may; or**
- (b) the term purports to confer a benefit on him, unless**

⁵⁰

As discussed in Chapter 1, under certain circumstances, the contract between a developer and the purchasers may provide that the developer would exercise its best endeavours to enforce all defects and maintenance obligations under all contracts relating to the construction of the development, and where the developer is wound up, all warranties and guarantees under such contracts would be assigned by the developer to the prospective owners' corporation or manager of the development.

on a proper construction the parties did not intend the term to be enforceable by him;

and where a contractual term excludes or limits liability, references to the third party's enforcement of the term should be regarded as references to his availing himself of the exclusion or limitation.

4.46 There are two issues related to a third party's enforcement of the benefit conferred on him by the contract. The first is whether, in enforcing the right, a third party should be subject to other relevant terms of the contract. The second is what remedies should be available to a third party.

Australia

4.47 Under section 55(3)(b) of the 1974 Act (QInd), upon acceptance, a beneficiary will be bound by the promise and subject to a duty to do or refrain from doing such acts as are required in the promise. A promisor will be entitled to such remedies and relief as may be just and convenient for the enforcement of the duty. A promisor and a beneficiary may vary or discharge the terms of the promise and the duty of the promisor and beneficiary. There are almost identical provisions in section 56(3) of the 2000 Act (NT). Under section 11(2)(c) of the 1969 Act (WA), a promisor is entitled to enforce, as against the third party, all the obligations imposed by the contract on the third party for the promisor's benefit.

4.48 Under section 55(3)(a) of the 1974 Act (QInd) (section 56(3)(a) of the 2000 Act (NT)), a beneficiary is entitled to such remedies and relief as may be just and convenient for the enforcement of the promisor's duty.

Canada

4.49 Section 4(1) of the 1993 Act (NB) provides that a third party can enforce the promise "*by a claim for damages or otherwise*". The provision expressly provides that a third party can claim for damages, but leaves it open as to the other remedies that may be available to him.

England and Wales

4.50 Section 1(4) the 1999 Act (E & W) expressly provides that the Act does not confer a right on a third party to enforce a contractual term otherwise than subject to and in accordance with any other relevant terms of the contract. The purpose of this provision is to prevent a third party from picking and choosing as between contract terms. If he is empowered to enforce a particular obligation, he is bound by the restrictions relating to the enforcement, including exemption clauses and agreed limitation periods.⁵¹

⁵¹ R Merkin, *Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999*, LLP, 2000, at para 5.44.

4.51 According to section 1(5), the remedies available to a third party in enforcing a contractual term are those that would have been available to him in an action for breach of contract if he had been a party to the contract. The rules relating to damages, injunctions, specific performance and other relief will apply accordingly. Section 7(4) provides expressly that a third party should not be treated as a party to the contract for other enactments merely because of the reference in section 1(5) to treating him as if he was a party to the contract.

New Zealand

4.52 Section 8 of the 1982 Act (NZ) provides that a beneficiary can enforce the obligations imposed on a promisor as if the beneficiary were a party to the contract. In other words, a beneficiary can obtain full contract damages and also equitable relief.⁵²

Singapore

4.53 Sections 2(4) and (5) and section 8(4) of the 2001 Act (Sg) are nearly identical to the equivalent provisions in the 1999 Act (E & W).

Conclusion

4.54 As to the first issue, the provisions in the Northern Territory, Queensland and Western Australia amount to imposing obligations on third parties. This derogates from the general principle that a contract cannot impose a burden on a third party, and also deviates from the focus of the present reform (ie conferring benefits, rather than imposing obligations, on third parties). In contrast, the English provision only imposes conditions on a third party if he chooses to enforce the benefits conferred on him. It is in line with the above general principle of contract law and is well within the scope of the present reform. We believe that contracting parties should have the freedom to place conditions on the third party's rights, since they are the ones who confer those rights on the third party. We therefore recommend that a third party's right to enforce a contractual term should be subject to, and in accordance with, other relevant terms of the contract.

4.55 In respect of the remedies available to third parties, the provision in Queensland is general in nature: "*such remedies and relief as may be just and convenient for the enforcement*". The provision in New Brunswick does not give much guidance to the courts. Under the New Zealand provision, a third party can enforce his right as if "*he were a party to the deed or contract*". The remedies under the English provision have three characteristics.⁵³ They are remedies available in an action for breach of contract, and this means that termination of a contract for a promisor's substantial breach is excluded since termination is a self-help, not a judicial, remedy. They also exclude restitutionary remedies because a promisor may

⁵² Andrew Burrows, Finn & Todd, *Law of Contract in New Zealand*, 2nd Edition 2002, at 532.

⁵³ Law Commission Report No 242 (cited above), at para 3.33. Merkin, *Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999*, LLP, 2000, at para 5.49.

be unjustly enriched at the expense of the promisee, but not the third party. Finally, the clause "*if he had been a party to the contract*" means that the rules as to remedies are to apply by analogy, including the application of the rules of remoteness and mitigation, the possibility of specific performance, etc. The consultation paper recommended adopting the approach followed in Queensland. The Queensland provision is concise and would give the courts the required discretion to award the most appropriate remedies in the light of the particular circumstances of each case.

4.56 While fully endorsing the aims of the recommendation, Professor Hugh Beale of the Law Commission expressed concern that a provision along these lines might be open to misinterpretation. It might be understood to mean that the question of whether or not to grant a remedy to the third party, and the extent of the remedy, should depend on what the court thinks is "just and convenient." In other words, it would be a matter of judicial discretion. It might be argued, for example, that the court has the discretion to limit a third party's damages to recovery of reliance loss if the court thinks that is just because the third party is a mere volunteer.⁵⁴ Professor Beale did not understand this to be what was intended. The British Chamber of Commerce considered that the remedies and relief available to third parties should be set out in the legislation. This view was shared by the Hong Kong Association of Banks, which suggested adopting the English provision since it was clearer as to what remedies would be available.

4.57 The consultation paper recommended adopting the Queensland provision because it would give the courts more discretion. We note Professor Beale's view that the discretion might be so wide as to allow the court to limit a third party's damages to recovery of reliance loss, but we believe that such an interpretation of the recommended legislation would arguably run counter to the spirit of the legislation, especially when the legislation provides that, as against the promisor, the third party can be a volunteer.⁵⁵ We agree, however, that the Queensland provision is less certain than the English provision. On further reflection, we think that the jurisdictional question as to whether the remedies available to third parties should be contractual or tortious in nature should be worked out as a matter of principle in the recommended legislation, rather than on a case-by-case basis by the courts. We also believe that more guidance should be given to the courts. We therefore recommend adopting section 1(5) of the 1999 Act (E & W).

4.58 The Hong Kong Federation of Insurers queried the quantification of damages, specifically in relation to whether consequential loss could be recovered under the recommended legislation. For example, would an insurer be liable for the difference in property prices due to a delay in payment if a beneficiary alleged that he had communicated to the insurer at the time of contracting that he would purchase a property immediately after he received

⁵⁴ Reliance-loss damages are the "*reimbursement for losses or expenses that the plaintiff suffers in reliance on the defendant's contractual promise that has been breached*" (*Black's Law Dictionary*, West Group, 7th Edition, 1999, at 396).

⁵⁵ Recommendation 8.

the insurance benefits? As discussed above, the clause "*if he had been a party to the contract*" means that the rules as to remedies under the existing contract law are to apply by analogy, including the rules of remoteness and mitigation, etc.

Recommendation 5

We recommend that:

(a) a third party's right to enforce a contractual term should be subject to, and in accordance with, other relevant terms of the contract; and

(b) in enforcing the promisor's duty, a third party should be entitled to any remedy that would have been available to him in an action for breach of contract if he had been a party to the contract (and the rules relating to damages, injunctions, specific performance and other relief should apply accordingly).

Can the contracting parties vary or rescind the contract?

4.59 This issue concerns the rights of the contracting parties to alter or cancel their contract *after* a third party has been conferred rights under the contract. Here, a balance has to be struck between the freedom of contracting parties to change the contract in accordance with their intentions, and the interests of the third party, who may suffer some injustice as a result of the variation or rescission.

4.60 Not allowing the parties to vary the contract would unduly restrict the parties' freedom of contract. In contrast, to give the parties unfettered power to vary the contract would mean that the third party could not rely on any right conferred by the contract. Hence, there should be a cut-off point after which the parties cannot vary or rescind the contract. In other words, there should be a "crystallisation" test for determining when and/or how a third party's rights "crystallise", thereby putting an end to the contracting parties' rights to vary or cancel the contract.

Australia

4.61 In Queensland and the Northern Territory, under section 55(1) of the 1974 Act (Qld) and section 56(1) of the 2000 Act (NT) respectively, a promisor is subject to a duty to perform the promise "upon acceptance by the beneficiary". Prior to acceptance, the parties may, without the consent of the

third party, vary or discharge the promise.⁵⁶ Both Acts use a third party's "acceptance" as the crystallisation test. "Acceptance" means:

*"an assent by words or conduct communicated by or on behalf of the beneficiary to the promisor, or to some person authorised on the promisor's behalf, in the manner (if any), and within the time, specified in the promise or, if no time is specified, within a reasonable time of the promise coming to the notice of the beneficiary."*⁵⁷

The key is that a beneficiary must communicate his assent to the promisor. Mr Justice Andrew Rogers considers that although the provision is "*no doubt fair and sensible on the face of it, [it] may well bring about the failure of some otherwise meritorious beneficiaries*".⁵⁸

4.62 In Western Australia, the parties can, with mutual consent, cancel or modify the contract at any time before a third party "*has adopted it either expressly or by conduct*" under section 11(3) of the 1969 Act (WA). Chief Justice Burt of the Supreme Court of Western Australia said, as an *obiter dictum* in the *Westralian Farmers* case, that the third party had adopted the contract by crediting the account of one of the buyers with the price less commission.⁵⁹

England and Wales

4.63 Section 2(1) of the 1999 Act (E & W) provides that the parties cannot rescind or vary the contract in such a way as to extinguish or alter a third party's rights where

- (a) the third party has communicated his assent to the contractual term to the promisor;
- (b) the promisor is aware that the third party has relied on the contractual term, or
- (c) the promisor can reasonably be expected to have foreseen that the third party would rely on the term and the third party has in fact relied on it.⁶⁰

In other words, both the "acceptance" test and the "reliance" test are used. In this context, acceptance means communication of one's assent.⁶¹ Reliance means conduct induced by the belief (or expectation) that the promise will be performed, or at least the belief that there is a legal entitlement to performance of the promise. The reliance need not be

⁵⁶ Section 55(2) of the 1974 Act (Qld) and section 56(2) of the 2000 Act (NT).

⁵⁷ Section 55(6) of the 1974 Act (Qld) and section 56(6) of the 2000 Act (NT).

⁵⁸ *Essays on Contract*, Edited by P D Finn, The Law Book Company Limited, 1987, at 98.

⁵⁹ *Westralian Farmers v Southern Meat* [1981] WAR 241, at 246.

⁶⁰ Section 2(1)(b) and (c).

⁶¹ Law Commission Report No 242 (cited above), at para 9.16.

detrimental. In other words, the conduct need not make the plaintiff's position worse than it was before the promise was made.⁶²

4.64 In *Precis (521) plc v William M Mercer Ltd*, the Court of Appeal held that words of restriction could not be read into section 2(1)(a).⁶³ In this case, Glen Dimplex ("Dimplex") made an offer through *Precis (521) plc* ("Precis"), its subsidiary, to purchase the issued shares of *Stoves Group plc* ("Stoves"). Dimplex and Stoves entered into a confidentiality agreement which, among other matters, purported to exclude liability for the negligence of Stoves' agents in relation to any information supplied to Dimplex. William M Mercer Ltd ("Mercer"), an actuarial firm, negligently prepared an actuarial report for one of the pension funds of Stoves. One of the issues was whether Mercer, as a third party, could rely on the exclusion clause in the confidentiality agreement by virtue of the 1999 Act. Mercer communicated its assent to *Precis* in 2003 for the purposes of section 2(1)(a) of the 1999 Act, but *Precis* contended that Mercer should have done so before the performance of the act in respect of which Mercer sought to exclude liability. That act was performed on 21 November 2000. In view of well-established principles of statutory interpretation, the Court of Appeal rejected *Precis*' argument since its effect was to read words of restriction into section 2(1)(a).

New Zealand

4.65 The 1982 Act (NZ) uses different tests. Under section 5, the parties cannot vary or discharge the promise where

- (a) the position of a beneficiary has been materially altered by the reliance of the beneficiary or any other person on the promise (whether or not the beneficiary or that other person knows the precise terms of the promise); or
- (b) a beneficiary has obtained judgment against the promisor, or an arbitrator's award on the promise.

The first test is akin to a "reliance" test, but has the element of "material". It is a matter of fact as to what amounts to a "material" alteration. No cases can be found on this.⁶⁴ The second test is the "judgment/award" test.

Singapore

4.66 The tests in the Singaporean provisions are similar to their English counterparts, except that the Singaporean provisions make it clear

⁶² Law Commission Report No 242 (cited above), at para 9.14.

⁶³ [2005] EWCA Civ 114.

⁶⁴ "It could be helpful to draw comparisons with cases concerning the circumstances in which a promisor may be estopped from reneging on his or her promise even though no consideration has been given for it." Burrows, Finn & Todd, *Law of Contract in New Zealand*, 2nd Edition 2002, at 531.

that the tests in (b) and (c) above still apply whether or not the third party has knowledge of the precise terms of the promise.⁶⁵

Options and conclusions

4.67 Different tests are adopted in different jurisdictions. Five options can be considered in Hong Kong:

- (a) the "acceptance" test (the Northern Territory, Queensland, England and Singapore);
- (b) the "adoption expressly or by conduct" test (Western Australia);
- (c) the "reliance" test (England and Singapore);
- (d) the "material reliance" test (New Zealand); and
- (e) the "already obtained judgment or arbitrator's award" test (New Zealand).

It should be noted that these tests are not mutually exclusive, and they can be used in different combinations (as in England and Singapore).

4.68 Other options considered and rejected by the Law Commission were the "awareness" test, the "detrimental reliance" test and the "third party's bringing suit on the promise" test. The first of these tests requires merely that the third party is aware of the terms of the contract. It is the crystallisation point most favourable to the third party, and comes close to rejecting a right to vary. We do not favour the "awareness" test as it puts unnecessary restrictions on the contracting parties' rights. The "detrimental reliance" test means that the third party's conduct in reliance on the promise renders him worse off than he would have been if the promise had never been made.⁶⁶ That is to say, the third party has suffered some detriment in reliance on the promise. The Law Commission did not favour this test since the essential injustice caused to a third party by the privity rule was that his reasonable expectations of the promised performance were disappointed. It was the expectation interest which the crystallisation test should seek to protect, and the Law Commission was of the view that the normal contractual measure of recovery (the expectation measure) should apply.⁶⁷ To require the reliance to be detrimental would shift the focus away from protecting the third party's expectation interest to protecting the plaintiff's reliance interest.⁶⁸

⁶⁵ Section 3(1) of the 2001 Act (Sg).

⁶⁶ Law Commission Report No 242 (cited above), at para 9.15.

⁶⁷ Law Commission Report No 242 (cited above), at para 9.33.

⁶⁸ Law Commission Report No 242 (cited above), at para 9.19. In any event, as argued by Professor Andrew Phang of the School of Business, Singapore Management University, there would not be any real difference in practice because, where a third party has relied on the term, he would, in most cases, have conducted his affairs such that any variation or rescission would probably cause him detriment (see Singapore Law Reform and Revision Division, *Report on*

As to the third test, if a third party sues on the promise, he is relying on the promise since he believes that he is entitled to it. In the Law Commission's opinion, this test adds nothing new. We share the views of the Law Commission and we have accordingly rejected all three of these tests. Furthermore, none of the other jurisdictions reviewed have adopted these three tests.

4.69 The meaning of the "adoption expressly or by conduct" test in Western Australia is ambiguous. It is not clear what a third party needs to show in order to prove his "adoption" of the contract. The 1969 Act (WA) itself does not shed any light on this, nor do any cases.⁶⁹ According to the Law Commission, "adoption" may have the same meaning as "acceptance", and another possibility is that it means either "acceptance" or "reliance". In view of its ambiguity, we believe that this test should be avoided. The same can be said about the "material reliance" test in New Zealand, since there can be much uncertainty as to what amounts to "material". As the Law Commission rightly pointed out, "it would be a recipe for litigation".⁷⁰ In addition, the shortcomings of the "detrimental reliance" test discussed above also apply to this test. In other words, it is the third party's expectation interest which the crystallisation test should seek to protect. Whether the reliance is detrimental or not should be irrelevant. The "already obtained judgment or arbitrator's award" test in New Zealand is not particularly helpful either. If a third party has already obtained judgment or an arbitrator's award upon the promise, it will be of little concern to him whether or not the parties can vary or rescind the contract.

4.70 Once a promise has been made by a promisor to the promisee, the third party may have expectations that the promise will be performed, and may, in relying on the promise, regulate his affairs accordingly. This may cause injustice to the third party. We are therefore of the view that the "reliance" test can best capture the essence of the reform. In other words, once a third party has relied on the promise, the parties should not be free to rescind or vary the contract. The test should apply not only where a promisor is aware that the third party has relied on the promise, but also where the promisor can reasonably be expected to have foreseen that the third party would rely on the promise and the third party has indeed relied on it. A promisor need not actually foresee the third party's reliance or his particular mode of reliance, so long as reliance of some sort is reasonably foreseeable.⁷¹ This would protect the third party where the promisor is willfully blind to the third party's reliance on the promise. We note that the New Zealand provision covers the case where someone other than the third party acts in reliance on the promisor's promise. While we believe that contracting parties should check whether the third party has relied on the promise, it is too onerous for the parties to make sure that apart from the third party, no one else has acted in reliance on the promise. If too heavy a

the Proposed Contracts (Rights of Third Parties) Bill 2001, at para 3.7.6.)

⁶⁹ The Supreme Court of Western Australia applied the test in *Westralian Farmers v Southern Meat* [1981] WAR 241 (at 246 and 251), without explaining what "adoption" meant.

⁷⁰ Law Commission Report No 242 (cited above), at para 9.31.

⁷¹ Neil Andrews, "Strangers to Justice No Longer: The Reversal of the Privity Rule under the Contracts (Rights of Third Parties) Act 1999" [2001] CLJ 353, at 367.

burden is imposed on contracting parties, they may be discouraged from conferring benefits on third parties. Furthermore, since it is difficult for a promisor to prove that the third party has not relied on the promise, the burden to prove reliance should be borne by the third party.

4.71 In response to the Sub-committee's consultation paper, the Hong Kong Federation of Insurers commented that an insurer, as a promisor, would have difficulties in assessing whether the third party had relied on the promise. In the Federation's opinion, the "could reasonably be expected to have foreseen" limb is unfair to promisors. This opinion was shared by the British Chamber of Commerce, which regarded the limb as an invitation to litigate. The Hong Kong Federation of Insurers suggested prescribing clear guidance in the recommended legislation. We would emphasise that it is usually a third party who asserts that the contracting parties' right to vary or rescind the contract has come to an end. The burden is thus on the third party to prove that the promisor is aware of the third party's reliance or could reasonably be expected to have foreseen that reliance. In deciding whether he can vary or rescind the contract, a promisor will, of course, have no difficulties in deciding whether he is actually aware of the third party's reliance. As for the "could reasonably be expected to have foreseen" limb, the court would determine whether that test has been met on an objective basis. The court routinely carries out such types of objective assessment. It is neither necessary nor possible to set out simple guidelines which will cater for all eventualities. Accordingly, we believe that we have struck a reasonable balance between protecting third parties' interests and ensuring a modicum of certainty for promisors.

4.72 Apart from the "reliance" test, the Sub-committee's consultation paper also recommended that a third party who had "accepted" (ie communicated his assent by word or conduct to the promisor) should also be protected from the parties' variation or rescission of the contract. In response to the consultation paper, Stephenson Harwood & Lo disagreed and observed that the "acceptance" test had not struck the right balance between protecting contracting parties' rights and those of third parties. However, we consider that in communicating his assent to the promisor, a third party has already done his part in alerting the promisor. Since the promisor is aware of the assent, he should not be free to vary or rescind the contract. One obvious advantage of the "acceptance" test is certainty. To be fair to the promisor and for the sake of certainty, the postal rule that acceptance of an offer takes effect where the letter is posted should not apply. This will ensure that the promisor is actually informed of the third party's assent. A third party should bear the responsibility to check whether the promisor is in a position to perform before relying on the promise. We have therefore come to the conclusion that both the "reliance" test and the "acceptance" test should be adopted as alternatives to each other. Where a contract has more than one provision conferring benefits on a third party, only the provision which has been relied on or accepted by the third party would become irrevocable. We also recommend that an assent sent to the promisor should not be regarded as communicated to the promisor until received by him.

4.73 Neil Andrews points out that "*by agreement... rescind... or vary...*" was adopted to replace the original "*vary or cancel...*" in section 2(1) of the 1999 Act (E & W) during the Parliamentary debate⁷² because in the Lord Chancellor's words:

*"We would not want a contracting party to be prevented from accepting a repudiation because of the interests of the third party".*⁷³

In other words, only variation or rescission by agreement of the parties will be caught by section 2. If B decides to end the contract because of A's repudiation or some vitiating factors for which A is responsible, B can still terminate the contract even after C (the third party) has relied on or assented to the benefit. This is because the contract is not rescinded "by agreement". By the same token, where a contract is frustrated, C's rights under the contract would also be extinguished and section 2(1) would not apply.⁷⁴ We believe that in these situations, the parties' right to rescind or vary the contract should not be restricted simply because of the third party's interests. We agree that "by agreement" should be added to the provision.

4.74 Related issues The Law Commission also considered some related issues. First, the Law Commission concluded that where more than one third party satisfied the test of enforceability, the principles relating to the case of "plurality of creditors" as discussed by Sir Guenter Treitel should apply by analogy.⁷⁵ The effect of the application is that where A contracts with B to pay C and D each \$10 separately, crystallisation of C's rights (or C's consent to variation of the promise) will not affect D's rights and vice versa. In contrast, where A contracts with B to pay C and D \$10 jointly, crystallisation of C's rights will also crystallise D's rights and vice versa. These rules apply to the situation mentioned by the British Chamber of Commerce where some members of a group of third parties have communicated their assent to the promisor while some other members have not. Furthermore, the relevant statutes in Queensland, Western Australia and New Zealand have not dealt with the issue. The Law Commission thus concluded that no legislative provision was needed. We agree that this issue can be left to the courts to determine. Secondly, the Law Commission regarded performance by a

⁷² Neil Andrews (cited above).

⁷³ *Hansard* HL, 27 May 1999, col 1055.

⁷⁴ Neil Andrews, "Strangers to Justice No Longer: The Reversal of the Privity Rule under the Contracts (Rights of Third Parties) Act 1999" [2001] CLJ 353, at 363-364.

⁷⁵ Law Commission Report No 242 (cited above), at para 9.43. By plurality of creditors, Sir Guenter Treitel refers to the situation where a promise is made to more than one person. If X promises to pay A and B \$10, there can be two types of scenarios. First, X may make two separate promises, under which A and B are promised \$10 each. Alternatively, X may make one promise to A and B jointly so that X is obliged to pay \$10 in all to both A and B. G Treitel, *The Law of Contract*, Sweet and Maxwell, 9th Edition, 1995, at 529-533. See also the 11th Edition, 2003, at 575-579.

A release granted by one joint creditor discharges the debt whereas that granted by one of a number of creditors entitled severally releases only the share of the grantor (*Steeds v Steeds* (1889) 22 QBD 537.). Similarly, payment to one of two joint creditors discharges the debt (*Husband v Davies* (1851) 10 CB 645.), but payment to one of a number of several creditors does not discharge the whole debt since each creditor is separately entitled to his share. G Treitel, *The Law of Contract* (cited above), at 532 (see also the 11th Edition, 2003, at 577).

promisor to the promisee (rather than to the third party) or release of the promisor by the promisee as a variation or cancellation of the contract.⁷⁶ If the contract can still be varied (ie before crystallisation of the third party's right), the performance or release would discharge the promisor. Thus the consultation paper concluded that there was no need to include provisions on these issues in the recommended legislation. The British Chamber of Commerce, however, believed that, for the sake of certainty, the recommended legislation should provide for these issues. In response, we would observe that the recommended legislation is meant to cover all major issues, but not all eventualities.

Recommendation 6

We recommend that the contracting parties' right to vary or rescind their contract by agreement should come to an end once:

- (a) the third party has communicated to the promisor his assent by word or conduct to the provision conferring benefit on him, or**
- (b) the third party has relied on that provision and the promisor**
 - (i) is aware of that reliance, or**
 - (ii) could reasonably be expected to have foreseen that the third party would so rely.**

An assent sent to the promisor is not to be regarded as communicated to the promisor until received by him.

Can the parties vary or rescind the contract after crystallisation, or lay down their own crystallisation test?

4.75 There are two further issues relating to the contracting parties' rights to vary or rescind the contract. The first is whether the parties should be allowed to reserve their rights to vary or rescind the contract even after crystallisation (ie where the third party has assented to, or relied on, the benefit). The second issue is whether the parties should be allowed, by an express term, to lay down in the contract a crystallisation test different from the default tests laid down in the recommended legislation. None of the three jurisdictions in Australia have provisions to these effects.

⁷⁶ Law Commission Report No 242 (cited above), at para 11.11.

Canada

4.76 According to section 4(3) of the 1993 Act (NB), contracting parties may amend or terminate the contract at any time, but where, by doing so, they cause loss to the third party who has incurred expenses or undertaken an obligation in the expectation that the contract would be performed, the third party may recover the loss from any party to the contract who knew or ought to have known that the expenses would be or had been incurred or that the obligation would be or had been undertaken. The third party cannot, however, recover his loss in relation to expenses incurred or obligation undertaken before the commencement of the provision (section 4(4)).

England and Wales

4.77 Under section 2(3)(a) of the 1999 Act (E & W), if a contract expressly provides that the parties may by agreement rescind or vary the contract *without* the consent of the third party, then they may do so. According to section 2(3)(b), the contract may also expressly provide that the third party's consent to rescission or variation is required in circumstances other than those specified in subsection (1). Hence, the parties to the contract can, by express terms, provide for rescission or variation without the third party's consent, or provide that his consent to rescission or variation is required only in circumstances specified by the parties themselves.

New Zealand

4.78 Section 6 of the 1982 Act (NZ) is similar in its effect to the English provisions. Where there is an express contractual provision allowing the variation or discharge of the contract, and the beneficiary knows of this provision before materially altering his position in reliance on the promise, any party or parties to the contract can vary or discharge the contract according to that provision. Since this section refers only to reliance by the beneficiary, variation may be still possible where a beneficiary's position is materially altered by *another person's* reliance before the beneficiary is aware of the contractual provision.⁷⁷

Singapore

4.79 Section 3(3) of the 2001 Act (Sg) is identical to its English counterpart, allowing contracting parties to vary or rescind the contract without the third party's consent, or to set their own crystallisation tests.

⁷⁷ Burrows, Finn & Todd, *Law of Contract in New Zealand*, 2nd Edition, 2002, at 531.

Options and conclusions

4.80 The New Brunswick provision does not provide for any crystallisation test, but allows contracting parties to amend or terminate the contract at any time. Contracting parties may need to compensate the third party who has suffered some loss as a result of incurring expenses or undertaking an obligation in the expectation of the promisor's performance. We are of the view that there should be a crystallisation test so that contracting parties and third parties would know their respective positions. The New Brunswick provision cannot easily fit with the crystallisation tests proposed in Recommendation 6. In addition, even though a third party who has suffered some loss can claim against any of the contracting parties under the 1993 Act (NB), the third party would probably need to litigate, incurring costs and time. We prefer a mechanism which is preventive in nature. The relevant legislation in Australia (the Northern Territory, Queensland and Western Australia) does not allow the parties to reserve the right to vary or rescind the contract once the third party's benefit is crystallised. The alternative approach (adopted in England, New Zealand and Singapore) is to allow the parties to do so. We believe that the parties should be free to reserve the right to themselves to vary or rescind the contract after crystallisation of the third party's benefit, as it is the contracting parties who confer a benefit on the third party. Nevertheless, it would be unfair to the third party, and would create considerable uncertainty, if their freedom to vary or rescind the contract were unfettered.

4.81 To alleviate the uncertainty, section 6 of the 1982 Act (NZ) in New Zealand allows the contracting parties to vary or rescind the contract by virtue of an express contractual provision only if the third party is aware of that provision before materially altering his position in reliance on the promise. England takes a different approach in dealing with this issue. After considering the New Zealand provision, the Law Commission recommended that requiring contracting parties to spell out the right of variation or rescission in the contract would strike a balance between alleviating the uncertainty for the third party and respecting the parties' intentions.⁷⁸ Section 2(3)(a) of the 1999 Act (E & W) implements the Law Commission's recommendation. Neil Andrews, however, finds it surprising that the parties' express reservation need not be communicated to the third party, nor need he be aware of it. He submits that elementary fairness requires the courts to strictly construe such contractual provisions so as to lean against the parties who want to "*pull the carpet from under the innocent third party's feet*".⁷⁹ Catherine Macmillan also considers that it is not difficult to envisage unfortunate cases where a third party could develop a reasonable expectation of benefit and be unaware of the actual terms of the contract which conferred it.⁸⁰ The situation is even more unfortunate if a promisee is using the contract as a means to fulfill another obligation owed to the third party.

⁷⁸ Law Commission Report No 242 (cited above), at para 9.39.

⁷⁹ Neil Andrews, "Strangers to Justice No Longer: The Reversal of the Privity Rule under the Contracts (Rights of Third Parties) Act 1999" [2001] CLJ 353, at 368.

⁸⁰ Catherine Macmillan, "A Birthday Present for Lord Denning: The Contracts (Rights of Third Parties) Act 1999", (2000) 63 MLR 721, at 728.

4.82 On the one hand, we appreciate that contracting parties should have the freedom to allow themselves by a contractual clause to vary or rescind the contract even after crystallisation. On the other hand, we realize that the third party might be unaware of the existence of such a clause, especially when he is a consumer. The problem would be particularly acute if there was fraud on the part of the contracting parties. After careful deliberation, the Sub-committee suggested in their consultation paper a middle-of-the-road approach: contracting parties can by virtue of a contractual term added before crystallisation vary or rescind the contract even after crystallisation so long as the promisor has taken reasonable steps to bring the term to the notice of the third party before his rights crystallise, such as by a notice published in the press. In other words, the proviso is that a third party knew of the existence of that contractual term, or reasonable steps have been taken to bring it to his notice, before his rights are crystallised.

4.83 Professor Hugh Beale did not see the logic of having such a proviso. In his opinion, a third party should be more proactive in asking to see the relevant contractual terms before relying on the promise for his benefit. The British Chamber of Commerce supported the recommendation, but observed that the proviso was an invitation to litigation. Given that third parties may not be in existence at the time of the original contract, or even when the additional contractual provision was inserted, the Hong Kong Association of Banks questioned how practicable the proviso was, as it would be difficult for contracting parties to advise third parties of the existence of that contractual provision. This view was shared by Clement Shum of Lingnan University and the Hong Kong Society of Accountants. The Hong Kong Association of Banks preferred an approach whereby, prior to crystallisation, contracting parties have unfettered rights to add new provisions to the contract, while the Hong Kong Federation of Insurers favoured the provision in the 1999 Act (E & W), which provided an almost unfettered right.

4.84 We have carefully considered the consultees' concerns on the proviso. There appear to be three options: (a) doing away with any proviso; (b) imposing a duty on contracting parties to bring the relevant term to the third party's notice; and (c) imposing on a third party the responsibility to ascertain the relevant term. The proviso was added after the Sub-committee's careful consideration of the views of Neil Andrews and Catherine Macmillan (referred to earlier) on the provision in the 1999 Act (E & W). We are concerned that third parties, especially consumers, might be unaware of the existence of the contractual term which enables contracting parties to vary or rescind the contract. There must be a balance between respecting contracting parties' freedom to vary or rescind the contract and protecting third parties. We do not think that the English provision is sufficient for this purpose, and therefore rule out the first option. In considering the relative merits of the second and third options, we believe it preferable that contracting parties take responsibility for advising the third party of the terms of the contract. Actual notice to the third party is not required if he ought to have known the relevant term because reasonable steps have been taken to bring it to his notice, such as by, for example, the contracting parties

publishing a notice in the press. We think that the second option is to be preferred, and hence we recommend retaining Recommendation 7 from our consultation paper.

4.85 The Hong Kong Federation of Insurers raised a specific concern about the proviso because of insurers' current practice of allowing an insured to change the beneficiaries at his discretion. Their concern is whether it is the insurer or the insured who should bear the responsibility of informing the beneficiaries of the change. In response, we would emphasise that the proviso only requires contracting parties to bring the contractual term authorizing variation or rescission (but not the change in beneficiaries as understood by the Federation) to the third party's notice. Moreover, an insurer (as promisor) can stipulate in the contract that the insured (the promisee) should bear the responsibility of informing third parties of that contractual term.

4.86 Another issue is whether a contracting party can vary or rescind the contract unilaterally, as under section 6 of the 1982 Act (NZ). It seems unlikely that contracting parties can, under section 2(3) of the 1999 Act (E & W), include a contractual term under which one of the parties may unilaterally bring the contract to an end or vary its terms. In Professor Merkin's opinion, such contractual terms are common in construction contracts, where the specification of works can be altered as matters progress. He believes that the better construction of section 2(3) is that it permits the parties to include an express term providing for variation or termination, whether unilateral or bilateral.⁸¹ We agree that contracting parties should have the freedom to allow themselves to vary or rescind the contract unilaterally, especially when the spirit of the reform is to give effect to the parties' intention.

4.87 As to whether the parties' should be able to lay down their own crystallisation test, Hong Kong could, like England and Singapore, allow contracting parties to stipulate in their contract a test different from those set out in the recommended legislation. An alternative would be to remain silent on this point, as in the three Australian jurisdictions and New Zealand. We take the view that in terms of the principle of freedom of contract, the parties should be allowed to set their own criteria or tests for determining their rights to vary or rescind their contract. In other words, they should have the right to set a crystallisation test which is either more favourable to a third party (such as the "awareness" test) or less favourable to him (such as a "written acceptance" test). A related issue is whether contracting parties can by an express term make the contract irrevocable. The Law Commission decided not to give effect to a contractual term, enforceable by a third party, that the contract was irrevocable whether or not his right had crystallised.⁸² Professor Andrew Burrows is, however, of the opinion that "the broad wording of section 2(3)(b)" of the 1999 Act would probably allow the parties to add

⁸¹ R Merkin, *Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999*, LLP, 2000, at para 5.77. He continues to say, "*This was the apparent intention behind s 2(3), and an amendment proposed at Committee Stage in the House of Lords' deliberations on the Bill, making it clear that a third party was bound by a unilateral variation clause, was rejected on the very basis that it was superfluous* [HL Hansard, 27 May 1999, cols 1056]."

⁸² Law Commission Report No 242 (cited above), at para 9.45.

such a term.⁸³ We agree with the Law Commission that it is an unreasonable fetter on the contracting parties' freedom of contract, and it also runs counter to the general contract principle that the parties are free to vary any contractual term, including a "no-variation" term. We thus conclude that the recommended legislation should not allow contracting parties by an express term to make the contract irrevocable.

Recommendation 7

We recommend that the contracting parties should be allowed by an express provision added before crystallisation:

- (a) to reserve the right to rescind or vary the contract unilaterally or bilaterally without the third party's consent; and**
- (b) to set their own criteria or tests for determining when and how their rights to vary or rescind their contract will end (ie when and how the third party rights will crystallise),**

provided that the provision would not be enforceable against the third party unless he knew of the existence of that provision, or reasonable steps have been taken to bring it to his notice, before his rights are crystallised.

Should there be any judicial discretion to authorise variation or cancellation?

4.88 The question arises as to whether the courts should have discretion in a deserving case to authorise variation or cancellation of the contract even after the third party's right has crystallised. There are no provisions on this in the three jurisdictions in Australia discussed in this chapter.

England and Wales

4.89 Section 2(4) of the 1999 Act (E & W) gives the court a limited judicial discretion, upon the parties' application, to dispense with a third party's consent to variation or rescission (which is required under the section) where his consent cannot be obtained because his whereabouts cannot reasonably be ascertained or where he is mentally incapable of giving his consent. Under section 2(5), if consent is required under section 2(1)(c) (where a promisor can reasonably be expected to have foreseen a third party's

⁸³ Andrew Burrows, "The Contracts (Rights of Third Parties) Act 1999 and Its Implications for Commercial Contracts", [2000] LMCLQ 540, at 547.

reliance), the court may dispense with the consent so long as the consent cannot reasonably be ascertained, whether or not there is third party reliance. Arbitral tribunals are also given the same discretion under the Act. In dispensing with the consent, the court or arbitral tribunal can impose such conditions, including compensation to a third party, as it thinks fit.

New Zealand

4.90 Where variation or discharge of a promise is precluded because the beneficiary's position has been materially altered (because of his or another person's reliance) or it is uncertain whether the variation or discharge is so precluded, section 7(1) of the 1982 Act (NZ) confers jurisdiction on a court to authorise the contracting parties to vary or discharge the contract if it is just and practicable to do so. According to subsection (2), however, the court must make it a condition of the variation or discharge that the promisor should pay compensation to the beneficiary where the beneficiary has suffered damage as a result of the reliance upon the promise.

Singapore

4.91 Section 3(4) and (5) of the 2001 Act (Sg) is equivalent to the English provisions, giving the court and arbitral tribunal the discretion to order variation or discharge of a contract without the third party's consent.

Options and conclusions

4.92 We consider that the judicial discretion to authorise variation or rescission is useful. It can cater for situations in which the contracting parties are locked into their contract because the third party cannot be found. It is also useful in a consumer situation where there is a large class and it is impossible to locate each and every member of that class. There are two alternative approaches as to how to grant the discretion. One is the English and Singaporean approach and the other is that adopted in New Zealand. The former approach only applies in designated circumstances and does not give a residual power to the court to dispense with consent whenever it considers that just.⁸⁴ We do not favour the English and Singaporean approach of a limited judicial discretion. The alternative approach adopted in New Zealand is to give the court jurisdiction to authorise a variation or rescission of the contract if it is just and practicable to do so. We are aware of Mr Justice Andrew Rogers' comments on the New Zealand approach that it is "*unfortunate where the only guidance given to the court is that the order be 'just and practicable'*".⁸⁵ In the consultation paper, we recommended that the legislation should allow a sufficiently wide judicial discretion to enable the court to do justice in deserving cases. On further reflection, however, we

⁸⁴ R Merkin, *Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999*, LLP, 2000, at para 5.89.

⁸⁵ P D Finn (ed), *Essays on Contract*, The Law Book Company Limited, 1987, at 101.

believe that it would be useful to make it clear that the courts can authorise variation or rescission only when it is “just and practicable” to do so. Under the English provision, an application to the court has to be made by both the contracting parties. One consultee expressly supported the approach in the English provision. In contrast, either party can apply to the court under the New Zealand Act. In our opinion, allowing a single party to apply would avoid the possibility that one party's wishes may be blocked by the unwillingness of the other to apply to court. Accordingly, the consultation paper proposed that either party should be allowed to make the application. We maintain that view, but emphasise that although a single party would be able to apply to the court to seek authorisation to vary the contract, the other contracting party would need to have agreed to the variation.

4.93 A number of consultees, including Clement Shum of Lingnan University and the Hong Kong Society of Accountants proposed that there should be clear guidelines to assist the courts in exercising the discretion. The Hong Kong Society of Accountants also suggested that the recommended legislation should empower the courts to award compensation to a third party where the courts thought fit. We believe that guidelines in the legislation may mislead or hamper the courts. We agree, however, that it would be helpful for the recommended legislation to provide the courts with a statutory power to award compensation, even though (as pointed out in the consultation paper) it is within the courts' inherent jurisdiction to do so in deserving cases. Apart from compensation, the court should also be able to impose such other conditions as it sees fit.

4.94 The British Chamber of Commerce highlighted the recommendation's implications on costs and delay. We emphasise that this recommendation caters for the situation where contracting parties are locked into their contract because the third party cannot be found. It may also be useful where there is a large class of third parties and it is impossible to locate every member of that class. Making an application to the court would no doubt incur costs, but it provides a practical solution for the parties in such circumstances. The Hong Kong Federation of Insurers also commented that Recommendations 6, 7 and 8 were unduly complex, uncertain, artificial and unfair. In their opinion, it would be undesirable and unfair to impose any restriction on the contracting parties' rights to vary or rescind the contract. As discussed earlier, we stress that there should be a balance between respecting the contracting parties' freedom to vary or rescind the contract and protecting third parties. The right of the contracting parties to vary or rescind the contract should not be unfettered, lest it prove prejudicial to third parties. We therefore maintain our recommendation in the consultation paper that the court should have a wide discretion to authorise variation or rescission of the contract without the third party's consent upon application by any of the contracting parties.

4.95 An outstanding issue is whether arbitral tribunals should have the same discretion. Arbitral tribunals in New Zealand do not have that. In contrast, section 2(4) of the 1999 Act (E & W) and section 3(4) of the 2001 Act (Sg) give arbitral tribunals this discretion. Professor Merkin, however, points

out a jurisdictional problem where contracting parties apply to an arbitral tribunal, and the arbitrators' jurisdiction is limited to disputes arising out of or under the parties' contract. He points out that there has by definition been a subsequent agreement between the contracting parties to vary their original contract. Not only may that later contract fall outside the arbitration clause, there is also plainly no "dispute" between the parties, as the person adversely affected is the third party.⁸⁶

4.96 We believe that the problems highlighted by Professor Merkin would need to be dealt with on a case-by-case basis if arbitral tribunals are given the discretion. Our main concern is that arbitration is held behind closed doors and the awards are not public documents. Conversely, court proceedings are open to the public. Another difference is that the court is the custodian of justice and would look after the interests of those who are not parties to the proceedings. Arbitrators would, however, only deal with the dispute between the parties, and could not go beyond the arbitral rules to investigate. A third party would be likely to feel more aggrieved by a decision allowing a variation made by an arbitral tribunal behind closed doors than one made in open court. There is little the court can subsequently do in respect of the arbitral tribunal's decision so as to address the third party's grievances. We are accordingly of the view that arbitral tribunals should not have the discretion to authorise variation or cancellation.

Recommendation 8

We recommend that the court should be given a wide discretion to authorise variation or rescission of the contract without the consent of the third party upon the application of any of the contracting parties where it is just and practicable to do so. Although the application may be made by a single party to the contract, the other contracting party would need to have consented to the variation. In authorising variation or rescission, the court may impose such conditions as it thinks fit, including compensation to a third party.

4.97 Finally, the Hong Kong Federation of Insurers wondered whether contracting parties might apply to the court for variation or rescission of the contract after the crystallisation of the third party's rights where the crystallisation criteria are set down by the parties themselves. We believe that the court would still have discretion to authorise variation or rescission even where the crystallisation criteria are set by the parties themselves.

⁸⁶ R Merkin, *Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999*, LLP, 2000, at para 5.90.

Should consideration be an issue?

4.98 The law of contract has a maxim that "consideration must move from the promisee". This maxim is generally understood to mean that consideration must be provided by the party seeking to enforce the contract. Thus, merely abrogating the privity doctrine would not in itself give third parties who have not provided consideration a right to enforce the contract. It is therefore important that the rule "consideration must move from the promisee" is also reformed to the extent necessary to avoid nullifying the proposed reform of the privity doctrine.

4.99 However, as the requirement of consideration is a basic tenet of the common law, a general abolition of the rule would have far-reaching, and perhaps unintended, consequences.

Australia

4.100 Section 55(1) of the 1974 Act (Qld) makes express provision that a promisor who, for a valuable consideration moving from the promisee, promises to do something for the benefit of a beneficiary will be under a duty to perform the promise (if other conditions in the section are fulfilled). Section 55(3)(a) goes on to provide that relief to the beneficiary under the section will "*not be refused solely on the ground that, as against the promisor, the beneficiary may be a volunteer*". There are equivalent provisions in section 56(1) and (3)(a) of the 2000 Act (NT). The Acts put it beyond doubt that there is no need for the beneficiary to provide consideration to the promisor.

4.101 Section 11 of the 1969 Act (WA) has not addressed this issue. The promisor in *Westralian Farmers Co-op Ltd v Southern Meat Packers Ltd*⁸⁷ sought to rely on the defence that the third party had not provided consideration for the benefit. This argument was rejected on the ground that a third party is necessarily a stranger to the consideration, if the contract purports to confer a benefit on him. It would deny the efficacy of the major part of section 11 if a contracting party could rely on a lack of consideration as a defence.

England and Wales

4.102 The Law Commission took the view that the phrase "*consideration must move from the promisee*" was probably generally understood to mean that consideration must have moved from the plaintiff, even though the promise was already supported by consideration provided by another.⁸⁸ In other words, the party seeking to enforce the contract must have provided consideration. In this case, reforming the privity rule while leaving the consideration rule intact would allow an impediment to the

⁸⁷ [1981] WAR 241.

⁸⁸ Law Commission Report No 242 (cited above), at para 6.5.

recognition of third party rights to remain. The Law Commission therefore recommended that the prospective legislation should ensure that the consideration rule should be reformed to the extent necessary to avoid nullifying its proposed reform on the privity rule.⁸⁹ This is, in Sir Guenter Treitel's opinion, a "quasi-exception" to the consideration rule.⁹⁰

4.103 After discussions with the law draftsman, the Law Commission was satisfied that it was unnecessary to make specific provision in respect of consideration, as the proposed statutory recognition of third party rights would necessarily imply reform of the consideration rule. Thus, there is no express provision on this either in the bill attached to the Law Commission's report or in the 1999 Act (E & W). In Professor Robert Merkin's words:

"The 1999 Act does not contain any express provision relating to consideration, and s 1 of the 1999 Act simply provides that a third party may enforce a contract term if the contract provides that he may or if the term purports to confer a benefit on him. This general statement of principle would seem to do all that is required. Section 1 of the 1999 Act does not say that the rights of a third party to enforce a contract term is not to be defeated only because he is not a party to the contract, as such wording would have left intact any other objection to third party enforcement, specifically, want of consideration. Instead, the wording adopted simply allows the third party to enforce the term free of legal objection, so that the abolition of privity takes the rule that consideration must move from the promisee along with it."⁹¹

New Zealand

4.104 The New Zealand Contracts and Commercial Law Reform Committee adopted a different approach:

"where consideration is provided by a party to a contract [though not by the third party], that should be sufficient to constitute lawful rights in a third person as contemplated by, and in accordance with, the terms of the contract".⁹²

The 1982 Act (NZ), in implementing the Committee's recommendation, makes it clear in section 8 that relief sought by a third party "*shall not be refused on the ground that ... as against the promisor, the beneficiary is a volunteer*". Thus, a third party can be a volunteer provided that the promisee has given consideration for the contract.

⁸⁹ Law Commission Report No 242 (cited above), at para 6.8.

⁹⁰ G Treitel, *The Law of Contract* (cited above), at 657.

⁹¹ R Merkin, *Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999*, LLP, 2000, at para 5.52.

⁹² New Zealand Contracts and Commercial Law Reform Committee, *Privity of Contract* (1981), at para 1.4.

Singapore

4.105 Section 2(5) of the 2001 Act (Sg) makes it express that any remedy available to a third party under the Act will not be refused merely because, as against the promisor, the third party is a volunteer.

Options and conclusion

4.106 The two alternatives are to follow the approach adopted in England, or to adopt a provision along the lines of that in New Zealand or Singapore. The proposed reform of the privity rule is to give a third party (who may not even be in existence at the time of contracting) a statutory right to enforce a contract. The third party may not therefore be in a position to provide consideration for the promise. We agree with the New Zealand Contracts and Commercial Law Reform Committee that it should be sufficient that consideration has been provided by the promisee. Mr Justice Andrew Rogers observes that section 8 deals with "*the problems of privity and consideration with clarity, obviating the difficulties which the Western Australian and Queensland Acts may have passed over*".⁹³ In our view, the recommended legislation should provide that consideration moving from the promisee is sufficient. Some of those who responded to the Subcommittee's consultation paper, including the British Chamber of Commerce, expressly endorsed this proposal.

4.107 We also favour the adoption of a provision along the lines of section 8 of the 1982 Act (NZ). This would make it clear that the third party can be a volunteer. There is the concern, however, that if the New Zealand provision is adopted, the promisor may challenge the existence of the contract for want of consideration from the promisee. The third party will in turn have to prove consideration from the promisee before he can sue. We do not see much force in this argument. It is usual that when a party sues on a contract, he must plead the consideration which he has provided. Even without the New Zealand provision, it would still be open to the defendant to ask where the promisee's consideration was. In our view, a third party should not be placed in a better position than the promisee.

Recommendation 9

We recommend that the recommended legislation should expressly provide that, as against the promisor, the third party can be a volunteer, provided the promisee has given consideration for the contract.

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P D Finn (ed), *Essays on Contract*, The Law Book Company Limited, 1987, at 99.

What defences, set-offs and counterclaims should be available to promisors?

4.108 This issue concerns the defences, set-offs and counterclaims that would be available to a promisor in an action by the third party to enforce his rights against the promisor.

Australia

4.109 Under section 55(4) of the 1974 Act (Qld), any matter which in proceedings not brought in reliance on this section:

- (a) would render a promise void, voidable or unenforceable, whether wholly or in part; or
- (b) is available by way of defence to enforcement of a promissory duty arising from a promise

would, in like manner and to the like extent, render void, voidable or unenforceable or be available by way of defence in proceedings for the enforcement of a duty to which this section gives effect. This is, however, subject to the parties' intention as expressed in the promise itself. There is an equivalent provision in section 56(4) of the 2000 Act (NT).

4.110 In Western Australia, all defences that would have been available to the defendant (promisor) had the plaintiff (third party) in an action to enforce the contract been named as a party to the contract, will be so available under section 11(2)(a) of the 1969 Act (WA).

Canada

4.111 Under section 4(2) of the 1993 Act (NB), when a third party sues the promisor, the promisor can raise any defence that could have been raised in proceedings between the contracting parties.

England and Wales

4.112 Section 3(2) of the 1999 Act (E & W) sets out the default position. In an action brought by a third party, the promisor can avail himself of any defence or set-off that would have been available to him had the proceedings been brought by the promisee, provided the defence or set-off arises from, or in connection with, the contract and is relevant to the term being enforced. Thus, a promisor may raise a defence which questions the existence, validity or enforceability of the contract because the contract is void for mistake or voidable for misrepresentation, or because of the promisee's repudiatory breach. Under section 3(3), contracting parties can, however, agree to enable the promisor to avail himself of any defences and set-offs which would be available against the promisee, even if they are irrelevant to

the term being enforced by the third party or are unconnected with the contract.

4.113 Section 3(4) further enables a promisor to raise defences, set-offs and counterclaims (only those not arising from the contract) that are specific to the third party only and would not be available to the promisor in an action by the promisee. Examples would be where a promisor had been induced to enter into the contract by the third party's misrepresentation, or where the third party was indebted to the promisor under a separate deal. Unlike the defences and set-offs under section 3(2) which are capable of further expansion, the defences, set-offs and counterclaims under section 3(4) have no scope for expansion since they are already as wide as they could be. The defences, set-offs and counterclaims under both subsections can, nevertheless, be narrowed down by an express term in the contract under section 3(5).

4.114 Section 3(6) provides an approach analogous to that in subsection (2) where a third party seeks to enforce an exclusion or limitation clause in response to an action brought by the promisor. A third party cannot enforce the clause if he could not have done so (whether or not because of any particular circumstances relating to him) had he been a party to the contract. Thus, a third party would not be able to rely on an exclusion or limitation clause which is invalid as between the parties (because of the inducement by the promisee's fraud, duress or undue influence, or because of its falling foul of the Unfair Contract Terms Act 1977), or which is unenforceable because of the third party's own conduct (such as fraud).⁹⁴ In other words, the validity of the clause depends on the position between the promisor and the promisee, as well as that between the promisor and the third party.⁹⁵

4.115 Section 7(2) ensures that section 2(2) of the Unfair Contract Terms Act 1977 does not apply where a third party sues the promisor under the 1999 Act for negligence which consists of the breach of a contractual obligation. The purpose is to allow a promisor to exclude his liability to the third party for the breach of a contractual obligation, whether or not the exclusion clause is reasonable.

New Zealand

4.116 Under section 9(2) of the 1982 Act (NZ), a promisor can avail himself by way of defences, counterclaims and set-offs of any matter which would have been available

- (a) if the beneficiary had been a party to the deed or contract in which the promise is contained; or

⁹⁴ Law Commission Report No 242 (cited above), at para 10.22.

⁹⁵ R Merkin, *Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999*, LLP, 2000, at para 5.107.

- (b) if (i) the beneficiary were the promisee; and (ii) the promise to which the proceedings relate had been made for the promisee's benefit; and (iii) the proceedings had been brought by the promisee.

A promisor can only avail himself of a set-off or counterclaim against the beneficiary if the subject-matter of that set-off or counterclaim arises out of, or in connection with, the deed or contract in which the promise is contained (section 9(3)). Furthermore, according to section 9(4), a beneficiary would not be liable on a counterclaim, unless he elects, with full knowledge of the counterclaim, to proceed with his claim against the promisor. In any event, his liability on the counterclaim would not exceed the value of the benefit conferred on him by the promise (section 9(4)).

Singapore

4.117 Section 4 and section 8(2) of the 2001 Act (Sg) are almost identical to section 3 and section 7(2) of the 1999 Act (E & W) respectively. The discussion on the English provisions is relevant to their Singaporean counterparts.

Options and conclusion

4.118 The provisions in New Brunswick and all three jurisdictions in Australia allow a promisor to raise all defences which would have been available to him in an action brought by the promisee. This is the first option open to Hong Kong (option 1). A second option is to follow the New Zealand approach (option 2). The English (or Singaporean) provision is the third option (option 3). The Law Commission also considered two other options in its report: (a) allow the promisor only defences affecting the existence or validity of the contract (or of the contractual provision being enforced) (option 4); and (b) allow the promisor all defences, set-offs and counterclaims which would have been available in an action brought by the promisee (option 5).⁹⁶

4.119 We rule out both options 1 and 4 since they do not include set-offs and counterclaims. Option 4 is even narrower in that it only includes defences affecting the existence or validity of the contract (or of the contractual provision being enforced). In suggesting that the position of a third party should be the same as an assignee's,⁹⁷ the Bar Association seemed to support option 5. We think, however, that option 5 is too wide. The third party is not simply stepping into the shoes of the promisee, and may be unaware of the counterclaims that the promisor might have against the promisee. This could be unfair to the third party since his liability on the

⁹⁶ Law Commission Report No 242 (cited above), at para 10.8.

⁹⁷ The Bar Association wondered why the mere fact that a third party did not step into the shoes of the promisee justified placing him in a better position than an assignee. Although in theory the promisor could always sue the promisee even if he is not allowed a set-off against the third party and the result should be the same, the position would be different in the event of insolvency of one of the parties.

counterclaims may well exceed the value of the benefit conferred on him by the promise. The effect would be to defeat the parties' intention to benefit the third party. Any counterclaim that a promisor might have against the promisee should be borne by the promisee himself. The mere fact that a third party is given a benefit by the contract does not mean that he should be liable to some unknown liability. Furthermore, if the position of a third party is equated with that of an assignee, the question is whether the promisee's right to enforce the contract against the promisor is assigned to the third party, and the promisee cannot then enforce the contract.

4.120 Our choice is therefore between option 2 and option 3. On balance, we favour option 3 for the following reasons. Firstly, a separate provision along the lines of section 9(4) in the 1982 Act (NZ) would be needed if option 2 is adopted so as to make sure that a third party will not be liable to counterclaims exceeding the value of the benefit conferred on him. A reference to defences and set-offs only, as in option 3 (section 3(2) of the 1999 Act (E & W)), would obviate the need for such a separate provision. Secondly, we share the Law Commission's concern that including counterclaims would imply that a third party could be sued by the promisor in a separate action on those counterclaims.⁹⁸

4.121 Thirdly, both options 2 and 3 allow a promisor to raise defences, set-offs and counterclaims specific to the third party, which would not be available in an action by the promisee. Professor Michael Bridge does not see the need to have this provision because the existing law on set-off and counterclaim already covers this.⁹⁹ Nonetheless, he understands that the Law Commission had in mind an "avoidance of doubt provision".¹⁰⁰ We agree that this is a sensible move. The difference between the two options is that option 3 expressly limits the counterclaims to those not arising from the contract while option 2 does not. In our opinion, it is advisable to provide specifically, as in option 3 (section 3(4) of the 1999 Act (E & W)), that a promisor can only raise counterclaims not arising from the contract in order to ensure that the burden of the contract will not pass to the third party.

4.122 Fourthly, section 3(1) of the 1999 Act (E & W) is more precise in referring to "*the enforcement of a term of a contract ... by a third party*", rather than merely referring to "*the contract*" as in section 9 in the 1982 Act (NZ). Section 3(2)(a) goes on to require the defence or set-off to be "*relevant to the term*", and not merely "*aris[ing] out of or in connection with the ... contract*" as is the case in section 9(3) in the 1982 Act (NZ). We think it makes sense that the promisor's defence or set-off should be relevant to the term being enforced by the third party. Catharine MacMillan also thinks that the narrowing is necessary so as to ensure that a third party will not be burdened by defences unrelated to the term which benefits him.¹⁰¹ This view is also shared by Professor Robert Merkin.¹⁰²

⁹⁸ Law Commission Report No 242 (cited above), at para 10.17.

⁹⁹ Michael Bridge, "The Contracts (Rights of Third Parties) Act" (2001) 5 Edin LR 85, at 96.

¹⁰⁰ Law Commission Report No 242 (cited above), at para 10.8.

¹⁰¹ Catherine MacMillan, "A Birthday Present for Lord Denning: The Contracts (Rights of Third Parties) Act 1999", (2000) 63 MLR 721, at 728.

¹⁰² R Merkin, *Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999*,

4.123 Fifthly, option 3 also allows the parties to broaden or restrict, by an express term in their contract, the defences and set-offs that would have been available to the promisor in an action by the promisee. The contracting parties can also restrict (but not broaden) defences, set-offs and counterclaims that would have been available to the promisor had the third party been a contractual party. Professor Michael Bridge is of the view that these provisions are "*entirely in accord with the contracting parties' ability to define or exclude the nature of the third party beneficiary's right under the contract*".¹⁰³ There are, however, no such provisions under option 2. The spirit of the present reform is to respect the parties' intention, and we welcome provisions that enshrine this spirit.¹⁰⁴

4.124 Finally, option 3 makes specific provision for the case where a third party enforces an exclusion or limitation clause in an action brought by the promisor (section 3(6) of the 1999 Act (E & W)). Since it is inaccurate to refer to defences in this case, we see the need to have a separate provision to the effect that a third party cannot rely on the exclusion or limitation clause if he could not have done so (whether or not because of any particular circumstances relating to him) had he been a party to the contract.

4.125 The consultation paper endorsed section 7(2) of the 1999 Act to the effect that a promisor should have the freedom to restrict or exclude his liability to the third party for the breach of a contractual obligation. This is because the purpose of the present reform is to give effect to the intentions of the contracting parties. If they agree that the third party's right is to be subject to an exclusion clause, the legislation should respect their consensus. As section 7(2) of the Control of Exemption Clauses Ordinance (Cap 71) is modelled on section 2(2) of the 1977 Act, the recommended legislation should disapply section 7(2) of Cap 71, just as the 1999 Act disappplied section 2(2) of the 1977 Act. One of those who responded to the Sub-committee's consultation paper considered that there was insufficient justification for disapplying section 7(2) of Cap 71 since the purpose of the recommended legislation was to confer rights on third parties. Similarly, Professor Hugh Beale observed that section 7(2) would apply if a promisee enforced the promisor's promise for the benefit of the third party, but not if the third party himself enforced the benefit. While understanding the need to respect the contracting parties' intention to restrict or exclude the promisor's liability to the third party, Professor Beale noted that the promisee might not be available or willing to bring an action. He illustrated this with the following example:

"[A] householder might agree to have building work done on terms that any defects that emerge within a five year period will be repaired by the contractor, and stipulate that this should be for the benefit of any subsequent owner to whom he might sell the house within that period. It might then emerge that, hidden in the small print of the contract and quite unknown to the

LLP, 2000, at para 5.97.

¹⁰³ Michael Bridge, "The Contracts (Rights of Third Parties) Act" (2001) 5 Edin LR 85, at 96.

¹⁰⁴ Sections 3(3) and 3(5) of the 1999 Act (E & W).

householder, there was a clause limiting the builder's liability for negligence in a way that reduces substantially the value of the promise to the third party. As against the householder that clause might well be invalid under s 7(2). As I understand it, if the promisee brought an action to enforce the promisor's obligation for the benefit of the third party, there is nothing to prevent the third party arguing that the exclusion clause (if relevant) is unreasonable and therefore invalid under the Act."

4.126 This issue may arise in other situations. In Professor Beale's opinion, it is arguable that a third party should equally have the right to challenge the exclusion clause as being unreasonable. It could, however, be argued that only promisees should be able to avail themselves of the protection in section 7(2) of Cap 71, since it is they, not third parties, who have provided consideration. We do not accept this argument. Under Recommendation 9, as against the promisor, the third party can be a volunteer. We see no compelling reason for distinguishing promisees from third parties where the protection of section 7(2) of Cap 71 is concerned. We share Professor Beale's concern that, after being attracted by the promised benefits, third parties may find themselves disadvantaged because of exemption clauses in small print.

4.127 We therefore withdraw our recommendation in the consultation paper that section 7(2) of Cap 71 should not apply where a third party sues the promisor under the recommended legislation for negligence which consists of the breach of a contractual obligation. However, we maintain our view that if the promisor's negligence causes personal injury or death, the third party should not be bound by the exclusion clause. This is because of the obvious policy reasons underlying section 2(1) of the 1977 Act (section 7(1) of Cap 71).¹⁰⁵ Similarly, an exclusion clause in respect of a third party's claim in tort of negligence should remain subject to the statutory control since a claim in tort is independent of the promisor's contractual obligations.

Recommendation 10

We recommend that

- (a) a promisor can avail himself of any defence or set-off that**
 - (i) arises from, or in connection with, the contract and is relevant to the term being enforced by the third party; and**
 - (ii) would have been available to him if the proceedings had been brought by the promisee, subject to any express contractual term that expands or restricts the scope of defences or set-offs;**

¹⁰⁵

Law Commission Report No 242 (cited above), at para 13.12.

(b) a promisor can avail himself of any defence, set-off or counterclaim (not arising from the contract) that would have been available to him if the third party had been a party to the contract, subject to any express contractual term that restricts the scope of defences, set-offs or counterclaims; and

(c) where in any proceedings brought against him a third party seeks to enforce a term of a contract (including, in particular, a term purporting to exclude or limit liability) under the recommended legislation, he may not do so if he could not have done so (whether or not by reason of any particular circumstances relating to him) had he been a party to the contract.

How should overlapping claims against promisors be dealt with?

4.128 Allowing third parties to enforce contracts between promisors and promisees raises a number of questions about promisors' liabilities. Should promisors be liable to both promisees and third parties? What should the promisors' position be upon performance of obligations to third parties? Should promisors be shielded from double liability? If so, how?

Promisor's duty owed both to the promisee and the third party

4.129 In Queensland, section 55(7) of the 1974 Act (QInd) provides that nothing in the section affects any right or remedy which exists or is available apart from the section. There is an equivalent provision in the Northern Territory (section 56(7) of the 2000 Act (NT)). This means that promisees retain their rights against promisors even though third parties may, by virtue of these provisions, be able to sue promisors directly. In other words, promisors are liable to both promisees and third parties. The 1969 Act (WA) is silent on this point.

4.130 In England, section 4 of the 1999 Act (E & W) provides that the fact that a third party has been given rights does not affect the promisee's rights to enforce any term of the contract. The Act gives the third party a right to enforce the contract which is additional to, and not at the expense of, the rights of the promisee. In Professor Robert Merkin's opinion, not only can a promisee claim his own loss, he can also bring an action on behalf of the third party where this was permitted by the common law or equity before the 1999 Act.¹⁰⁶ Promisees can also claim an injunction or other relief.

¹⁰⁶ He believes that a "promisee can thus sue as agent or trustee where the relationship is made out, and he can also bring an action for damages for the loss suffered by the third party in the circumstances contemplated in *The Albazero, Linden Gardens v Lenesta Sludge Disposals*

4.131 Section 14(1)(a) of the 1982 Act (NZ) similarly provides that nothing in this Act limits or affects any right or remedy which exists or is available apart from this Act. Singapore also has a provision modelled on section 4 of the 1999 Act (E & W).¹⁰⁷

4.132 Even with the enactment of our recommended legislation, promisees' rights to enforce the contract will still matter for two reasons. Firstly, disputes may arise from contracts ante-dating the legislation's enactment, and contracting parties can in any case contract out of the recommended legislation. Moreover, we consider it sensible that the promisor's duty to perform should be owed both to the third party and to the promisee since there will be no statutory assignment of the promisee's rights to the third party under the recommended legislation. Were it otherwise, the third party would be in a better position than the original promisee. Of the overseas provisions, we prefer those in England and Singapore which spell out clearly that the promisee's right to enforce any term of the contract should not be affected by the mere fact that the contract is enforceable at the suit of the third party under the Act. Some of those who commented on the Subcommittee's consultation paper, including the British Chamber of Commerce, supported our conclusion.

Recommendation 11

We recommend that a third party's rights under the recommended legislation should not affect any right of the promisee to enforce any term of the contract.

4.133 The Hong Kong Bar Association raised a number of queries about this recommendation.

- (a) If a third party releases the promisor from his obligation or has reached a compromise with the promisor, is the release or the compromise binding on the promisee?¹⁰⁸

and Darlington BC v Wiltshier." R Merkin, *Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999*, LLP, 2000, at para 5.60. The Law Commission was indeed at some pains to stress that these cases should be left unaffected by the 1999 Act: "remedies available to the promisee in a contract enforceable by a third party should be left to the common law" (Law Com No 242 (cited above), at 5.17). Professor Merkin, however, questions whether the courts will now be as willing, as on occasion they were before 1999, to find exceptions to the privity rule, in order to preserve the promisee's remedy.

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Section 5 of the 2001 Act (Sg).
In the Bar Association's opinion, Recommendations 11 to 13 (together with Recommendation 16) would appear to suggest that the promisee's right to sue the promisor should not be affected by any release of the promisor by the third party or compromise between the third party and the promisor. It is, however, difficult to see how the promisee could sue for specific performance or recover damages for breach in such circumstances. The promisor might justifiably argue that he could not be "in breach" of his obligation to confer a benefit on the third party if the latter refuses to accept it, especially when the performance would require the third party's co-operation.

- (b) Where a promisee is under a pre-existing liability to the third party, can the third party still claim against the promisee, despite the contracting parties' contract to benefit him?¹⁰⁹
- (c) Where a promisee is under a pre-existing liability to the third party who has released the promisor from his obligation or has reached a compromise with the promisor, can the third party then claim against the promisee?¹¹⁰
- (d) Where in an action brought by a third party against the promisor who has successfully established a set-off that would have been available to him had the proceedings been brought by the promisee (without joining the promisee as a party), can the promisee then bring another action against the promisor on the same issues? The question is whether the doctrine of *res judicata* would bar the promisee from litigating on the same issues already decided in the action brought by the third party. The Bar Association also questioned whether the promisee could recover damages which could be passed on to the third party who lost in his own action against the promisor.

4.134 The consultation paper had already considered the Law Commission's discussions in relation to the first two queries raised by the Bar. First, the Law Commission decided that a third party could not release the promisor's obligation to the promisee unless otherwise agreed in the contract.¹¹¹ The promisee should not be deprived of his right of action against the promisor, especially when the promise benefits both the promisee and the third party. In the Law Commission's opinion, this is in line with the principles relating to releases in the case of "plurality of creditors" discussed by Sir Guenter Treitel¹¹²: a release granted by one of a number of creditors entitled severally releases only the share of the grantor. Secondly, the Law Commission concluded that where the contractual benefit to the third party comprised the performance by the promisor of a pre-existing liability that the promisee owed to the third party, the third party could still claim against the promisee if the promisor did not fulfil his contractual obligation.¹¹³ A third party's acceptance of the benefit under the contract should discharge his claim against the promisee only to the extent that the promisor fulfils his contractual obligation. A third party, however, should not recover twice, and it is not necessary to have any order of priority for enforcement by the third

¹⁰⁹ The Bar Association believed that the third party could still claim against the promisee because of Recommendation 16: nothing in the recommended legislation should affect any right or remedy of a third party that exists or is available apart from the recommended legislation.

¹¹⁰ According to the Bar Association, it is arguable that the third party should be allowed to choose whom to sue. In the Bar's opinion, there may be a situation where the promisee remains liable to the third party but he is barred from in turn recovering from the promisor because of a release or compromise given to the promisor by the third party.

¹¹¹ Law Commission Report No 242 (cited above), at para 11.7.

¹¹² By plurality of creditors, Sir Guenter Treitel refers to the situation where a promise is made to more than one person.

¹¹³ Law Commission Report No 242 (cited above), at para 11.23.

party.¹¹⁴ We have re-considered the above matters, and agree that no legislative provisions are needed.

4.135 As to the third query, we agree with the Law Commission that the third party should be able to choose to claim against the promisor or the promisee.¹¹⁵ If the third party chooses to sue the promisee, the promisee's performance will discharge the promisor's contractual liability to the third party. The promisee can then seek an indemnity or reimbursement from the promisor because under the law of restitution, the promisee has discharged the promisor's liability, even if their contract has not provided for this.¹¹⁶

4.136 In relation to the Bar Association's fourth query, we observe that the court may of its own motion join in the promisee under Order 15 rule 6(2)(b) of the Rules of the High Court (Cap 4). Where the promisee has not been joined as a party in the action brought by the third party, whether the promisee can subsequently enforce the same contractual term against the promisor should best be determined by the common law rule *res judicata*. Assuming that the promisee is allowed to bring a subsequent action, if he has not suffered any loss as a result of the promisor's breach, he would only recover nominal damages. Where the promisee sues the promisor for the third party's loss and recovers damages for that loss as an exception to the rule that promisees can only recover their own losses,¹¹⁷ the promisee is then under a duty to account for the damages to the third party. Where he does suffer some loss because of the promisor's breach, the damages he recovers are to compensate himself. It is obviously difficult to cater for all eventualities in the recommended legislation and common law rules may have to be invoked.

4.137 The English Law Commission concluded that where both the promisee and the third party had rights of action against the promisor, there should be no prescribed order of priority of actions.¹¹⁸ We share the Law Commission's view that where a promisee wishes to sue, he should be joined as a party to the action brought by the third party so as to save costs and avoid inconvenience, and the same can be said in respect of a third party where the promisee sues first.¹¹⁹ The question is whether there should be a requirement as to joinder of parties in the recommended legislation. The Hong Kong Bar Association believed that if promisees were required to be joined as parties to the proceedings brought by third parties, their four queries discussed earlier would largely be resolved. The Bar Association therefore suggested imposing such a requirement. Under section 11(2)(b) of the 1969 Act (WA), each person named as a party to the contract is to be joined as a party to the action commenced by the third party. The New Zealand

¹¹⁴ Law Commission, Report No 242 (cited above), at para 11.24. A promisor's performance would discharge the promisee's pre-existing liability to the third party. Similarly, performance by the promisee would discharge the promisor's contractual liability to the third party, and the promisee could then seek indemnity from the promisor.

¹¹⁵ Law Commission Report No 242 (cited above), at para 11.23.

¹¹⁶ Law Commission Report No 242 (cited above), at para 11.24.

¹¹⁷ *Albazero* [1977] AC 774; *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85; *Darlington BC v Wiltshier Northern Ltd* [1995] 1 WLR 68.

¹¹⁸ Law Commission Report No 242 (cited above), at paras 11.14 and 14.1.

¹¹⁹ Law Commission Report No 242 (cited above), at paras 11.14 n13 and 14.1.

Contracts and Commercial Law Reform Committee, however, did not see the need for such a requirement because it could lead to unnecessary expense and possible problems as to service of the proceedings.¹²⁰ For similar reasons, the English Law Commission also rejected the approach adopted in Western Australia.¹²¹ We share the views of the Commissions in New Zealand and England, and believe that an additional rigid rule would increase costs. We further believe that the existing Rules of the High Court (Cap 4A) are flexible enough to facilitate the joinder of parties where it is desirable to do so.¹²² Besides, under the current law, parties to an action are free to decide whether to add another party to that action.

4.138 Lastly, the Hong Kong Bar Association wondered whether a third party should be able to recover from the promisee where the third party has obtained judgment against, or reached a compromise with, the promisor who, because of intervening insolvency, cannot satisfy his liability to the third party. We believe that in such circumstances, if the promisee is not under a pre-existing liability to the third party, the promisee should not be liable to the third party. Where the promisee is under a pre-existing liability to the third party, a third party's acceptance of the benefit under the contract would discharge his claim against the promisee only to the extent that the promisor fulfils his contractual obligation. In this case, the third party could still claim against the promisee in respect of the promisor's unfulfilled obligation, and this would be governed by the pre-existing contract between the promisee and the third party. We are thus of the view that no legislative provision is needed.

Discharge of promisor by performing obligation to the third party

4.139 None of the jurisdictions discussed in this report have specific provisions on this issue. The Law Commission believes that a promisor who performs his obligation, wholly or partly, to the third party should obtain discharge, to that extent, from his obligations to the promisee. The Law Commission nevertheless considers this to be self-evident and that a specific legislative provision on this principle is unnecessary.¹²³ We take the view, however, that this seemingly evident and sensible principle should be spelt out explicitly in the legislation for the avoidance of doubt. Some of those who responded to the Sub-committee's consultation paper, including the British Chamber of Commerce, share our view. We believe that this recommendation would address the concern of the Hong Kong Federation of Insurers that insurers may face the risk of double liability to both the insured and the third party, as where an employer takes out a group medical insurance policy for the benefit of his employees. The Federation also pointed out that insurers' administrative costs would be increased because of their need to handle claims from third parties under the recommended

¹²⁰ New Zealand Contracts and Commercial Law Reform Committee, Report on Privity of Contract (1981), at para 7.1.

¹²¹ Law Commission Report No 242 (cited above), at para 14.1.

¹²² Rules of the High Court (Cap 4A), Order 4, rule 9, Order 15, rule 4 and rule 6(2)(b) and Order 16, rule 1.

¹²³ Law Commission Report No 242 (cited above), at para 11.5.

legislation. This would be particularly onerous in circumstances such as group medical insurance where there are a large number of third parties. We note, however, that under some group medical insurance schemes, employees already claim against insurers directly under the existing arrangements.

Recommendation 12

We recommend that the recommended legislation should specifically provide that a promisor who performs his obligations, wholly or partly, to the third party will obtain discharge, to that extent, from his obligations to the promisee.

4.140 A related issue is the effect of a release by one third party on the promisor's obligation to other third parties. The English Law Commission concluded that this depended on whether the promise was intended to confer benefits on the third parties jointly or separately. A release given by one of the third parties should release the promisor's obligation to other third parties in the former case, but not in the latter.¹²⁴ We agree with the Law Commission that the issue should be dealt with according to the principles relating to releases in the case of "plurality of creditors" as discussed by Sir Guenter Treitel, and like the Law Commission we have concluded that specific legislative provisions are unnecessary.

Avoidance of double liability

4.141 A consequence of our recommendation to allow a promisee and the third party to enforce the contract is that the promisor may face double liability for the same loss. There are two situations where double liability for the same loss may arise.¹²⁵ The first is where a promisee sues the promisor for the third party's loss and recovers damages for that loss as an exception to the rule that promisees can only recover their own losses.¹²⁶ The promisee is then under a duty to account for the damages to the third party. If the promisee fails to do so, the third party may wish to sue the promisor who has already discharged his obligation by paying damages to the promisee. The second situation is where a promisee recovers damages from the promisor on the basis that the former will make good the latter's default to the third party. In this case, the damages recovered by the promisee represent his own loss, since he has accepted liability to the third party. If the promisee fails to make

¹²⁴ Law Commission Report No 242 (cited above), at para 11.9.

¹²⁵ Law Commission Report No 242 (cited above), at para 11.20. See also R Merkin, *Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999*, LLP, 2000, at paras 5.68–9; and G Treitel, *The Law of Contract* (cited above), at 665.

¹²⁶ *Albazero* [1977] AC 774; *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85; *Darlington BC v Wiltshier Northern Ltd* [1995] 1 WLR 68.

good the promisor's default, the third party can still claim for his own loss against the promisor who will then face double liability.

4.142 Of the jurisdictions studied in this report, only England and Singapore have provided for these situations. Section 5 of the 1999 Act (E & W) provides that if the promisee sues the promisor and:

"has recovered a sum in respect of – (a) the third party's loss in respect of the term; or (b) the expense to the promisee of making good to the third party the default of the promisor, then, in any proceedings brought in reliance on that section by the third party, the court or arbitral tribunal shall reduce any award to the third party to such extent as it thinks appropriate to take account of the sum recovered by the promisee".

In Singapore, there is an identical provision in section 6 of the 2001 Act (Sg). Since these provisions refer to the recovery of "a sum", they would not apply where a promisee has obtained specific performance against the promisor. Sir Guenter Treitel observes that in addition to the receipt of the performance, a third party can still claim damages from the promisor in respect of, for example, delay in rendering performance, since this would not make the promisor liable twice for the same loss.¹²⁷

4.143 In our view, if the proposed reform results in the promisor's owing a duty both to the third party and to the promisee, there is a possibility that the promisor may face a duplicity of claims for the same loss in the two situations discussed above. As to the first situation, there is a view that after paying damages to the promisee, the promisor would not be liable to the third party, since the promisee's duty to account means that the third party has no loss to recover from the promisor.¹²⁸ We believe that it would be prudent to put this beyond doubt and we therefore recommend an express provision to deal with the possible double liability in the two situations. Some commentators on the Sub-committee's consultation paper, including the British Chamber of Commerce, share our view. The Hong Kong Association of Banks suggested that there should be a specific provision under which a promisee was under a duty to account to the third party for the amount recovered by the promisee. However, we think that it should be for the courts and arbitral tribunals, rather than the legislature, to determine the circumstances under which a promisee may be under a duty to account to the third party for the sum that the promisee has recovered. The Law Commission also decided that it was best left to the courts to decide when a promisee was under a duty to do so.¹²⁹

4.144 The Hong Kong Federation of Insurers pointed out the possibility of a third party and the promisee suing the promisor at the same time in different jurisdictions, and wondered what the courts should do in such a case. We believe that in such circumstances the promisor can inform the court or

¹²⁷ G Treitel, *The Law of Contract* (cited above), at 666.

¹²⁸ Law Commission Report No 242 (cited above), at para 11.17.

¹²⁹ Law Commission Report No 242 (cited above), at para 11.22.

arbitral tribunal in each action so that appropriate account can be taken of the action in the other jurisdiction. In our opinion, there is no need to have a separate provision on this. The Federation further pointed out that policyholders and insurers often compromised claims. Under the current law, payment to the insured normally discharges the insurer's liability. Under the recommended legislation, a third party may think that he deserves more than the settled amount, and may claim against the insurer for the difference. We think that it should be left to the court or arbitral tribunal in the proceedings instigated by the third party to take account of any amount already agreed or recovered by the promisee. If that amount is regarded as reasonable by the court or arbitral tribunal, there may be cost implications for the third party. In addition, a compromise settlement between a promisor and the promisee may amount to a variation of the contract, and the validity of the settlement will depend on whether the third party's rights have crystallised or not. Contracting parties could not label a variation as a compromise.

4.145 The Commissioner of Insurance observed that most of the recommendations in the Sub-committee's consultation paper sought to enable a third party to be subrogated to the promisee's contractual rights. The Commissioner was also concerned that in the case of liability insurance policies, insurers might be exposed to a wide range of claimants which they might not have foreseen at the time of contracting. Another concern was that insurers' liability would be extended, which would translate into higher premiums to be borne by the community as a whole. We emphasise that the present reform does not seek to substitute a third party for the promisee. Subrogation is not the aim of the reform. A promisor owes a duty both to the promisee and to the third party (Recommendation 11). However, this does not mean that a promisor will be subject to double liability (Recommendations 12 and 13). In any event, even in the case of a liability insurance policy, an insurer (promisor) can always restrict the size of the category of third parties by name, as a class or as answering a particular description. In view of Recommendations 12 and 13, the total liability of an insurer would not increase.

4.146 For the sake of completeness, we have also considered the situation where a third party has recovered damages from the promisor first. The question is whether the promisor should be protected from double liability (ie liability to the promisee for the same loss). The Hong Kong Association of Banks proposed that, for the avoidance of doubt, there should be an express provision to that effect in the recommended legislation. We agree with the English Law Commission, however, that the promisee would then be left with no corresponding loss outstanding, and the promisor would not face double liability.¹³⁰ Hence, we do not think an express provision is necessary.

¹³⁰ Law Commission Report No 242 (cited above), at para 11.16.

Recommendation 13

We recommend that where a promisee has recovered substantial damages (or an agreed sum) representing the third party's loss or the promisee's expense in making good the promisor's default, the court or arbitral tribunal should in any subsequent proceedings by the third party reduce any award to the third party to the extent appropriate to take account of the amount already recovered by the promisee.

Should arbitration clauses and exclusive jurisdiction clauses be binding on third parties?

4.147 Contracting parties may include in their contract an arbitration clause which requires any dispute arising from the contract to be resolved only by arbitration, and an exclusive jurisdiction clause which specifies the jurisdiction for any action in relation to the contract. The question is whether these clauses should bind a third party. Of the jurisdictions discussed in this report, only England & Wales and Singapore have a statutory provision on arbitration clauses. None of these jurisdictions have provided for exclusive jurisdiction clauses.

England & Wales

4.148 Section 8(1) of the 1999 Act (E & W) provides that where a contractual term confers a benefit on a third party (the substantive term) and its enforcement is subject to a written arbitration clause, the third party will be treated as a party to that clause for the purposes of any dispute between the promisor and the third party relating to the enforcement of the substantive term. This subsection deals with the situation where contracting parties confer a benefit (including that of an exclusion clause) on a third party subject to disputes being referred to arbitration (see section 1(4)).¹³¹ This is based on a "conditional benefit" approach, and ensures that a third party who wants to enforce his substantive right is not only entitled to arbitration, but is also bound to enforce his right by arbitration (so that, for example, a stay of proceedings can be ordered against him under section 9 of the Arbitration Act 1996). The Explanatory Notes explain that the approach is analogous to that applied to assignees who may be prevented from unconscionably taking a substantive benefit free of its procedural burden. "*Disputes relating to the enforcement of the substantive term by the third party*" in section 8 is intended to have a wide ambit and to include disputes between the third party and the promisor as to the validity, interpretation, existence or performance of the

¹³¹ Explanatory Notes to Contracts (Rights of Third Parties) Act 1999, at para 34.

substantive term; the third party's entitlement to enforce the term; the jurisdiction of the arbitral tribunal; or the recognition and enforcement of an arbitration award.¹³² However, section 8(1) does not cover a separate dispute in relation to a tort claim by the promisor against the third party for damages, so as not to impose a "pure" burden on a third party.

4.149 Section 8(2) provides that where a third party can enforce under section 1 a contractual term providing for a dispute between the promisor and the third party to be submitted to arbitration (the arbitration agreement), the third party, if he so enforces, will be treated as a party to the arbitration agreement, if he is not so treated under section 8(1). Section 8(2) deals with situations where a third party is given a unilateral right to arbitrate under section 1 and the "conditional benefit" approach underpinning subsection (1) is inapplicable.¹³³ For instance, where a promisor seeks to bring a tort action against a third party which does not concern a right conferred on the third party under section 1, section 8(2) allows the third party to choose whether to stay the court proceedings and to have the dispute arbitrated instead, or to continue the court proceedings. This gives a third party the "pure" benefit of an arbitration clause.

Singapore

4.150 Section 9 of the 2001 Act (Sg) is almost identical to section 8 of the 1999 Act (E & W), and the above discussion is equally relevant.

Options and conclusions

4.151 In the following paragraphs, we will first deal with arbitration clauses, followed by exclusive jurisdiction clauses. We note that the Law Commission initially argued against conferring on third parties rights of enforceability in respect of arbitration agreements or jurisdiction agreements because these agreements impose burdens as well as conferring benefits. The Law Commission considered that this would contradict a central philosophy of its reform, which was to confer rights, but not impose burdens, on third parties.¹³⁴ However, the Law Commission changed its mind during the legislative process and the result is the present section 8 on arbitration agreements:

"while arbitration and exclusive jurisdiction clauses should be enforceable by third parties, those clauses cannot operate satisfactorily unless the entitlement to enforce also carries a duty on the third party to submit to arbitration or to comply with the jurisdiction agreement, as the case may be. But, as I said, the reform deals solely with conferring benefits on third parties, not with imposing duties or burdens on them. It would be

¹³² Explanatory Notes to Contracts (Rights of Third Parties) Act 1999, at para 34.

¹³³ Explanatory Notes to Contracts (Rights of Third Parties) Act 1999, at para 35.

¹³⁴ Law Commission Report No 242 (cited above), at para 14.18.

unsatisfactory, however, if the third party could take the benefit of a clause such as this, without being bound by it. ...on further reflection, the Law Commission concluded that in practice the third party would not be able to do so. The Law Commission concluded that, although in theory the third party might seek to rely on an arbitration clause to stay court proceedings without being bound to arbitrate, in practice no stay would be granted by the court unless he had shown willingness to go to arbitration. On that basis, the conclusion was that there was no good reason to exclude these clauses from the operation of the reform."¹³⁵

(i) *Arbitration agreements*

4.152 There are three options in respect of arbitration agreements. The first option is that arbitration agreements should apply to third parties, regardless of the parties' intention. The second option is that arbitration agreements should *not* apply to third parties. The third option is that an arbitration agreement should apply to a third party if it expressly covers the third party, but would otherwise not apply to him. In responding to the Subcommittee's consultation paper, the Hong Kong Association of Banks expressed its preference for the first option, and considered that an arbitration clause should apply to a third party in the same way as it applied to the contracting parties. The Association was concerned that if that were not the case, there would be some confusion of court and arbitration proceedings. We consider, however, that the first option would make arbitration agreements binding on third parties regardless of the circumstances. This would force third parties to arbitrate even if the contracting parties do not want to. Unlike the first option, the second option prevents arbitration agreements from applying to third parties, and may deprive third parties of the benefits of those agreements. We have concluded that the third option offers the more appropriate approach. Contracting parties should have the right to decide whether a third party should be bound by the dispute resolution clause, since it is they who confer benefits on the third party. As Anthony Diamond has pointed out, if the parties' intention is that the third party should enforce the right conferred on him by arbitration, the third party, in choosing to enforce the right, must do so by means of arbitration.¹³⁶ This is in line with the "conditional benefit" approach underpinning section 8 of the 1999 Act (E & W), without imposing burdens on third parties, and we believe strikes a fair balance.

4.153 Anthony Diamond has some doubts about the meaning of section 8(1) of the 1999 Act when it speaks of a right under section 1 being "*subject to a term providing for the submission of disputes to arbitration*":

"Does the subsection refer only to cases where the term conferring substantive rights on the third party is strictly

¹³⁵ Hansard HL, 11 Jan 1999, Cols 32-33.

¹³⁶ Anthony Diamond QC, "The Third Man: The 1999 Act Sets Back Separability?" (2001) 17 AR 211, at 213.

conditional upon the third party enforcing that term only by arbitration ('the conditional benefit theory') or does the subsection apply more broadly: for example, whenever the third party has a right under section 1 to enforce a term of the contract and another term of the contract contains an arbitration agreement?

There are two further general considerations to be borne in mind in construing section 8(1). The first is the general principle of the autonomy of the parties which underlies so much of the law and practice of arbitration. A party should not be bound to arbitrate unless he has agreed to do so and this consent should be real and not merely notional or hypothetical. This consideration might be thought to suggest that the third party should only be bound to arbitrate if the term conferring substantive rights upon him is strictly conditional.

*The second consideration may, however, point in the direction of a broader approach to the words 'subject to' in section 8(1). This is section 1(4), which provides as follows: '[Section 1] does not confer a right on a third party to enforce a term of a contract otherwise than subject to and in accordance with any other relevant terms of the contract.'*¹³⁷

4.154 It is arguable that Mr Justice Colman adopted the broader approach in *Nisshin Shipping Co Ltd v Cleaves & Co Ltd*.¹³⁸ In that case, the broker on behalf of the owner negotiated charters, each providing for payment of commission to the broker and containing an arbitration clause. The arbitration clauses referred to the disputes between "*the parties to the charterparty*" or between "*Owner and Charterer*", and the wording was wide enough to cover the charterers' claims against the owner for his commission to the broker. The broker claimed the commission directly against the owner. Mr Justice Colman highlighted the explanation in the Explanatory Notes that the approach in section 8(1) was analogous to that applied to assignees. He emphasized that the explanation was directed to the words "*a right under section 1... is subject to an arbitration agreement*" in section 8. The broker, a third party, was not expressed to be a party to the arbitration clauses but had become a statutory assignee of the charterers' right of action against the owner. Under section 1(4), the broker was confined to the means of enforcement provided by the contract to the charterers, namely arbitration, and the broker was treated as standing in the shoes of the charterers for the purpose of the enforcement. Mr Justice Colman went on to say:

"Thus although the wording of sub-section (1)(a) – 'is subject to a term' – is capable of having a range of possible meanings, one of those meanings is that which I have described and, having regard to the further words of the sub-section, entirely reflects

¹³⁷ Anthony Diamond QC, "The Third Man: The 1999 Act Sets Back Separability?" (2001) 17 AR 211.

¹³⁸ [2003] EWHC 2602, paras 38 and 42.

the assignment analogy referred to in the Explanatory Notes."

4.155 We are not obliged to follow Mr Justice Colman's conclusion, however, and are free to formulate the most appropriate policy. We consider that the advantages of the "conditional benefit theory" are three-fold. Firstly, this would be in line with the third option we recommended above. Secondly, the onus would be on contracting parties to spell out expressly in the contract that the third party is to enforce his rights by arbitration. This would avoid doubt and argument. Thirdly, the approach is consistent with the principle that no burden (conditional benefit in this case) should be imposed on a third party without his consent. We see no disadvantages in adopting the "conditional benefit theory". On the other hand, the only advantage in adopting the broader approach is that a third party would still be bound by the arbitration clause even if the contracting parties forget to express their wish in the contract. In order to avoid the interpretation problem pointed out by Anthony Diamond, the recommended legislation should have the effect that a third party is not obliged to enforce his rights by arbitration, unless the contracting parties spell it out expressly in the contract. In its response to the Sub-committee's consultation paper, the British Chamber of Commerce wondered whether the effect would be that contracting parties could exclude a third party from their arbitration agreement. In our opinion, given that the spirit of the present reform is to give effect to the contracting parties' intention, they should be able to decide whether or not the third party would be bound by the arbitration agreement. According to section 2AC of the Arbitration Ordinance (Cap 341), an arbitration agreement is not an arbitration agreement for the purposes of the ordinance unless it is in writing. We therefore recommend that an arbitration agreement between contracting parties should only bind the third party if it is in writing.

4.156 We are aware that Professor Robert Merkin has identified three problems with section 8 in respect of the effect of treating a third party as a party to the arbitration agreement.¹³⁹ Firstly, it is unclear whether the section makes a third party part of the arbitration in substitution for, or in addition to, the promisee. The second question is whether a promisee and a third party have separate or common rights in relation to the arbitration, such as the right to appoint an arbitrator. Finally, the 1999 Act may not have the effect of consolidating arbitration proceedings or allowing all disputes among a promisor, promisee and third party to be resolved in a single set of proceedings unless all the parties so wish. Anthony Diamond also notes that a third party is to be treated as a party to the arbitration clause only "*as regards disputes between himself and the promisor relating to the enforcement of the substantive term by the third party*" under section 8. As a result, if the promisor has a counterclaim against the third party, whether in tort or for breach of another contract, he cannot bring that counterclaim in the arbitration commenced by the third party unless with the third party's consent.

4.157 We have considered whether section 8 should be fine-tuned or clarified to meet these concerns. We believe that section 6B of the

¹³⁹ R Merkin, *Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999*, LLP, 2000, at paras 5.118 to 5.120.

Arbitration Ordinance (Cap 341) should to some extent answer the problems. Section 6B(1) empowers the court to, *inter alia*, consolidate or hear at the same time or consecutively two or more arbitration proceedings on such terms as it thinks just where there are common questions of law or fact, the rights to the relief claimed arise out of the same transaction, or for other reasons it is desirable to do so. Subsections (2) and (3) provide for the appointment of arbitrators or umpires for the proceedings and other incidental matters. The limitation of section 6B is that it can only be invoked where there are two or more arbitration proceedings. If a promisor's counterclaim is not the subject matter of another arbitration proceedings, section 6B will not apply. We are of the view that it is unnecessary and impossible to provide in the recommended legislation for all eventualities. There is no global solution and each case has to be decided on its own facts. We conclude that section 8 of the 1999 Act strikes an appropriate balance, and recommend adopting section 8(1) as the default position: a third party is to be treated as a party to the arbitration clause only "*as regards disputes between himself and the promisor relating to the enforcement of the substantive term by the third party*", subject to the contracting parties' contrary intention. Section 8(2) deals with the rare situation where a third party is given a unilateral right to arbitrate under section 1 and the "conditional benefit" approach underpinning subsection (1) is inapplicable.¹⁴⁰ We do not see any strong reasons for providing for such situations.

Recommendation 14

We recommend that:

- (a) where (but only where) a contractual term conferring substantive rights on a third party is conditional upon the third party enforcing that term by arbitration, and**
- (b) the arbitration agreement is an agreement in writing for the purposes of the Arbitration Ordinance (Cap 341),**

the third party should be treated for the purposes of that Ordinance as a party to the arbitration agreement as regards disputes between himself and the promisor relating to the enforcement of the substantive right by the third party, subject to the contracting parties' contrary intention.

(ii) Exclusive jurisdiction clauses

4.158 None of the jurisdictions discussed in this report have provided specifically for exclusive jurisdiction clauses. Although the Law Commission has changed its mind concerning arbitration clauses, the 1999 Act is silent

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Explanatory Notes to Contracts (Rights of Third Parties) Act 1999, at para 35.

about exclusive jurisdiction clauses. The reasons for this are not known. In the opinion of some academics, it is arguable that the 1999 Act already covers exclusive jurisdiction clauses. Neil Andrews is of the view that the Explanatory Notes to Contracts (Rights of Third Parties) Act 1999 clearly assume that the Act covers such clauses:¹⁴¹

"The question of whether a third party given a procedural right to enforce a jurisdiction agreement under section 1 of this Act falls within Article 17 [of the Brussels Convention (on jurisdiction agreements)], or whether a third party with a substantive right under section 1, subject to a jurisdiction clause, is 'bound' by that clause under Article 17 (applying a conditional benefit analysis) is a matter for the European Court of Justice."¹⁴²

Professor Robert Merkin believes that even in the absence of an express provision, it would appear to be the intention of Parliament to allow a third party to rely upon an exclusive jurisdiction clause by reason of its status as a conditional benefit.¹⁴³ Catharine MacMillan thinks that exclusive jurisdiction clauses may be included within the 1999 Act, but "*the current position ... is less than happy*".¹⁴⁴ Commenting on the Sub-committee's consultation paper, the British Chamber of Commerce suggested that exclusive jurisdiction clauses should bind third parties, save and except where the contracting parties had indicated a contrary intention. The Hong Kong Association of Banks observed that an exclusive jurisdiction clause should apply to a third party in the same way as it applied to the contracting parties. The Association was concerned that if that were not the case, there would be a mismatch between court and arbitration proceedings. We agree that it is undesirable to leave the issue open. After considering the responses to the consultation paper, we have concluded that our earlier recommendation on arbitration clauses should apply analogously to exclusive jurisdiction clauses. In other words, if contracting parties want the third party to enforce the right conferred on him in a particular jurisdiction, the parties should be free to impose such a "condition". The third party, if he chooses to enforce the right, must do so in that jurisdiction. We are aware of the concern that a remote and totally unrelated jurisdiction may be chosen so as to deter enforcement. We believe that in this case, the court could step in by invoking its overriding discretion to ignore the jurisdiction clause.

Recommendation 15

We recommend that where a contractual term conferring substantive rights on a third party is conditional upon the

¹⁴¹ Neil Andrews, "Strangers to Justice No Longer: The Reversal of the Privity Rule under the Contracts (Rights of Third Parties) Act 1999", (2001) 60 CLJ 353, at 375.

¹⁴² *Explanatory Notes to Contracts (Rights of Third Parties) Act 1999*, at para 32.

¹⁴³ R Merkin, *Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999*, LLP, 2000, at para 5.124.

¹⁴⁴ Catherine MacMillan, "A Birthday Present for Lord Denning: The Contracts (Rights of Third Parties) Act 1999", (2000) 63 MLR 721, at 733.

third party enforcing that term in a specified jurisdiction, the third party should be treated as a party to the exclusive jurisdiction clause as regards disputes between himself and the promisor relating to the enforcement of the substantive rights by the third party, subject to the contracting parties' contrary intention.

What should the scope of the present reform be?

4.159 There are two main issues under this heading. The first is whether the existing rights of third parties should be preserved. The second issue is whether there are areas to which the recommended legislation should not apply. We also discuss some miscellaneous issues relating to the new legislative scheme.

Preservation of existing rights of third parties

4.160 Under the existing common law rules and statutory provisions, a third party may in certain circumstances already be able to enforce his rights against the promisor. The question is what the interrelationship should be between these existing rights and those a third party might obtain under the recommended legislation.

4.161 According to section 55(7) of the 1974 Act (QInd), nothing in the section affects any right or remedy which exists or is available apart from the section. There is an equivalent provision in section 56(7) of the 2000 Act (NT), but not in the 1969 Act (WA).

4.162 Section 7(1) of the 1999 Act (E & W) also provides that section 1 does not affect any right or remedy of a third party that exists or is available apart from the Act. According to Professor Andrew Burrows, it was not part of the Law Commission's intention to place third parties in a worse position than they had been.¹⁴⁵ Sir Guenter Treitel believes that there are four possibilities resulting from section 7(1).¹⁴⁶ Firstly, where a third party has rights under the Act but none at common law or under other statutes, his remedies are confined to the Act. Secondly, where a third party has no rights under the Act, but has some rights according to some existing common law or statutory rules, those rights would not be affected by the Act. A third possibility is that where a third party has rights both under the Act and according to existing common law or statutory rules, he could choose between making his claim under the Act or under those existing rules. Finally, if a third party has no rights under the Act or any existing rules, his only hope is to persuade the court to circumvent the privity doctrine by creating a new rule. The Law Commission made it clear that its

¹⁴⁵ Andrew Burrows, "The Contracts (Rights of Third Parties) Act 1999 and Its Implications for Commercial Contracts", [2000] LMCLQ 540, at 549.

¹⁴⁶ G Treitel, *The Law of Contract* (cited above), at 663.

recommendations should not hamper judicial development of third party rights.¹⁴⁷

4.163 The 1982 Act (NZ) puts it beyond doubt that nothing in the Act limits or affects any right or remedy which exists or is available apart from the Act (section 14(1)(a)), and it does not limit or affect, in particular, the law of agency and the law of trusts (section 14(1)(d) and (e)). Hence the law on, for instance, assignment, agency, trusts, covenants running with land, promisees' remedies and actions in tort still applies irrespective of the Act.¹⁴⁸

4.164 *Conclusion* - The main reason for reforming the privity doctrine is to give effect to the contracting parties' intention to benefit a third party. That is to say, the objective of the reform is to confer rights on a third party rather than to derogate from them. Thus, the existing rights of a third party under statute and at common law should not be affected by the present reform. We agree that the recommended legislation should be understood as a general and wide-ranging exception to the privity doctrine, without abolishing it.¹⁴⁹ We therefore think that there is no valid reason not to preserve existing statutory and common law rules. Our consultation paper proposed that nothing in the recommended legislation should affect any right or remedy of a third party that exists or is available apart from the legislation (Recommendation 16). A number of consultees, including the Hong Kong Bar Association, supported this recommendation. The British Chamber of Commerce suggested, however, that for the sake of certainty, as in the case of the New Zealand legislation, specific areas of law which would not be affected by the recommended legislation should be set out in that legislation. We believe that the above recommendation, which is general in nature, should already cover those specific areas, and there is therefore no need to set them out in the legislation.

4.165 The Hong Kong Federation of Insurers commented that the recommended legislation should not impair the effect of section 64C of the Insurance Companies Ordinance (Cap 41). That section provides that no life insurance contract should be entered into unless the name of the beneficiary is specified, or the class or description of beneficiaries is stated in the contract with "*sufficient particularity*" to make it possible to establish the identity of the beneficiaries.¹⁵⁰ We must emphasise that the recommended legislation does not conflict with that section since the rights given to a third party under our proposals are in addition to his rights under the existing law.

¹⁴⁷ Law Commission Report No 242 (cited above), at para 5.11.

¹⁴⁸ Burrows, Finn & Todd, *Law of Contract in New Zealand*, 2nd Edition, 2000, at 523.

¹⁴⁹ Law Commission Report No 242 (cited above), at para 13.2.

¹⁵⁰ Section 64C reads as follows:

"(1) Subject to subsections (3) and (4), no contract of insurance shall be entered into on the life of any person or other event without inserting in the contract the name of the person-

(a) interested in the life or event; or

(b) for whose use or benefit or on whose account the contract is entered into.

(2) A contract of insurance entered into in contravention of subsection (1) is void by reason of that contravention.

(3) Subsections (1) and (2) shall not invalidate a contract of insurance for the benefit of unnamed persons from time to time falling within a specified class or description if the class or description is stated in the contract with sufficient particularity to make it possible to establish the identity of all persons who at any given time are entitled to benefit under the contract."

4.166 A related issue is whether the recommended legislation should leave room for judicial development alongside the legislation so as not to hamper the development of third party rights in deserving cases which do not fall within the recommended legislation or other existing rules which have the effect of circumventing the privity doctrine. Catharine MacMillan is of the view that while the 1999 Act may provide for the possibility of further judicial development of third party rights, the House of Lords may not be keen to do so. Her analysis is that, since the Act has provided a means to confer benefits on third parties, if contracting parties choose not to employ it, the House of Lords can justifiably assume that the contracting parties do not wish to confer benefits on third parties.¹⁵¹ In Neil Andrews' opinion, it is unlikely that the courts would create further exceptions alongside the 1999 Act, bearing in mind that they have had ample opportunity to allow third parties to sue and yet they have not done so. He also observes that if the courts were to create other exceptions in parallel to the Act, it would be likely to lead to confusion:

"The House [of Lords] delegated to the legislature the task of changing the privity rule. Jack Beatson has correctly observed that the judges perceived the privity rule as too tough a nut to crack: 'Our senior judges have consistently taken the view that this matter is not appropriate for judicial activity because of a sensitive and ... entirely proper understanding of the respective creative roles of the courts and the legislature.'

It would be odd if the House of Lords now found it possible to carve out a doctrine of third party rights which will operate in parallel to the statutory scheme. Furthermore, the result would be untidy, even chaotic: a legislative regime conferring rights on third parties in accordance with a precise scheme of rules, with complex controls and limitations; co-existing with this, a malleable judicial doctrine allowing the same relief for the benefit of third parties, but ex hypothesi wider and more pliable than the legislative scheme. At first, the judicial doctrine would be used circumspectly to fill gaps in the legislative scheme. But soon the pressure exerted by litigants would cause it to usurp the legislative scheme. This would create a profound tension in the law and uncertainty."¹⁵²

The Hong Kong Association of Banks agreed with the academics' views in responding to the Sub-committee's consultation paper. After considering the academics' opinions, we still find it desirable to leave room for judicial development alongside the recommended legislation so that effect can be given to the parties' intention of conferring benefits on third parties in cases which are not caught by the recommended legislation or other existing rules.

¹⁵¹ Catherine MacMillan, "A Birthday Present for Lord Denning: The Contracts (Rights of Third Parties) Act 1999", (2000) 63 MLR 721, at 730-731.

¹⁵² Neil Andrews, "Strangers to Justice No Longer: The Reversal of the Privity Rule under the Contracts (Rights of Third Parties) Act 1999" [2001] CLJ 353, at 379.

4.167 The Judiciary Administrator pointed out that Recommendation 16 in the consultation paper would result in some areas of law being governed by two parallel regimes (statutory and common law) and that this could give rise to much confusion and uncertainty. The consultation paper also recommended disapplying the legislation to certain specific areas of law (Recommendations 17 and 18).¹⁵³ The Administrator believed that individual areas of law should be specifically examined before either subjecting them to two parallel regimes, or excluding them from the scope of the recommended legislation.¹⁵⁴ The Judiciary Administrator suggested two other alternatives: (a) abrogating existing common law and statutory principles which allow third parties to enforce rights in the light of the recommended legislation; (b) formulating a new principle to allow third parties to enforce rights in the light of the general philosophy behind the recommended legislation and the peculiar nature of the area of law in question.

4.168 We have carefully considered the Judiciary Administrator's comments. We do not favour adopting either of the two alternatives suggested by the Administrator since each would tamper with existing common law and statutory principles which allow third parties to enforce rights. As to the suggestion that the impact of the reform on each individual area of law should be assessed, after careful deliberation we have decided to maintain our approach of disapplying the recommended legislation to certain areas of law for the reasons set out in the following paragraphs, and subjecting the remaining areas to two parallel regimes. We have attempted to assess the impact of the reform on the specific areas of law referred to by the Administrator. We have looked, for example, at the effect of the reforms on the building management regime, in particular section 16 of the Building Management Ordinance (Cap 344), and are of the view that the impact of the reform would be small. We do not think it is possible to foresee all eventualities, or how the reform would affect every area of law. More importantly, in our judgment, the present reform would have only minimal impact on the remaining areas of law. The legislation would in any case allow contracting parties to specifically exclude the application of the legislation if they wished to do so.

¹⁵³ These areas of law are bills of exchange, contracts for the carriage of goods by sea or by air, contracts under section 23 of the Companies Ordinance (Cap 32) and employment contracts.

¹⁵⁴ The Judiciary Administrator suggested a non-exhaustive list of areas of law:

- (a) Building Management Ordinance (Cap. 344);
- (b) Conveyancing and Property Ordinance (Cap. 219) and land matters in general (leases, mortgages, government leases, assignment, privity of estate);
- (c) Employment Compensation Ordinance (Cap. 282) (rights against insurers);
- (d) Housing Ordinance (Cap. 283) (rights of family members under housing tenancies);
- (e) insurance (motor etc);
- (f) Motor Vehicles Insurance (Third Party Risks) Ordinance (Cap. 272);
- (g) Third Parties (Rights against Insurers) Ordinance (Cap. 273);
- (h) copyright and other intellectual property rights;
- (i) pension (government and private) (rights of family members);
- (j) administration of trusts and estates (including Trustee Ordinance (Cap. 29));
- (k) Probate and Administration Ordinance (Cap. 10)
- (l) Trusts.

Recommendation 16

We recommend that nothing in the recommended legislation should affect any right or remedy of a third party that exists or is available apart from the recommended legislation.

Areas to which the recommended legislation should not apply

4.169 The main concern is whether allowing third parties to claim a right of enforceability under the recommended legislation would contradict or prejudice the underlying policies of any areas of law. In England, the 1999 Act does not apply to the following specified areas:

- (a) contracts on bills of exchange, promissory notes or other negotiable instruments;
- (b) contracts under section 14 of the Companies Act 1985;
- (c) terms in contracts of employment that enable a third party to sue an employee, or in a worker's contract to sue a worker, or in a relevant contract to sue an agency worker;
- (d) terms that enable a third party to sue upon contracts for the carriage of goods by sea; and
- (e) terms that enable a third party to sue upon contracts for the carriage of goods by air.¹⁵⁵

The 2001 Act in Singapore has equivalent provisions (section 7). Section 14(1) of the 1982 Act in New Zealand also provides that the Act does not limit or affect:

- (a) the Contracts Enforcement Act 1956 or any other enactment that requires any contract to be in writing or to be evidenced by writing; or
- (b) section 49A of the Property Law Act 1952 (requiring that interest in land can only be created or disposed of by writing).

4.170 We have identified two categories of contract to which the recommended legislation should not apply. The first is where a third party already has an enforceable right under existing rules reflecting international conventions. The second category is where a third party has no rights of enforceability under existing rules, but where there are sound policy reasons for maintaining that position. Some commentators on the Sub-committee's consultation paper, including the British Chamber of Commerce, agreed that these two categories of contracts should be excluded. There are four types

¹⁵⁵ Mance LJ observed in *Western Digital Corporation and others v British Airways plc* [2001] QB 733 (at 752) that the reason for such exclusion might be that the extent to which third parties were entitled to take such benefit was expressly governed by the Warsaw Convention.

of contract which fall within the first category, and the reasons for excluding them are set out below.

4.171 (a) *Bills of exchange, promissory notes or other negotiable instruments* - These contracts have their own regime and only certain third parties are given rights of enforceability under the Bills of Exchange Ordinance (Cap 19). In our opinion, this separate regime should be preserved to avoid uncertainty and undermining the underlying policy of Cap 19. The Hong Kong Association of Banks suggested that cheques should also be excluded from the recommended legislation. However, since a cheque is a bill of exchange¹⁵⁶, we believe that there is no need to mention cheques separately. The Association also commented that the phrase "*other negotiable instrument*" in Recommendation 17 of the consultation paper would mean that for a bill of exchange or promissory note to be excluded, it would need to be negotiable. However, not all bills of exchange and promissory notes are negotiable in the sense that they are transferable without being subject to defects in title. They may nevertheless be transferable, subject to defects in title. The Association suggested that bills of exchange, and promissory notes, whether or not negotiable, should be excluded from the recommended legislation. Our understanding is that a negotiable instrument can be transferred by delivery and endorsement to a *bona fide* purchaser for value in such circumstances that he takes free from defects in the title of prior parties. Nonetheless, the term "negotiable instrument" is not always used in this strict sense. It can be used to mean any instrument embodying a monetary obligation and transferable by endorsement and delivery, regardless of its capability of being transferred free from equities.¹⁵⁷ It is this second sense which we have adopted. The recommendation in the consultation paper already covers the suggestion made by the Hong Kong Association of Banks. We agree, however, that it may be prudent to put beyond doubt the fact that bills of exchange and promissory notes, negotiable or not, are to be excluded from the recommended legislation.

4.172 (b) *Contracts for the carriage of goods by sea contained in a bill of lading, sea waybill or ship's delivery order* - Under section 5 of the Bills of Lading and Analogous Shipping Documents Ordinance (Cap 440), the liabilities (such as the freight) are also transferred to a third party (such as a holder of a bill of lading). A carrier (promisor) can sue the third party for the freight, and the carrier can use the freight both as a shield and a sword. Under the recommended legislation, by contrast, the liabilities would not be transferred to a third party. The promisor (carrier) would not be able to sue the third party for the freight. If, however, the third party sues the promisor, his claim would be subject to the set-off in respect of the freight. The promisor can only use the freight as a shield but not as a sword. Another difference between Cap 440 and the recommended legislation is that under Cap 440 a shipper (promisee) will have no rights of enforcement against the carrier. However, under the recommended legislation, the carrier would be liable to both the promisee and the third party. The provisions in Cap 440

¹⁵⁶ Section 73 (1) of the Bills of Exchange Ordinance (Cap 19).

¹⁵⁷ Goode, *Commercial Law*, 2004 3rd Edition, at 49 n164 and 477 n11.

are tailored to the particular needs of the shipping industry, and in order not to undermine the policy which underlies that Ordinance, there is a need to exclude it from the recommended legislation's ambit. Nonetheless, as Cap 440 is not concerned with enforceability of exclusion or limitation clauses, there is no clash of policy between Cap 440 and the recommended legislation. This being so, a third party should be allowed to rely on the recommended legislation to enforce an exclusion or limitation clause in this type of contract.¹⁵⁸

4.173 (c) *Carriage of goods by air* - Contracts for the carriage of goods by air are governed by international conventions given force in Hong Kong by the Carriage By Air Ordinance (Cap 500). A third party acquiring rights under Cap 500 to enforce an international contract of carriage takes also the burdens under the contract,¹⁵⁹ but our proposed reform is not intended to impose burdens on a third party. Because of this clash of policies, such types of contract should also be excluded from the recommended legislation. We notice that Article 25A of the amended Warsaw Convention (Schedule 1, Cap 500)¹⁶⁰ enables servants or agents (but not other third parties, such as independent contractors) to avail themselves of an exclusion or limitation clause, but all types of third parties are covered by the recommended legislation. In this case, the recommended legislation would deviate from the amended Warsaw Convention. Hence, unlike the case of carriage of goods by sea, the enforcement by a third party of an exclusion or limitation clause should be excluded from the recommended legislation in the case of carriage of goods by air.

4.174 (d) *Letters of credit* - The Hong Kong Association of Banks suggested that letters of credit should also be excluded from the recommended legislation. We note that a letter of credit is not a negotiable instrument, and is therefore not covered by Recommendation 17. The purpose of a letter of credit is to benefit a third party (usually a seller) who can enforce it. Letters of credit have their own regime. Sir Roy Goode has summarised the issue as follows:

¹⁵⁸ The policy of Cap 440 is to confine the enforcement of contracts of carriage to certain third parties only (such as subsequent holders of a bill of lading or persons entitled to delivery under a sea waybill or a ship's delivery order). By contrast, under the recommended legislation, other third parties (such as servants, agents and independent contractors engaged in the loading and unloading process) are given rights to enforce such contracts. An exclusion or limitation clause may be invoked by these "other third parties".

¹⁵⁹ Under Article 14 of the amended Warsaw Convention (Sch 1 of Cap 500), a consignee can enforce all the rights given him by Article 13, in his own name, whether he is acting in his own interest or in the interest of another, provided that he carries out the obligations imposed by the contract. According to Article 13, a consignee is entitled, on arrival of the cargo at the place of destination, to require the carrier to hand over to him the air waybill and to deliver the cargo to him, on payment of the charges due and on complying with the conditions of carriage set out in the air waybill.

¹⁶⁰ "(1) *If an action is brought against a servant or agent of the carrier arising out of damage to which this Convention relates, such servant or agent, if he proves that he acted within the scope of his employment, shall be entitled to avail himself of the limits of liability which that carrier himself is entitled to invoke under Article 22.*"

"The problem is to reconcile the binding nature of the bank's undertaking with traditional concepts of general law, which deny legal effect to a simple promise unless consideration is furnished by the promisee, producing a contract, or the promisee is induced to act in reliance on the promise, generating some form of estoppel. The difficulty created by the undertaking embodied in an irrevocable letter of credit is that it appears to be binding on IB [the issuing bank], and enforceable by S [the seller], despite the fact that S has furnished no consideration for IB's promise and, indeed, may not have taken steps to act upon it nor even have signified his assent to its terms. The same applies to AB's [the affirming bank] confirmation. How, then, can the bank concerned become bound to the beneficiary solely by virtue of the issue of the letter of credit to him?"

Various ingenious theories have been advanced designed to accommodate the binding nature of the bank's undertaking within the framework of traditional contract law. All of these fall to the ground because, in an endeavour to produce an acceptable theoretical solution, they distort the character of the transaction and predicate facts and intentions at variance with what is in practice done and intended by the parties. The defects in these various theories show the undesirability of trying to force all commercial instruments and devices into a strait-jacket of traditional rules of law. Professor Ellinger has rightly argued that the letter of credit should be treated as a sui generis instrument embodying a promise which by mercantile usage is enforceable without consideration. Professor Kozolchyk takes the description a stage further, treating a letter of credit as a new type of mercantile currency embodying an abstract promise of payment, which, like the bill of exchange, possesses a high, though not total, immunity from attack on the ground of breach of duty of S to B [the buyer]."¹⁶¹

We agree with the Hong Kong Association of Banks that letters of credit are *sui generis*. The regime also reflects international conventions and should not be tampered with lightly. The regime should therefore be specifically excluded from the recommended legislation.

Recommendation 17

We recommend that a third party should not have any rights under the recommended legislation in respect of:

- (a) a bill of exchange or promissory note, whether negotiable or not;**
- (b) a contract for the carriage of goods by sea governed**

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Goode, *Commercial Law*, 2004 3rd Edition, at 970-971.

by the Bills of Lading and Analogous Shipping Documents Ordinance (Cap 440), except that a third party should be able to enforce an exclusion or limitation clause in such a contract;

(c) a contract for the carriage of goods by air governed by the Carriage by Air Ordinance (Cap 500); and

(d) a letter of credit.

The recommended legislation should not affect existing rights in respect of (a) to (d) above.

4.175 The second category of contract to which the recommended legislation should not apply is where a third party has no rights of enforceability under existing rules and there are sound policy reasons for maintaining that position. There are two types of contract which fall within this category.

4.176 (a) *Contracts under section 23 of the Companies Ordinance (Cap 32)* - Section 23 creates a contract between a company and its members. It is not intended that the contract should confer rights upon third parties. There is a consistent body of case law on this.¹⁶²

4.177 (b) *Contracts of employment, etc* - This covers the situation in which an employer and an employee enter into a contract and the employee is seconded to work for a third party. It would be unfair to the employee if the third party (on whom the benefit of the employment contract is conferred) could sue on the contract. We think it would be undesirable for the present reform to jeopardise the position of an employee in an employment contract.

4.178 In responding to the Sub-committee's consultation paper, the Hong Kong Society of Accountants observed that there might be other types of contract which should be excluded from the recommended legislation, and suggested giving the courts discretion to exclude such types of contract as the courts might think appropriate, or alternatively, publishing the types of contract to be excluded in legislation or the Government Gazette from time to time. In response, we do not believe that the courts are the proper forum to legislate, nor is it desirable to identify the types of contract to be excluded in a piecemeal manner.

Recommendation 18

We recommend that the recommended legislation should confer no right on a third party to enforce (a) any term of a contract binding on a company and its members under

¹⁶² R Merkin, *Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999*, LLP, 2000, at para 5.109, n134.

section 23 of the Companies Ordinance (Cap 32); and (b) any term of a contract of employment against an employee.

4.179 A number of consultees suggested excluding certain types of contracts or sectors from the recommended legislation. Among them was the Hong Kong Construction Association Ltd, which proposed disapplying the new regime to the construction industry for the following reasons.

- (a) The industry is suffering from a significantly reduced level of workload in both the public and private sectors, and the unemployment rate in the industry is high. The unemployment situation may even worsen.
- (b) The contractual framework for any construction project is complex, and may involve many stakeholders.¹⁶³ In such a complex situation, there would be lengthy deliberations at every level in order to specifically list the third parties, or class of third parties, to be benefited. This would give rise to uncertainty and confusion.
- (c) Apart from these contractual chains, there are collateral warranties between stakeholders who have no direct contractual relationships. This should address, to a certain extent, the anomalies of the privity doctrine.
- (d) The standard sale and purchase agreement could be amended to the effect that a developer would no longer be able to carry out a development by a one-project vehicle, or to limit its liability to purchasers to a one-year period, and the developer would assign the benefits of the main contractor's obligations to purchasers.
- (e) Where a contractor has carried out defective work, that contractor must be liable for the work. The question was how best to ensure that there is a proper right of recourse against that contractor without unduly complicating the already complex web of contractual relationships.
- (f) If the experience of the 1999 Act (E & W) is any guide, most parties to building contracts would be likely to contract out of the recommended legislation. Where some building contracts contract out and some do not, there would be confusion. Only one standard form of contract in England has not contracted out. It took two years to amend the form so as to decide which third parties or classes of third parties should specifically benefit under the main contract, and in turn main contractors had

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(a) developer and onward purchasers or tenants (and possibly further purchasers or tenants) up the lines; (b) developer and funding institutions; (c) developer and architect or engineer; (d) developer and contractor; (e) contractor and sub-contractors; (f) contractor and architect or engineer; (g) architect or engineer and sub-consultants; (h) main contractor and insurance companies; (i) sub-Contractors and sub-sub-contractors, and so on.

similarly to consider the position under the other agreements in which they were involved.

- (g) The contractual framework of the industry, developed over the last thirty years, generally works well. To apply the recommended legislation to the industry would be a retrograde step, and would cause confusion, uncertainty and chaos. The industry does not need the reform.

4.180 We have carefully considered the Association's concerns and arguments, but do not see any strong reasons for excluding the industry from the ambit of the recommended legislation. We have the following responses:

- (a) The decision whether or not to apply the legislation to the construction industry should not depend on what may well be transient market conditions, but should be based on the merits of the case. The enactment of any legislation is a measured process, and there is every likelihood that conditions in the construction industry may have changed by the time the recommended legislation is introduced.
- (b) We do not think that the task of benefiting third parties, or a class of third parties, is as daunting as suggested.
- (c) The Law Commission had compared its proposals with collateral warranties used in the construction industry and concluded that its proposals were more advantageous and convenient.¹⁶⁴ We share that view. The Law Commission considered:
- Its proposals would enable contracting parties to incorporate the terms in collateral warranties into their existing contracts without the inconvenience and burden of drafting and entering separate contracts.
 - A collateral warranty, once executed, can only be varied with the consent of the third party purchaser, tenant or finance house. Under the Commission's proposals, however, contracting parties can vary or rescind the contract without the third party's consent unless his right has crystallised.
 - In order that purchasers and tenants down the line can benefit from collateral warranties, the benefits of the warranties would need to be assigned to them. This is not necessary under the Commission's proposals, as these third parties could simply be identified as a class or as answering a particular description.
- (d) Even if the Association's suggestions can be implemented, this would only deal with the problems that third party purchasers and tenants are facing, but not the third party rule itself. Our proposals address the anomalies of the third party rule at large.

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Law Commission Report No 242 (cited above), at paras 3.10 to 3.23.

- (e) Contracting parties should be able to expressly benefit third parties without unduly complicating their contractual relationships.
- (f) The recommended legislation allows contracting parties to contract out of the legislation, though we hope that market forces would discourage them from doing so. We do not believe that the possibility of exposure to third parties' claims should have any insurance premium implications.
- (g) The anomalies of the privity doctrine are apparent in the construction industry. We share the Law Commission's view that, apart from removing those anomalies, the industry would benefit in other ways from the reform.¹⁶⁵
 - The present reform would allow a main contractor to include in the contract with the employer exclusion clauses for his own benefit as well as that of sub-contractors.
 - Under the existing law, a sub-contractor cannot sue the employer directly for payment if the main contractor does not pay the sub-contractor. The present reform would allow the parties to provide for payment direct by an employer to the sub-contractor, and enable the sub-contractor to sue the employer for payment once the work is performed.

4.181 At a meeting with the Sub-committee, the Association presented the consolidated views of the Association itself, the Hong Kong Federation of Electrical & Mechanical Contractors, the Hong Kong Institute of Surveyors, the Hong Kong Institute of Architects and the Association of Consulting Engineers. The consolidated views reiterated the Association's earlier written response to the consultation paper. The Association took the opportunity to highlight their main concern that in the wake of the reform, purchasers might need to face multi-party court or arbitration proceedings. Under the existing law, purchasers could only claim against developers. Under the new law, a purchaser might also be able to claim against contractors, sub-contractors and others, but would first need to decide which party to sue. It might not be possible to decide whether the breach was caused by the design or the workmanship. To play safe, the purchaser would need to sue both the architect and the contractor. The contractor would then join in its sub-contractors. The result would be multi-party proceedings. The possibility of third party actions would create uncertainty for contractors and sub-contractors. The Association was also concerned that contractors had weak bargaining power vis-a-vis developers in respect of contracting out of the legislation. All in all, the reform would not only create problems for the construction sector, but would also not be in the consumers' interests.

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Law Commission Report No 242 (cited above), at paras 3.20 to 3.21.

4.182 We have carefully considered the Association's concern that the proposed reforms would prompt multi-party proceedings. In our opinion, the question is whether, after balancing the interests of contractors and of purchasers, purchasers should have the right to sue as a matter of principle. Under the current law, contractors are not liable to purchasers directly. By paying the purchase price, a purchaser pays the contractor indirectly (through the developer) for the construction work up to a specified standard. It would seem unfair to the purchaser if the contractor were not to assume any responsibility for defects or sub-standard materials used in the development. There is no valid reason why the purchaser should not be given the benefits of any warranty given by the contractor to the developer. On balance, we believe that purchasers' interests should prevail, and it is appropriate to allow contracting parties to enable third parties (purchasers) to enforce their contracts. It seems to us that it is only irresponsible contractors who will be adversely affected by this change in the law. There may be an increase in insurance premiums, but we still believe that the changes are to the overall benefit of purchasers.

4.183 The Hong Kong Federation of Insurers also proposed that the recommended legislation should not apply to insurance contracts for the following reasons.

- (a) Insured parties have the duty of utmost good faith. This duty is unique to insurance contracts. If third parties are not subject to this duty, it would be unfair to insurance companies. Where an insured event involves illegal activities on the part of the insured, or is brought about by him, it would be unfair to the insurance company if the third party could still benefit from the policy.
- (b) In life insurance contracts, insured parties can change the beneficiaries from time to time. The Federation was concerned about the degree of flexibility in respect of the crystallisation of third parties' rights.
- (c) The problem of an insured party's rights to change beneficiaries is particularly acute where there are conflicting claims by the insured party's wife representing his estate and by his mistresses, either as third party beneficiaries or as beneficiaries taking the place of the wife. This is partly due to the private nature of the beneficiary designation.
- (d) There is already protection for third party beneficiaries under life insurance contracts. Under Section 13 of the Married Persons Status Ordinance (Cap 182), if a life insurance contract confers a benefit on the spouse or child of the insured, a statutory trust is implied in favour of the beneficiary who can enforce his interest against the insurance company. The money payable under the policy will not form part of the estate of the insured or be subject to his debts.
- (e) Insurers may face complicated situations after the proposed reform. Where several insurance policies cover the same accident or liability, there may be double or multiple indemnities

under the policies as a consequence of the recommended legislation.

- (f) An insurance contract is different from other types of contracts. It has its own underlying policies with measures to protect third parties' interests. An insurance contract is special in that it is a contract of utmost good faith, a contract for payment made on the happening of certain events and subject to certain conditions precedent. Applying the recommended legislation to insurance contracts would create uncertainties as it would change the law fundamentally. If the recommended legislation is to apply to insurance contracts, contracting parties should be able to contract out of the legislation.

4.184 After carefully considering the Federation's concerns and arguments, we are of the view that:

- (a) Under Recommendation 10, a promisor (an insurer) can avail himself of any defence or set-off relevant to the term being enforced by the third party that arises from, or is in connection with, the contract and would have been available to the promisor if the proceedings had been brought by the promisee (the insured). Where a promisee has breached a contractual term (such as the duty of utmost good faith), the promisor would have a defence. The defence would still be available in an action brought by the third party under the recommended legislation.
- (b) The crystallisation of third parties' rights will still be governed by the tests of "assent" and "reliance" in Recommendation 6.
- (c) The recommended legislation would not affect the current practice of changing beneficiaries in insurance contracts.
- (d) Section 13 of Cap 182 only applies to a policy of assurance or endowment expressed to be for the benefit of, or by its express terms purporting to confer a benefit upon, the wife, husband or child of the insured (section 13(1)). The section would not cover other types of insurance policies, let alone other types of contracts.
- (e) Both "double insurance"¹⁶⁶ and "over-insurance"¹⁶⁷ are lawful at common law. An insured can insure with as many insurers as he wishes and up to the full amount of his interests with each of them. An insured can claim against any one or more insurers the total amount of loss, subject to a *pro rata* contribution clause. This is already the case under the existing law.

We have considered the special features of insurance contracts referred to by the Federation, but we do not think there is any convincing reason to exempt

¹⁶⁶ Double insurance occurs when an insured insures the same risk on the same interest in the same property with two or more insurers.

¹⁶⁷ Over-insurance occurs when the aggregate of all the insurances is greater than the total value of the insured's interest.

insurance contracts from the recommended legislation. As discussed, contracting parties can always contract out of the legislation.

4.185 Finally, the Judiciary Administrator wondered whether contracts made by the government or other public bodies for the benefit of the general public or a section of the public should be given special attention. He raised the question as to whether the public could sue on the contracts as third parties, or could sue a utility company with which the government had entered into a contract for the provision of a service or utility to the public. Similarly, can a family member of a government tenant sue on the tenancy agreement? Contracts made by private or charitable bodies or institutions with a "public" element may be in a similar position. After considering the points raised by the Judiciary Administrator, we have concluded that such contracts do not need to be excluded as the recommended legislation already enables contracting parties to tailor their contracts to fit their needs. To invoke the legislation, a third party has to satisfy one of two enforceability tests (Recommendation 4). The third party must also be identified by name, as a member of a class or as answering a particular description in the contract (Recommendation 3). Contracting parties can vary or rescind the contract (Recommendations 6 and 7). In any event, contracting parties can contract out of the legislation, and the legislation would not affect contracts made before its commencement.

Miscellaneous issues

4.186 There are four incidental issues: the limitation period, third parties not to be treated as contracting parties for other enactments, the commencement date of the recommended legislation and the choice of law. We believe that the limitation period for an action brought by a third party should be the same as that which would have applied if the third party had been a contracting party. In response to the Sub-committee's consultation paper, the British Chamber of Commerce proposed that a six-year time limit and a twelve-year time limit should be adopted for "*actions founded on simple contract*" or "*actions upon a specialty*" respectively. As the Limitation Ordinance (Cap 347) governs limitation of actions, we believe that it is more appropriate to adopt the terms used in that Ordinance. We recommend that it should be made clear that actions brought by third parties under the recommended legislation should be treated as "*actions founded on simple contract*" or "*actions upon a specialty*" under section 4(1)(a) and section 4(3) of the Limitation Ordinance (Cap 347) respectively.

Recommendation 19

We recommend that actions brought by third parties under the recommended legislation should be treated as "*actions founded on simple contract*" or "*actions upon a specialty*" under section 4(1)(a) and section 4(3) of the Limitation Ordinance (Cap 347) respectively.

4.187 Section 7(4) of the 1999 Act (E & W) provides that a third party will not be treated as a party to the contract for the purposes of other statutory provisions merely because of the reference to treating him as if he were a party to the contract in section 1(5) (in respect of remedies available to third parties) as well as sections 3(4) and (6) (in respect of defences, etc, available to promisors). The present reform is not intended to have the effect of treating a third party as a party to the contract for all purposes. We agree with section 7(4) of the 1999 Act that a third party should not be treated as a contracting party for the purposes of other statutory provisions simply because of the reference to treating him as if he were such a party in certain specified situations. Nonetheless, as pointed out in the Sub-committee's consultation paper, a third party's rights under the recommended legislation should be assignable in the same way as a contracting party's rights under the contract. The British Chamber of Commerce disagreed, however, and observed that contracting parties might contemplate that only the third party would benefit from the promise. The Chamber suggested that a third party's right should be assignable only where the contract had made a specific provision for this.

4.188 The English Law Commission was of the view that a third party's right under the 1999 Act was closely analogous to a contractual right, and standard common law contractual principles should in general apply to it. The Law Commission recommended that a third party's right should be assignable in the same way as a contracting party's rights under the contract.¹⁶⁸ We think that there are three possible approaches. Firstly, a third party's rights should not be assignable. Secondly, a third party's rights should be assignable unless the parties have expressly agreed otherwise or circumstances at the time of contracting indicate that the benefit to the third party is personal to him and is not intended to be assignable. Thirdly, a third party's right should be assignable only where the contract has specifically provided for it. We are of the view that the second option is the most appropriate, since a third party's right, as the Law Commission pointed out, is closely analogous to a contractual right. Under general contract law, contracting parties can assign their contractual rights unless the contract provides otherwise or the circumstances indicate otherwise.

4.189 Where a third party has assigned his right to another person, there are two other related questions. The first question is whether it would be a third party's action or an assignee's that would crystallise the rights under Recommendation 6. Secondly, where contracting parties, by an express provision added before crystallisation, have reserved the right to rescind or vary the contract or have set their own criteria or tests for crystallisation of third parties' rights under Recommendation 7, should the contracting parties bring that provision to the third party's notice, or to the assignee's? In our opinion, it is natural and logical that these two questions should depend on whether contracting parties have been notified of the assignment. If the contracting parties have been notified of the assignment,

¹⁶⁸ Law Commission Report No 242 (cited above), at para 14.6.

they should bring that provision to the notice of the assignee, and the assignee's action would crystallise his rights. By contrast, if the contracting parties have not been notified of the assignment, they should bring that provision to the notice of the third party, and the third party's action would crystallise the rights.

Recommendation 20

We recommend that a third party should not be treated as a party to the contract for the purposes of other statutory provisions merely because of the reference to treating him as if he were a party to the contract in some provisions in the recommended legislation.

Recommendation 21

We recommend that a third party's rights should be assignable unless the parties have expressly agreed otherwise or circumstances at the time of contracting indicate that the benefit to the third party is personal to him and is not intended to be assignable.

4.190 Our consensus is that the recommended legislation should not have retrospective effect. We understand that the present reform would affect a number of professions specifically and also the public at large. There should be a reasonable period between the enactment and commencement of the recommended legislation so as to ensure public awareness of the provisions.

4.191 According to section 13A of the 1982 Act (NZ), the Act does not apply to any promise which is not governed by New Zealand law. Under Hong Kong law, where a contract is governed by a foreign law, disputes arising from the contract would be determined according to that foreign law.¹⁶⁹ The standard choice of law rules determine whether a foreign law governs the contract (or its relevant provision). Where a third party seeks to rely, under the recommended legislation, on an exclusion clause in a contract to which he is not a party in an action of tort, the exclusion clause needs to be valid according to both the choice of law rules for contract and those for tort. The British Chamber of Commerce suggested that there should be a specific provision on this for the sake of certainty. We are, however, of the view that the existing common law rules should be sufficient, and there is no need to have specific provisions on these issues.

¹⁶⁹ L Collins (ed), *Dicey and Morris on the Conflict of Laws*, 13th Edition, Sweet and Maxwell, 2000 at paras 32-003 and 32-007. See also the 11th Edition, 1987, at 1162.

Chapter 5

Summary of recommendations

5.1 We recommend reform of the general rule that only the parties to a contract may enforce rights thereunder, but not the complete abolition of the rule. (*Recommendation 1*)

5.2 We recommend that a clear and straightforward legislative scheme (the "recommended legislation") be enacted whereby, subject to the manifest intentions of the parties to an agreement, the parties can confer legally enforceable rights or benefits on a third party under that agreement. (*Recommendation 2*)

5.3 We recommend that a third party should be expressly identified by name, as a member of a class or as answering a particular description. It should be possible to confer rights on a third party who was not in existence at the time of contracting. (*Recommendation 3*)

5.4 We recommend that a third party should be able to enforce a contractual term if:

- (a) the contract expressly provides that he may; or
- (b) the term purports to confer a benefit on him unless on a proper construction, the parties did not intend the term to be enforceable by him;

and where a contractual term excludes or limits liability, references to the third party's enforcement of the term should be regarded as references to his availing himself of the exclusion or limitation. (*Recommendation 4*)

5.5 We recommend that:

- (a) a third party's right to enforce a contractual term should be subject to, and in accordance with, other relevant terms of the contract; and
- (b) in enforcing the promisor's duty, a third party should be entitled to any remedy that would have been available to him in an action for breach of contract if he had been a party to the contract (and the rules relating to damages, injunctions, specific performance and other relief should apply accordingly). (*Recommendation 5*)

5.6 We recommend that the contracting parties' right to vary or rescind their contract by agreement should come to an end once:

- (a) the third party has communicated to the promisor his assent by word or conduct to the provision conferring benefit on him, or
- (b) the third party has relied on that provision and the promisor

- (i) is aware of that reliance, or
- (ii) could reasonably be expected to have foreseen that the third party would so rely.

An assent sent to the promisor is not to be regarded as communicated to the promisor until received by him. (*Recommendation 6*)

5.7 We recommend that the contracting parties should be allowed by an express provision added before crystallisation:

- (a) to reserve the right to rescind or vary the contract unilaterally or bilaterally without the third party's consent; and
- (b) to set their own criteria or tests for determining when and how their rights to vary or rescind their contract will end (ie when and how the third party rights will crystallise),

provided that the provision would not be enforceable against the third party unless he knew of the existence of that provision, or reasonable steps have been taken to bring it to his notice, before his rights are crystallised. (*Recommendation 7*)

5.8 We recommend that the court should be given a wide discretion to authorise variation or rescission of the contract without the consent of the third party upon the application of any of the contracting parties where it is just and practicable to do so. Although the application may be made by a single party to the contract, the other contracting party would need to have consented to the variation. In authorising variation or rescission, the court may impose such conditions as it thinks fit, including compensation to a third party. (*Recommendation 8*)

5.9 We recommend that the recommended legislation should expressly provide that, as against the promisor, the third party can be a volunteer, provided the promisee has given consideration for the contract. (*Recommendation 9*)

5.10 We recommend that

- (a) a promisor can avail himself of any defence or set-off that
 - (i) arises from, or in connection with, the contract and is relevant to the term being enforced by the third party; and
 - (ii) would have been available to him if the proceedings had been brought by the promisee, subject to any express contractual term that expands or restricts the scope of defences or set-offs;
- (b) a promisor can avail himself of any defence, set-off or counterclaim (not arising from the contract) that would have been available to him if the third party had been a party to the contract, subject to any express contractual term that restricts the scope of defences, set-offs or counterclaims; and
- (c) where in any proceedings brought against him a third party seeks to enforce a term of a contract (including, in particular, a term purporting to exclude or limit liability) under the recommended legislation, he may not do so

if he could not have done so (whether or not by reason of any particular circumstances relating to him) had he been a party to the contract. *(Recommendation 10)*

5.11 We recommend that a third party's rights under the recommended legislation should not affect any right of the promisee to enforce any term of the contract. *(Recommendation 11)*

5.12 We recommend that the recommended legislation should specifically provide that a promisor who performs his obligations, wholly or partly, to the third party will obtain discharge, to that extent, from his obligations to the promisee. *(Recommendation 12)*

5.13 We recommend that where a promisee has recovered substantial damages (or an agreed sum) representing the third party's loss or the promisee's expense in making good the promisor's default, the court or arbitral tribunal should in any subsequent proceedings by the third party reduce any award to the third party to the extent appropriate to take account of the amount already recovered by the promisee. *(Recommendation 13)*

5.14 We recommend that:

(a) where (but only where) a contractual term conferring substantive rights on a third party is conditional upon the third party enforcing that term by arbitration, and

(b) the arbitration agreement is an agreement in writing for the purposes of the Arbitration Ordinance (Cap 341),

the third party should be treated for the purposes of that Ordinance as a party to the arbitration agreement as regards disputes between himself and the promisor relating to the enforcement of the substantive right by the third party, subject to the contracting parties' contrary intention. *(Recommendation 14)*

5.15 We recommend that where a contractual term conferring substantive rights on a third party is conditional upon the third party enforcing that term in a specified jurisdiction, the third party should be treated as a party to the exclusive jurisdiction clause as regards disputes between himself and the promisor relating to the enforcement of the substantive rights by the third party, subject to the contracting parties' contrary intention. *(Recommendation 15)*

5.16 We recommend that nothing in the recommended legislation should affect any right or remedy of a third party that exists or is available apart from the recommended legislation. *(Recommendation 16)*

5.17 We recommend that a third party should not have any rights under the recommended legislation in respect of:

(a) a bill of exchange or promissory note, whether negotiable or not;

(b) a contract for the carriage of goods by sea governed by the Bills of

Lading and Analogous Shipping Documents Ordinance (Cap 440), except that a third party should be able to enforce an exclusion or limitation clause in such a contract;

(c) a contract for the carriage of goods by air governed by the Carriage by Air Ordinance (Cap 500); and

(d) a letter of credit.

The recommended legislation should not affect existing rights in respect of (a) to (d) above. (*Recommendation 17*)

5.18 We recommend that the recommended legislation should confer no right on a third party to enforce (a) any term of a contract binding on a company and its members under section 23 of the Companies Ordinance (Cap 32); and (b) any term of a contract of employment against an employee. (*Recommendation 18*)

5.19 We recommend that actions brought by third parties under the recommended legislation should be treated as "actions founded on simple contract" or "actions upon a specialty" under section 4(1)(a) and section 4(3) of the Limitation Ordinance (Cap 347) respectively. (*Recommendation 19*)

5.20 We recommend that a third party should not be treated as a party to the contract for the purposes of other statutory provisions merely because of the reference to treating him as if he were a party to the contract in some provisions in the recommended legislation. (*Recommendation 20*)

5.21 We recommend that a third party's rights should be assignable unless the parties have expressly agreed otherwise or circumstances at the time of contracting indicate that the benefit to the third party is personal to him and is not intended to be assignable. (*Recommendation 21*)

List of those who responded to the consultation paper

1. Actuarial Society of Hong Kong
2. Australian Chamber of Commerce
3. Professor Hugh Beale
4. Richard Bobb
5. British Chamber of Commerce
6. Director of Administration
7. Duty Lawyer Service
8. Cheung Kam Chuen
9. The Chinese General Chamber of Commerce
10. City University of Hong Kong, Department of Accountancy
11. City University of Hong Kong, School of Law
12. Commerce and Industry Bureau
13. Commissioner of Insurance
14. Consumer Council
15. The Hong Kong Association of Banks
16. Hong Kong Bar Association
17. Hong Kong Confederation of Insurance Brokers
18. The Hong Kong Construction Association Ltd
19. The Hong Kong Federation of Insurers
20. Hong Kong Federation of Women Lawyers
21. Hong Kong International Arbitration Centre
22. Hong Kong Society of Accountants
23. Housing, Planning and Lands Bureau
24. Insurance Claims Complaints Bureau
25. Judiciary Administrator
26. The Law Society of Hong Kong
27. Legal Aid Department
28. Lingnan University
29. Motor Insurers' Bureau of Hong Kong
30. Norwegian Chamber of Commerce
31. Professional Insurance Brokers Association Limited
32. Stephenson Harwood & Lo

Comparison table of the rules on reforming the privity doctrine

(This table tabulates the current rules in the legislative schemes reforming the privity doctrine in Australia, Canada, England and Wales, New Zealand and Singapore.)

	Australia			Canada	England and Wales (the 1999 Act)	New Zealand (the 1982 Act)	Singapore (the 2001 Act)
	Queensland (the 1974 Act)	Northern Territory (the 2000 Act)	Western Australia (the 1969 Act)	New Brunswick (1993 Act)			
Who is a third party (TP)?	<ul style="list-style-type: none"> person other than the promisor (p'or) and promisee (p'ee); includes a person who at the time of acceptance is identified and in existence, albeit not having been identified or in existence at the time when the promise was given; "acceptance" is defined (s 55(6)) 	same as Queensland (s56(6))	person not named as a party to the contract (s11(2))	any person, not being a party to a contract, is identified by or under the contract as being benefited (s 4(1))	<ul style="list-style-type: none"> expressly identified in the contract by name, as a member of a class or as answering a particular description; need not be in existence when the contract is entered into (s1(3)) 	<ul style="list-style-type: none"> designated by name, description, or reference to a class; not a party to the contract (whether or not in existence at the time when contract is made) (s 4) 	same as England (s2(3))
What is the test of enforceability?	<ul style="list-style-type: none"> a promise (a) which is or appears to be intended to be legally binding; and (b) which creates or appears 	same as Queensland but a promise is a promise in writing (s56(6); s56(3)(b-d) and s56(3)(a))	<ul style="list-style-type: none"> contract expressly purports to confer a benefit directly on TP (s11(2)); 	a person, not being a party to a contract, who is identified by or under the contract as being intended to receive some performance or	<ul style="list-style-type: none"> (a) contract expressly provides that TP may enforce the contract; or (b) contractual term purports to confer a benefit on 	<ul style="list-style-type: none"> contract confers, or purports to confer, a benefit on B, subject to parties' intention on a proper construction of the 	same as England (s2(1),(2)(4) to (6))

	Australia			Canada	England and Wales	New Zealand	Singapore
	Queensland (the 1974 Act)	Northern Territory (the 2000 Act)	Western Australia (the 1969 Act)	New Brunswick (1993 Act)	(the 1999 Act)	(the 1982 Act)	(the 2001 Act)
	<p>to be intended to create a duty enforceable by a beneficiary ("B");</p> <ul style="list-style-type: none"> whether made by deed, or in writing, or, orally, or party in writing and partly orally (s55(6)); <p>consequences:</p> <ul style="list-style-type: none"> upon acceptance, B is bound by the promise and subject to the duties in the promise (s55(3)(b-d)); remedies to B: as may be just and convenient for the enforcement (s55(3)(a)) 		<p>consequences:</p> <ul style="list-style-type: none"> p'or can enforce against TP obligations imposed on TP (s11(2)(c)) 	<p>forbearance under it may enforce that performance or forbearance, unless the contract provides otherwise (s 4(1))</p>	<p>TP, subject to parties' intention on a proper construction of the contract (s1(1)-(2));</p> <p>consequences:</p> <ul style="list-style-type: none"> TP's enforcement of the promise is subject to other relevant terms of the contract (s1(4)); remedies available to TP as if he had been a party to the contract (s1(5)); <p>where a contract term excludes or limits liability, references to TP's enforcement of the term = references to his availing himself of the exclusion or limitation (s1(6))</p>	<p>contract (s4);</p> <p>consequences:</p> <ul style="list-style-type: none"> remedies available to B as if he were a party to the contract (s8) 	
Can contracting parties vary or rescind the contract?	<p>prior to acceptance, parties may, without the consent of B, vary or discharge the promise s55(2)</p>	<p>same as Queensland s56(2)</p>	<p>parties can, with mutual consent, cancel or modify the contract before TP has adopted it either expressly or by conduct (s11(3))</p>	<p>NA</p>	<ul style="list-style-type: none"> parties cannot rescind or vary the contract where <p>(a) TP has communicated his assent to the p'or;</p> <p>(b) p'or aware that TP has relied on the contractual term,</p>	<p>parties cannot vary or discharge the promise where</p> <p>(a) B's position has been materially altered by his or another's reliance on the promise (whether or not B or that</p>	<p>same as England (whether or not TP knows the precise terms of the promise) (s3(1))</p>

	Australia			Canada	England and Wales	New Zealand	Singapore
	Queensland (the 1974 Act)	Northern Territory (the 2000 Act)	Western Australia (the 1969 Act)	New Brunswick (1993 Act)	(the 1999 Act)	(the 1982 Act)	(the 2001 Act)
					<p>or</p> <p>(c) p'or can reasonably be expected to have foreseen that TP would rely on the term and TP has in fact relied on it (s2(1));</p> <ul style="list-style-type: none"> • "assent" can be by words or conduct; postal rule not applicable (s2(2)) 	<p>another knows the precise terms of the promise); or</p> <p>(b) B has obtained against p'or judgment or an arbitrator's award on the promise (s5)</p>	
Can contracting parties vary or rescind the contract after crystallisation, or lay down their own crystallisation test?	NA	NA	NA	<p>parties may amend or terminate the contract at any time, but where, by doing so, they cause loss to the third party who has incurred expenses or undertaken an obligation in the expectation that the contract would be performed, the third party may recover the loss from any party to the contract who knew or ought to have known that the expenses would be or had been incurred or that the obligation would be or had been undertaken (s4(3)): except expenses</p>	<p>parties may expressly provide that:</p> <p>(a) they can, by agreement, rescind or vary the contract without TP's consent;</p> <p>(b) TP's consent to rescission or variation is required in circumstances other than those specified in the Act (s2(3))</p>	<p>if the contract expressly provides that parties can vary or discharge a contract and B knows of the provision before materially altering his position in reliance on the promise, any contracting party can do so according to that provision (s6)</p>	<p>same as England (s3(3))</p>

	Australia			Canada	England and Wales (the 1999 Act)	New Zealand (the 1982 Act)	Singapore (the 2001 Act)
	Queensland (the 1974 Act)	Northern Territory (the 2000 Act)	Western Australia (the 1969 Act)	New Brunswick (1993 Act)			
				incurred or obligation undertaken before the commencement of the provision (s4(4))			
Should there be any judicial discretion to authorise variation or cancellation?	NA	NA	NA	NA	<ul style="list-style-type: none"> the court may, upon the parties' application, dispense with TP's consent¹ where his consent cannot be obtained because his whereabouts cannot reasonably be ascertained, or where he is mentally incapable of giving his consent (s2(4)); where consent is required under s2(1)(c), the court may dispense with the consent if the consent cannot reasonably be ascertained whether or not there is TP's reliance (s2(5)); the court can impose such conditions, including compensation to TP, as it thinks fit 	<ul style="list-style-type: none"> where variation or discharge of a promise is precluded² or it is uncertain whether the variation or discharge is so precluded, the court may, on either party's application, authorise the variation or discharge, if it is just and practicable to do so (s7(1)); where B has suffered damage as a result of the reliance upon the promise, the court shall impose a condition that p'or is to compensate B (s7(2)) 	same as England (s3(4)-(6))

¹ required under this section

² under s5(1)(a), because the beneficiary's position has been materially altered (because of his or another person's reliance)

	Australia			Canada	England and Wales (the 1999 Act)	New Zealand (the 1982 Act)	Singapore (the 2001 Act)
	Queensland (the 1974 Act)	Northern Territory (the 2000 Act)	Western Australia (the 1969 Act)	New Brunswick (1993 Act)			
					(s2(6)); <ul style="list-style-type: none"> arbitral tribunals have the same discretion 		
Should consideration be an issue?	<ul style="list-style-type: none"> for a valuable consideration moving from the p'ee, p'or is under a duty to perform the promise (s55(1)); relief to B shall not be refused solely because, as against p'or, B is a volunteer (s55(3)(a)) 	same as Queensland (s56(1) & (3)(a))	NA ³	NA	NA. The Law Commission believes that no separate provision is needed.	relief to B will not be refused solely because, as against p'or, B is a volunteer (s8)	s2(5)
What defences, set-offs and counterclaims should be available to promisors?	subject to the parties' intention, any matter which in proceedings not brought under s55: (a) would render a promise void, voidable or unenforceable, whether wholly or in part; or (b) is available by way of defence to enforcement of a promissory	same as Queensland (s56(4))	all defences that would have been available to p'or had TP in an action to enforce the contract been named as a party to it, will be so available to the p'or (s11(2)(a))	any defence that could have been raised in proceedings between the contracting parties (s4(2))	<ul style="list-style-type: none"> defence or set-off, arising from or in connection with the contract as well as relevant to the term enforced, that would have been available to p'or had the proceedings been brought by p'ee(s3(2)); parties can agree to broaden the scope of defences and set-offs available to 	<ul style="list-style-type: none"> by way of defences, counterclaims, set-offs, any matter which would have been available (a) if B had been a party to the contract; or (b) if (i) B were the p'ee; and (ii) the promise had been made for the p'ee's benefit; and (iii)	same as England (s4) and (s8(2))

³ In *Westralian Farmers Co-op Ltd v Southern Meat Packers Ltd* [1981] WAR 241, the court rejected the promisor's defence that the third party had not provided consideration for the benefit.

	Australia			Canada	England and Wales	New Zealand	Singapore
	Queensland (the 1974 Act)	Northern Territory (the 2000 Act)	Western Australia (the 1969 Act)	New Brunswick (1993 Act)	(the 1999 Act)	(the 1982 Act)	(the 2001 Act)
	duty arising from a promise would, in like manner and to the like extent, render the promise void, voidable or unenforceable, or be available as defence to p'or under s55 (s55(4))				<ul style="list-style-type: none"> p'or(s3(3)); p'or can raise defences, set-offs and counterclaims (only those not arising from the contract) that are specific to TP only(s3(4)); defences, set-offs and counterclaims can be narrowed down by an express term in the contract (s3(5)); TP cannot enforce an exclusion clause if he could not have done so had he been a party to the contract (s3(6)); s2(2) of the Unfair Contract Terms Act not apply (s7(2)) 	<p>the proceedings had been brought by the p'ee (s9(2));</p> <ul style="list-style-type: none"> subject-matter of the set-off or counterclaim should arise out of or in connection with the contract (s9(3)); B not liable on a counterclaim, unless he has full knowledge of the counterclaim, and the counterclaim should not exceed the value of the benefit conferred on him (s9(4)) 	
How should overlapping claims against promisors be dealt with?	any right or remedy which exists or is available apart from s55 is not affected (s55(7))	same as Queensland (s56(7))	each party of the contract to be joined as a party to the action brought by TP (s11(2)(b))	NA	<ul style="list-style-type: none"> the fact that TP been given rights does not affect the p'ee's rights to enforce the contract (s4); if p'ee recovered from p'or a sum representing (a) TP's loss in respect of the term; or (b) 	any right or remedy which exists or is available apart from this Act is not affected (s14(1)(a))	same as England (s5 and s6)

	Australia			Canada	England and Wales	New Zealand	Singapore
	Queensland (the 1974 Act)	Northern Territory (the 2000 Act)	Western Australia (the 1969 Act)	New Brunswick (1993 Act)	(the 1999 Act)	(the 1982 Act)	(the 2001 Act)
					the expense to the p'ee of making good to the TP the p'or default; the court or arbitral tribunal shall in any subsequent proceedings by TP reduce an award to him so as to take account of the amount already recovered by the p'ee (s5)		
Should arbitration clauses and exclusive jurisdiction clauses be binding on third parties?	NA	NA	NA	NA	<ul style="list-style-type: none"> • where a contract term confers a benefit on TP (the substantive term) and the enforcement of it is subject to a written arbitration clause, TP be treated as a party to that clause as regards the dispute between p'or and TP relating to the enforcement of the substantive term (s8(1)); • where TP can enforce under s1 a contract term providing for the dispute between p'or and him to be submitted to 	NA	same as England (s9)

	Australia			Canada	England and Wales (the 1999 Act)	New Zealand (the 1982 Act)	Singapore (the 2001 Act)
	Queensland (the 1974 Act)	Northern Territory (the 2000 Act)	Western Australia (the 1969 Act)	New Brunswick (1993 Act)			
					arbitration (the Agreement), TP, if he so enforces, will be treated as a party to the Agreement, provided that he is not so treated under s8(1) s8(2))		
What should the scope of the present reform be?	TP's existing rights are preserved (s55(7))	same as Queensland (s56(7))	NA	NA	<ul style="list-style-type: none"> any right or remedy of TP that exists or is available apart from the Act is not affected (s7(1)); the Act does not apply to various areas⁴ (s6) 	the Act does not limit or affect: <ul style="list-style-type: none"> (a) any right or remedy of B that exists or is available apart from the Act; (b) the law of agency and law of trusts; (c) Contracts Enforcement Act 1956 or any other enactment that requires any contract to be in writing or to be evidenced by writing; or (d) s49A of the Property Law Act 1952 (requiring that interest in land can only be 	same as England (s8 (1) & s7)

⁴ (a) contracts on bills of exchange, promissory notes or other negotiable instruments; (b) contracts under section 14 of the Companies Act 1985; (c) terms in contracts of employment that enable a third party to sue an employee, or in a worker's contract to sue a worker, or in a relevant contract against an agency worker; (d) terms that enable a third party to sue upon contracts for the carriage of goods by sea; and (e) terms that enable a third party to sue upon contracts for the carriage of goods by air, road and rail.

	Australia			Canada	England and Wales (the 1999 Act)	New Zealand (the 1982 Act)	Singapore (the 2001 Act)
	Queensland (the 1974 Act)	Northern Territory (the 2000 Act)	Western Australia (the 1969 Act)	New Brunswick (1993 Act)			
						created or disposed of by writing) (s14)	
Miscellaneous issues	NA	NA	NA	NA	<ul style="list-style-type: none"> • action brought by TP is within s5 and s8 of the Limitation Act 1980 (s7(3)); • TP not to be treated as a party to the contract for other enactments (s7(4)) 	the Act does not apply to any promise not governed by New Zealand law (s13A)	same as England (s8 (3) and (4))

Legislation in other jurisdictions

Australia

Northern Territory Law of Property Act 2000

56. Contracts for the benefit of third parties

(1) A promisor who, for valuable consideration moving from the promisee, promises to do or to refrain from doing an act or acts for the benefit of a beneficiary is, on acceptance by the beneficiary, subject to a duty enforceable by the beneficiary to perform that promise.

(2) Prior to acceptance by a beneficiary referred to in subsection (1), the promisor and promisee may, without the consent of the beneficiary, vary or discharge the terms of the promise and any duty arising from it.

(3) On acceptance by a beneficiary referred to in subsection (1) –

- (a) the beneficiary is entitled in the beneficiary's own name to the remedies and relief that are just and convenient for the enforcement of the duty of the promisor and relief by way of specific performance, injunction or otherwise is not to be refused only on the ground that, as against the promisor, the beneficiary may be a volunteer;
- (b) the beneficiary is bound by the promise and subject to a duty enforceable against the beneficiary in the beneficiary's own name to do or refrain from doing any act that is required of the beneficiary by the terms of the promise;
- (c) the promisor is entitled to the remedies and relief that are just and convenient for the enforcement of the duty of the beneficiary; and
- (d) the terms of the promise and the duty of the promisor or the beneficiary may be varied or discharged with the consent of the promisor and the beneficiary.

(4) Subject to subsection (1), a matter that, in proceedings not brought in reliance on this section –

- (a) would render a promise void, voidable or unenforceable, whether wholly or in part; or
- (b) is available by way of defence to enforce a promissory duty arising from a promise,

renders the promise void, voidable or unenforceable or is available by way of defence to enforce the promissory duty in like manner and to the like extent as if

in proceedings for the enforcement of a duty to which this section gives effect.

(5) To the extent that a duty to which this section gives effect may be capable of creating and creates an interest in land, the interest is, subject to section 11, capable of being created and of subsisting in land under an Act (but subject to that Act).

(6) In this section –

"acceptance" means an assent by words or conduct communicated by or on behalf of the beneficiary to the promisor, or to some person authorised on the promisor's behalf, in the manner (if any) and within the time specified in the promise or, if no time is specified, within a reasonable time of the promise coming to the notice of the beneficiary;

"beneficiary" means a person who is not the promisor or promisee and includes a person who, at the time of acceptance of a promise is identified and in existence although that person may not have been identified or in existence when the promise was made or given;

"promise" means a promise in writing that –

- (a) is or appears to be intended to be legally binding; and
- (b) creates or appears to be intended to create a duty enforceable by a beneficiary;

"promisee" means a person to whom a promise is made or given;

"promisor" means a person by whom a promise is made or given.

(7) Nothing in this section affects any right or remedy that exists or is available apart from this section.

(8) This section applies only to promises made after the commencement of this Act.

**Queensland
Property Law Act 1974**

55 Contracts for the benefit of third parties

(1) A promisor who, for a valuable consideration moving from the promisee, promises to do or to refrain from doing an act or acts for the benefit of a beneficiary shall, upon acceptance by the beneficiary, be subject to a duty enforceable by the beneficiary to perform that promise.

(2) Prior to acceptance the promisor and promisee may, without the consent of the beneficiary, vary or discharge the terms of the promise and any duty arising from it.

(3) Upon acceptance—

- (a) the beneficiary shall be entitled in the beneficiary's own name to such remedies and relief as may be just and convenient for the enforcement of the duty of the promisor, and relief by way of specific performance, injunction or otherwise shall not be refused solely on the ground that, as against the promisor, the beneficiary may be a volunteer; and
- (b) the beneficiary shall be bound by the promise and subject to a duty enforceable against the beneficiary in the beneficiary's own name to do or refrain from doing such act or acts (if any) as may by the terms of the promise be required of the beneficiary; and
- (c) the promisor shall be entitled to such remedies and relief as may be just and convenient for the enforcement of the duty of the beneficiary; and
- (d) the terms of the promise and the duty of the promisor or the beneficiary may be varied or discharged with the consent of the promisor and the beneficiary.

(4) Subject to subsection (1), any matter which would in proceedings not brought in reliance on this section render a promise void, voidable or unenforceable, whether wholly or in part, or which in proceedings (not brought in reliance on this section) to enforce a promissory duty arising from a promise is available by way of defence shall, in like manner and to the like extent, render void, voidable or unenforceable or be available by way of defence in proceedings for the enforcement of a duty to which this section gives effect.

(5) In so far as a duty to which this section gives effect may be capable of creating and creates an interest in land, such interest shall, subject to section 12,¹ be capable of being created and of subsisting in land under any Act but subject to that Act.

¹ Section 12 (Creation of interests in land by parol)

(6) In this section—

"acceptance" means an assent by words or conduct communicated by or on behalf of the beneficiary to the promisor, or to some person authorised on the promisor's behalf, in the manner (if any), and within the time, specified in the promise or, if no time is specified, within a reasonable time of the promise coming to the notice of the beneficiary.

"beneficiary" means a person other than the promisor or promisee, and includes a person who, at the time of acceptance is identified and in existence, although that person may not have been identified or in existence at the time when the promise was given.

"promise" means a promise—

- (a) which is or appears to be intended to be legally binding; and
- (b) which creates or appears to be intended to create a duty enforceable by a beneficiary;

and includes a promise whether made by deed, or in writing, or, subject to this Act, orally, or partly in writing and partly orally.

"promisee" means a person to whom a promise is made or given.

"promisor" means a person by whom a promise is made or given.

(7) Nothing in this section affects any right or remedy which exists or is available apart from this section.

(8) This section applies only to promises made after the commencement of this Act.

Western Australia

Property Law Act 1969

11. Persons taking who are not parties

(2) Except in the case of a conveyance or other instrument to which subsection (1) applies, where a contract expressly in its terms purports to confer a benefit directly on a person who is not named as a party to the contract, the contract is, subject to subsection (3), enforceable by that person in his own name but —

- (a) all defences that would have been available to the defendant in an action or proceeding in a court of competent jurisdiction to enforce the contract had the plaintiff in the action or proceeding been named as a party to the contract, shall be so available;
- (b) each person named as a party to the contract shall be joined as a party to the action or proceeding; and
- (c) such defendant in the action or proceeding shall be entitled to enforce as against such plaintiff, all the obligations that in the terms of the contract are imposed on the plaintiff for the benefit of the defendant.

(3) Unless the contract referred to in subsection (2) otherwise provides, the contract may be cancelled or modified by the mutual consent of the persons named as parties thereto at any time before the person referred to in that subsection has adopted it either expressly or by conduct.

New Brunswick

Law Reform Act 1993

Chapter L-1.2

4(1) A person who is not a party to a contract but who is identified by or under the contract as being intended to receive some performance or forbearance under it may, unless the contract provides otherwise, enforce that performance or forbearance by a claim for damages or otherwise.

4(2) In proceedings under subsection (1) against a party to a contract, any defence may be raised that could have been raised in proceedings between the parties.

4(3) The parties to a contract to which subsection (1) applies may amend or terminate the contract at any time, but where, by doing so, they cause loss to a person described in subsection (1) who has incurred expense or undertaken an obligation in the expectation that the contract would be performed, that person may recover the loss from any party to the contract who knew or ought to have known that the expenses would be or had been incurred or that the obligation would be or had been undertaken.

4(4) This section applies to contracts entered into before or after the commencement of this section, except that subsection (3) does not permit the recovery of loss arising in relation to an expense incurred or an obligation undertaken before the commencement of this section.

4(5) This section or any provision of it comes into force on a day or days to be fixed by proclamation.

England and Wales

Contracts (Rights of Third Parties) Act 1999 1999 Chapter c.31

Right of third party to enforce contractual term

1. - (1) Subject to the provisions of this Act, a person who is not a party to a contract (a "third party") may in his own right enforce a term of the contract if-

- (a) the contract expressly provides that he may, or
- (b) subject to subsection (2), the term purports to confer a benefit on him.

(2) Subsection (1)(b) does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party.

(3) The third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description but need not be in existence when the contract is entered into.

(4) This section does not confer a right on a third party to enforce a term of a contract otherwise than subject to and in accordance with any other relevant terms of the contract.

(5) For the purpose of exercising his right to enforce a term of the contract, there shall be available to the third party any remedy that would have been available to him in an action for breach of contract if he had been a party to the contract (and the rules relating to damages, injunctions, specific performance and other relief shall apply accordingly).

(6) Where a term of a contract excludes or limits liability in relation to any matter references in this Act to the third party enforcing the term shall be construed as references to his availing himself of the exclusion or limitation.

(7) In this Act, in relation to a term of a contract which is enforceable by a third party-

"the promisor" means the party to the contract against whom the term is enforceable by the third party, and

"the promisee" means the party to the contract by whom the term is enforceable against the promisor.

Variation and rescission of contract

2. - (1) Subject to the provisions of this section, where a third party has a right under section 1 to enforce a term of the contract, the parties to the contract may not, by agreement, rescind the contract, or vary it in such a way as to extinguish or alter his entitlement under that right, without his consent if-

- (a) the third party has communicated his assent to the term to the promisor,
 - (b) the promisor is aware that the third party has relied on the term, or
 - (c) the promisor can reasonably be expected to have foreseen that the third party would rely on the term and the third party has in fact relied on it.
- (2) The assent referred to in subsection (1)(a)-
- (a) may be by words or conduct, and
 - (b) if sent to the promisor by post or other means, shall not be regarded as communicated to the promisor until received by him.
- (3) Subsection (1) is subject to any express term of the contract under which-
- (a) the parties to the contract may by agreement rescind or vary the contract without the consent of the third party, or
 - (b) the consent of the third party is required in circumstances specified in the contract instead of those set out in subsection (1)(a) to (c).
- (4) Where the consent of a third party is required under subsection (1) or (3), the court or arbitral tribunal may, on the application of the parties to the contract, dispense with his consent if satisfied-
- (a) that his consent cannot be obtained because his whereabouts cannot reasonably be ascertained, or
 - (b) that he is mentally incapable of giving his consent.
- (5) The court or arbitral tribunal may, on the application of the parties to a contract, dispense with any consent that may be required under subsection (1)(c) if satisfied that it cannot reasonably be ascertained whether or not the third party has in fact relied on the term.
- (6) If the court or arbitral tribunal dispenses with a third party's consent, it may impose such conditions as it thinks fit, including a condition requiring the payment of compensation to the third party.
- (7) The jurisdiction conferred on the court by subsections (4) to (6) is exercisable by both the High Court and a county court.

Defences etc. available to promisor

3. - (1) Subsections (2) to (5) apply where, in reliance on section 1, proceedings for the enforcement of a term of a contract are brought by a third party.

(2) The promisor shall have available to him by way of defence or set-off any matter that-

- (a) arises from or in connection with the contract and is relevant to the term, and
- (b) would have been available to him by way of defence or set-off if the proceedings had been brought by the promisee.

(3) The promisor shall also have available to him by way of defence or set-off any matter if-

- (a) an express term of the contract provides for it to be available to him in proceedings brought by the third party, and
- (b) it would have been available to him by way of defence or set-off if the proceedings had been brought by the promisee.

(4) The promisor shall also have available to him-

- (a) by way of defence or set-off any matter, and
- (b) by way of counterclaim any matter not arising from the contract,

that would have been available to him by way of defence or set-off or, as the case may be, by way of counterclaim against the third party if the third party had been a party to the contract.

(5) Subsections (2) and (4) are subject to any express term of the contract as to the matters that are not to be available to the promisor by way of defence, set-off or counterclaim.

(6) Where in any proceedings brought against him a third party seeks in reliance on section 1 to enforce a term of a contract (including, in particular, a term purporting to exclude or limit liability), he may not do so if he could not have done so (whether by reason of any particular circumstances relating to him or otherwise) had he been a party to the contract.

Enforcement of contract by promisee

4. Section 1 does not affect any right of the promisee to enforce any term of the contract.

Protection of promisor from double liability

5. Where under section 1 a term of a contract is enforceable by a third party, and the promisee has recovered from the promisor a sum in respect of-

- (a) the third party's loss in respect of the term, or
- (b) the expense to the promisee of making good to the third party the default of the promisor,

then, in any proceedings brought in reliance on that section by the third party, the court or arbitral tribunal shall reduce any award to the third party to such

extent as it thinks appropriate to take account of the sum recovered by the promisee.

Exceptions

6. - (1) Section 1 confers no rights on a third party in the case of a contract on a bill of exchange, promissory note or other negotiable instrument.

(2) Section 1 confers no rights on a third party in the case of any contract binding on a company and its members under section 14 of the Companies Act 1985.

(2A) Section 1 confers no rights on a third party in the case of any incorporation document of a limited liability partnership or any limited liability partnership agreement as defined in the Limited Liability Partnerships Regulations 2001 (SI No 2001/1090).

(3) Section 1 confers no right on a third party to enforce-

- (a) any term of a contract of employment against an employee,
- (b) any term of a worker's contract against a worker (including a home worker), or
- (c) any term of a relevant contract against an agency worker.

(4) In subsection (3)-

- (a) "contract of employment", "employee", "worker's contract", and "worker" have the meaning given by section 54 of the National Minimum Wage Act 1998,
- (b) "home worker" has the meaning given by section 35(2) of that Act,
- (c) "agency worker" has the same meaning as in section 34(1) of that Act, and
- (d) "relevant contract" means a contract entered into, in a case where section 34 of that Act applies, by the agency worker as respects work falling within subsection (1)(a) of that section.

(5) Section 1 confers no rights on a third party in the case of-

- (a) a contract for the carriage of goods by sea, or
- (b) a contract for the carriage of goods by rail or road, or for the carriage of cargo by air, which is subject to the rules of the appropriate international transport convention,

except that a third party may in reliance on that section avail himself of an exclusion or limitation of liability in such a contract.

(6) In subsection (5) "contract for the carriage of goods by sea" means a contract of carriage-

- (a) contained in or evidenced by a bill of lading, sea waybill

- or a corresponding electronic transaction, or
 - (b) under or for the purposes of which there is given an undertaking which is contained in a ship's delivery order or a corresponding electronic transaction.
- (7) For the purposes of subsection (6)-
- (a) "bill of lading", "sea waybill" and "ship's delivery order" have the same meaning as in the Carriage of Goods by Sea Act 1992, and
 - (b) a corresponding electronic transaction is a transaction within section 1(5) of that Act which corresponds to the issue, indorsement, delivery or transfer of a bill of lading, sea waybill or ship's delivery order.
- (8) In subsection (5) "the appropriate international transport convention" means-
- (a) in relation to a contract for the carriage of goods by rail, the Convention which has the force of law in the United Kingdom under section 1 of the International Transport Conventions Act 1983,
 - (b) in relation to a contract for the carriage of goods by road, the Convention which has the force of law in the United Kingdom under section 1 of the Carriage of Goods by Road Act 1965, and
 - (c) in relation to a contract for the carriage of cargo by air-
 - (i) the Convention which has the force of law in the United Kingdom under section 1 of the Carriage by Air Act 1961, or
 - (ii) the Convention which has the force of law under section 1 of the Carriage by Air (Supplementary Provisions) Act 1962, or
 - (iii) either of the amended Conventions set out in Part B of Schedule 2 or 3 to the Carriage by Air Acts (Application of Provisions) Order 1967.

Supplementary provisions relating to third party

7. - (1) Section 1 does not affect any right or remedy of a third party that exists or is available apart from this Act.

(2) Section 2(2) of the Unfair Contract Terms Act 1977 (restriction on exclusion etc. of liability for negligence) shall not apply where the negligence consists of the breach of an obligation arising from a term of a contract and the person seeking to enforce it is a third party acting in reliance on section 1.

(3) In sections 5 and 8 of the Limitation Act 1980 the references to an action founded on a simple contract and an action upon a specialty shall

respectively include references to an action brought in reliance on section 1 relating to a simple contract and an action brought in reliance on that section relating to a specialty.

(4) A third party shall not, by virtue of section 1(5) or 3(4) or (6), be treated as a party to the contract for the purposes of any other Act (or any instrument made under any other Act).

Arbitration provisions

8. - (1) Where-

- (a) a right under section 1 to enforce a term ("the substantive term") is subject to a term providing for the submission of disputes to arbitration ("the arbitration agreement"), and
- (b) the arbitration agreement is an agreement in writing for the purposes of Part I of the Arbitration Act 1996,

the third party shall be treated for the purposes of that Act as a party to the arbitration agreement as regards disputes between himself and the promisor relating to the enforcement of the substantive term by the third party.

(2) Where-

- (a) a third party has a right under section 1 to enforce a term providing for one or more descriptions of dispute between the third party and the promisor to be submitted to arbitration ("the arbitration agreement"),
- (b) the arbitration agreement is an agreement in writing for the purposes of Part I of the Arbitration Act 1996, and
- (c) the third party does not fall to be treated under subsection (1) as a party to the arbitration agreement,

the third party shall, if he exercises the right, be treated for the purposes of that Act as a party to the arbitration agreement in relation to the matter with respect to which the right is exercised, and be treated as having been so immediately before the exercise of the right.

Northern Ireland

9. - (1) In its application to Northern Ireland, this Act has effect with the modifications specified in subsections (2) and (3).

(2) In section 6(2), for "section 14 of the Companies Act 1985" there is substituted "Article 25 of the Companies (Northern Ireland) Order 1986".

(3) In section 7, for subsection (3) there is substituted-

"(3) In Articles 4(a) and 15 of the Limitation (Northern Ireland) Order 1989, the references to an action founded on a simple contract and an action upon an instrument under seal shall respectively include references to an action brought in reliance on section 1 relating to a simple contract and an action brought

in reliance on that section relating to a contract under seal."

(4) In the Law Reform (Husband and Wife) (Northern Ireland) Act 1964, the following provisions are hereby repealed-

- (a) section 5, and
- (b) in section 6, in subsection (1)(a), the words "in the case of section 4" and "and in the case of section 5 the contracting party" and, in subsection (3), the words "or section 5".

Short title, commencement and extent

10. - (1) This Act may be cited as the Contracts (Rights of Third Parties) Act 1999.

(2) This Act comes into force on the day on which it is passed but, subject to subsection (3), does not apply in relation to a contract entered into before the end of the period of six months beginning with that day.

(3) The restriction in subsection (2) does not apply in relation to a contract which-

- (a) is entered into on or after the day on which this Act is passed, and
- (b) expressly provides for the application of this Act.

(4) This Act extends as follows-

- (a) section 9 extends to Northern Ireland only;
- (b) the remaining provisions extend to England and Wales and Northern Ireland only.

New Zealand

Contracts (Privity) Act 1982

1. Short Title and commencement

- (1) This Act may be cited as the Contracts (Privity) Act 1982.
- (2) This Act shall come into force on the 1st day of April 1983.

2. Interpretation

In this Act, unless the context otherwise requires —

"Benefit" includes —

- (a) Any advantage; and
- (b) Any immunity; and
- (c) Any limitation or other qualification of —
 - (i) An obligation to which a person (other than a party to the deed or contract) is or may be subject; or
 - (ii) A right to which a person (other than a party to the deed or contract) is or may be entitled; and
- (d) Any extension or other improvement of a right or rights to which a person (other than a party to the deed or contract) is or may be entitled;

"Beneficiary", in relation to a promise to which section 4 of this Act applies, means a person (other than the promisor or promisee) on whom the promise confers, or purports to confer, a benefit;

"Contract" includes a contract made by deed or in writing, or orally, or partly in writing and partly orally or implied by law;

"Court" means, in relation to any matter, the court, tribunal, or arbitral tribunal by or before which the matter falls to be determined

"Promisee", in relation to a promise to which section 4 of this Act applies, means a person who is both —

- (a) A party to the deed or contract; and
- (b) A person to whom the promise is made or given:

"Promisor" in relation to a promise to which section 4 of this Act applies, means a person who is both—

- (a) A party to the deed or contract; and
- (b) A person by whom the promise is made or given.

3. Act to bind the Crown—

This Act shall bind the Crown.

4. Deeds or contracts for the benefit of third parties—

Where a promise contained in a deed or contract confers, or purports to confer, a benefit on a person, designated by name, description, or reference to a class, who is not a party to the deed or contract (whether or not the person is in existence at the time when the deed or contract is made), the promisor shall be under an obligation, enforceable at the suit of that person, to perform that promise:

Provided that this section shall not apply to a promise which, on the proper construction of the deed or contract, is not intended to create, in respect of the benefit, an obligation enforceable at the suit of that person.

5. Limitation on variation or discharge of promise—

(1) Subject to sections 6 and 7 of this Act, where, in respect of a promise to which section 4 of this Act applies,—

- (a) The position of a beneficiary has been materially altered by the reliance of that beneficiary or any other person on the promise (whether or not that beneficiary or that other person has knowledge of the precise terms of the promise); or
- (b) A beneficiary has obtained against the promisor judgment upon the promise; or
- (c) A beneficiary has obtained against the promisor the award of an arbitral tribunal upon a submission relating to the promise,—

the promise and the obligation imposed by that section may not be varied or discharged without the consent of that beneficiary.

(2) For the purposes of paragraph (b) or paragraph (c) of subsection (1) of this section —

- (a) An award of an arbitral tribunal or a judgment shall be deemed to be obtained when it is pronounced notwithstanding that some act, matter, or thing needs to be done to record or perfect it or that, on application to a Court or on appeal, it is varied:
- (b) An award of an arbitral tribunal or a judgment set aside on application to a Court or on appeal shall be deemed never to have been obtained.

6. Variation or discharge of promise by agreement or in accordance with express provision for variation or discharge —

Nothing in this Act prevents a promise to which section 4 of this Act applies or any obligation imposed by that section from being varied or discharged at any time —

- (a) By agreement between the parties to the deed or contract and the beneficiary; or
- (b) By any party or parties to the deed or contract if —

- (i) The deed or contract contained, when the promise was made, an express provision to that effect; and
- (ii) The provision is known to the beneficiary (whether or not the beneficiary has knowledge of the precise terms of the provision); and
- (iii) The beneficiary had not materially altered his position in reliance on the promise before the provision became known to him; and
- (iv) The variation or discharge is in accordance with the provision.

7. Power of Court to authorise variation or discharge—

(1) Where, in the case of a promise to which section 4 of this Act applies or of an obligation imposed by that section,—

- (a) The variation or discharge of that promise or obligation is precluded by section 5(1)(a) of this Act; or
- (b) It is uncertain whether the variation or discharge of that promise is so precluded —

a Court, on application by the promisor or promisee, may, if it is just and practicable to do so, make an order authorising the variation or discharge of the promise or obligation or both on such terms and conditions as the Court thinks fit.

(2) If a Court—

- (a) Makes an order under subsection (1) of this section; and
- (b) Is satisfied that the beneficiary has been injuriously affected by the reliance of the beneficiary or any other person on the promise or obligation —

the Court shall make it a condition of the variation or discharge that the promisor pay to the beneficiary, by way of compensation, such sum as the Court thinks just.

8. Enforcement by beneficiary —

The obligation imposed on a promisor by section 4 of this Act may be enforced at the suit of the beneficiary as if he were a party to the deed or contract, and relief in respect of the promise, including relief by way of damages, specific performance, or injunction, shall not be refused on the ground that the beneficiary is not a party to the deed or contract in which the promise is contained or that, as against the promisor, the beneficiary is a volunteer.

9. Availability of defences —

(1) This section applies only where, in proceedings brought in a Court or an arbitration, a claim is made in reliance on this Act by a beneficiary against a promisor.

(2) Subject to subsections (3) and (4) of this section, the promisor shall have available to him, by way of defence, counterclaim, set-off, or otherwise, any matter which would have been available to him —

(a) If the beneficiary had been a party to the deed or contract in which the promise is contained; or

(b) If—

(i) The beneficiary were the promisee; and

(ii) The promise to which the proceedings relate had been made for the benefit of the promisee; and

(iii) The proceedings had been brought by the promisee.

(3) The promisor may, in the case of a set-off or counterclaim arising by virtue of subsection (2) of this section against the promisee, avail himself of that set-off or counterclaim against the beneficiary only if the subject-matter of that set-off or counterclaim arises out of or in connection with the deed or contract in which the promise is contained.

(4) Notwithstanding subsections (2) and (3) of this section, in the case of a counterclaim brought under either of those subsections against a beneficiary,—

(a) The beneficiary shall not be liable on the counterclaim, unless the beneficiary elects, with full knowledge of the counterclaim, to proceed with his claim against the promisor; and

(b) If the beneficiary so elects to proceed, his liability on the counterclaim shall not in any event exceed the value of the benefit conferred on him by the promise.

10. Jurisdiction of District Courts (Repealed)—

11. Jurisdiction of Disputes Tribunals (Repealed)—

12. Amendments of Arbitration Act 1908 (Repealed)—

13. Repeal—

Section 7 of the Property Law Act 1952 is hereby repealed.

13A. Act does not apply to promises, contracts, or deeds governed by foreign law—

This Act does not apply to any promise, contract, or deed, or any part of any promise, contract, or deed, that is governed by a law other than New Zealand law.

14. Savings—

- (1) Subject to section 13 of this Act, nothing in this Act limits or affects—
 - (a) Any right or remedy which exists or is available apart from this Act; or
 - (b) The Contracts Enforcement Act 1956 or any other enactment that requires any contract to be in writing or to be evidenced by writing; or
 - (c) Section 49A of the Property Law Act 1952; or
 - (d) The law of agency; or
 - (e) The law of trusts.
- (2) Notwithstanding the repeal effected by section 13 of this Act, section 7 of the Property Law Act 1952 shall continue to apply in respect of any deed made before the commencement of this Act.

15. Application of Act—

Except as provided in section 14(2) of this Act, this Act does not apply to any promise, contract, or deed made before the commencement of this Act.

Singapore

Contracts (Rights of Third Parties) Act 2001

Short title and application

1. — (1) This Act may be cited as the Contracts (Rights of Third Parties) Act.

(2) Subject to subsection (3), this Act shall not apply in relation to a contract entered into before the end of the period of 6 months from 1st January 2002.

(3) The restriction in subsection (2) shall not apply in relation to a contract which —

- (a) is entered into on or after 1st January 2002; and
- (b) expressly provides for the application of this Act.

Right of third party to enforce contractual term

2. — (1) Subject to the provisions of this Act, a person who is not a party to a contract (referred to in this Act as a third party) may, in his own right, enforce a term of the contract if —

- (a) the contract expressly provides that he may; or
- (b) subject to subsection (2), the term purports to confer a benefit on him.

(2) Subsection (1) (b) shall not apply if, on a proper construction of the contract, it appears that the parties did not intend the term to be enforceable by the third party.

(3) The third party shall be expressly identified in the contract by name, as a member of a class or as answering a particular description but need not be in existence when the contract is entered into.

(4) This section shall not confer a right on a third party to enforce a term of a contract otherwise than subject to and in accordance with any other relevant terms of the contract.

(5) For the purpose of exercising his right to enforce a term of the contract, there shall be available to the third party any remedy that would have been available to him in an action for breach of contract if he had been a party to the contract (and the rules relating to damages, injunctions, specific performance and other remedy shall apply accordingly) and such remedy shall not be refused on the ground that, as against the promisor, the third party is a volunteer.

(6) Where a term of a contract excludes or limits liability in relation to any matter, references in this Act to the third party enforcing the term shall be construed as references to his availing himself of the exclusion or limitation.

(7) In this Act, in relation to a term of a contract which is enforceable by a third party —

"promisee" means the party to the contract by whom the term is enforceable against the promisor;

"promisor" means the party to the contract against whom the term is enforceable by the third party.

Variation and rescission of contract

3. - (1) Subject to this section, where a third party has a right under section 2 to enforce a term of the contract, the parties to the contract may not, by agreement, rescind the contract, or vary it in such a way as to extinguish or alter the third party's entitlement under that right, without his consent if —

- (a) the third party has communicated his assent to the term to the promisor;
- (b) the promisor is aware that the third party has relied on the term (whether or not the third party has knowledge of its precise terms); or
- (c) the promisor can reasonably be expected to have foreseen that the third party would rely on the term and the third party has in fact relied on it (whether or not the third party has knowledge of its precise terms).

(2) The assent referred to in subsection (1) (a) —

- (a) may be by words or conduct; and
- (b) if sent to the promisor by post or other means, shall not be regarded as communicated to the promisor until it is received by him.

(3) Subsection (1) is subject to any express term of the contract under which —

- (a) the parties to the contract may by agreement rescind or vary the contract without the consent of the third party; or
- (b) the consent of the third party is required in circumstances specified in the contract instead of those set out in subsection (1) (a), (b) and (c).

(4) Where the consent of a third party is required under subsection (1) or (3), the court or arbitral tribunal may, on the application of the parties to the contract, dispense with his consent if it is satisfied that —

- (a) his consent cannot be obtained because his whereabouts cannot reasonably be ascertained; or
- (b) he is mentally incapable of giving his consent.

(5) The court or arbitral tribunal may, on the application of the parties to a contract, dispense with any consent that may be required under subsection (1)

(c) if it is satisfied that it cannot reasonably be ascertained whether or not the third party has in fact relied on the term of the contract.

(6) If the court or arbitral tribunal dispenses with a third party's consent, it may impose such conditions as it thinks fit, including a condition requiring the payment of compensation to the third party.

(7) The jurisdiction conferred on the court by subsections (4), (5) and (6) shall be exercisable by both the High Court and a District Court.

Defences, etc., available to promisor

4. — (1) Subsections (2) to (5) shall apply where proceedings for the enforcement of a term of a contract are brought by a third party in reliance on section 2.

(2) The promisor shall have available to him, by way of defence or set-off, any matter that —

- (a) arises from or in connection with the contract and is relevant to the term; and
- (b) would have been available to him by way of defence or set-off if the proceedings had been brought by the promisee.

(3) The promisor shall also have available to him, by way of defence or set-off, any matter if —

- (a) an express term of the contract provides for it to be available to him in proceedings brought by the third party; and
- (b) it would have been available to him by way of defence or set-off if the proceedings had been brought by the promisee.

(4) The promisor shall also have available to him —

- (a) by way of defence or set-off any matter; and
- (b) by way of counterclaim any matter not arising from the contract,

that would have been available to him by way of defence or set-off or by way of counterclaim against the third party, as the case may be, if the third party had been a party to the contract.

(5) Subsections (2) and (4) are subject to any express term of the contract as to the matters that are not to be available to the promisor by way of defence, set-off or counterclaim.

(6) Where, in any proceedings brought against him, a third party seeks to enforce a term of a contract (including, in particular, a term purporting to exclude or limit liability) in reliance on section 2, he may not do so if he could not have done so (whether by reason of any particular circumstances relating to him or otherwise) had he been a party to the contract.

Enforcement of contract by promisee

5. Section 2 shall not affect any right of the promisee to enforce any term of the contract.

Protection of promisor from double liability

6. Where under section 2, a term of a contract is enforceable by a third party, and the promisee has recovered from the promisor a sum in respect of —

- (a) the third party's loss in respect of the term; or
- (b) the expense to the promisee of making good to the third party the default of the promisor,

then, in any proceedings brought in reliance on that section by the third party, the court or arbitral tribunal shall reduce any award to the third party to such extent as it thinks appropriate to take account of the sum recovered by the promisee.

Exceptions

7. — (1) Section 2 shall not confer any right on a third party in the case of a contract on a bill of exchange, promissory note or other negotiable instrument.

(2) Section 2 shall not confer any right on a third party in the case of any contract binding on a company and its members under section 39 of the Companies Act (Cap. 50).

(3) Section 2 shall not confer any right on a third party to enforce any term of a contract of employment against an employee.

(4) Section 2 shall not confer any right on a third party in the case of —

- (a) a contract for the carriage of goods by sea; or
- (b) a contract for the carriage of goods by rail or road, or for the carriage of cargo by air, which is subject to the rules of the appropriate international transport convention,

except that a third party may in reliance on that section avail himself of an exclusion or limitation of liability in such a contract.

(5) In subsection (4) —

"appropriate international transport convention" means —

- (a) in relation to a contract for the carriage of cargo by air, the Convention which has the force of law in Singapore under section 3 of the Carriage by Air Act (Cap. 32A);
- (b) in relation to a contract for the carriage of goods by rail, such Convention which has the force of law in Singapore under such written law as the Minister may by order prescribe; and
- (c) in relation to a contract for the carriage of goods by road, such Convention which has the force of law in Singapore under such written law as the Minister may by order prescribe;

"contract for the carriage of goods by sea" means a contract of carriage —

- (a) contained in or evidenced by a bill of lading, sea waybill or a corresponding electronic transaction; or
 - (b) under or for the purposes of which there is given an undertaking which is contained in a ship's delivery order or a corresponding electronic transaction.
- (6) For the purposes of subsection (5) —
- (a) "bill of lading", "sea waybill" and "ship's delivery order" have the same meanings as in the Bills of Lading Act (Cap. 384); and
 - (b) a corresponding electronic transaction is a transaction within section 1 (5) of the Bills of Lading Act which corresponds to the issue, indorsement, delivery or transfer of a bill of lading, sea waybill or ship's delivery order.

Supplementary provisions relating to third party

8. — (1) Section 2 shall not affect any right or remedy of a third party that exists or is available apart from this Act.

(2) Section 2 (2) of the Unfair Contract Terms Act (Cap. 396) (exclusion of or restriction on liability for negligence) shall not apply where the negligence consists of the breach of an obligation arising from a term of a contract and the person seeking to enforce it is a third party acting in reliance on section 2.

(3) In section 6 of the Limitation Act (Cap. 163), the references to an action founded on a contract shall include references to an action brought in reliance on section 2 relating to a contract.

(4) A third party shall not, by virtue of section 2 (5) or 4 (4) or (6), be treated as a party to the contract for the purposes of any other written law.

Arbitration provisions

9. — (1) Where —

- (a) a right under section 2 to enforce a term (referred to in this section as the substantive term) is subject to a term providing for the submission of disputes to arbitration (referred to in this section as the arbitration agreement); and

- (b) the arbitration agreement is an agreement in writing for the purposes of the Arbitration Act (Cap. 10) or Part II of the International Arbitration Act (Cap. 143A),

the third party shall be treated for the purposes of the Arbitration Act or the International Arbitration Act, as the case may be, as a party to the arbitration agreement as regards disputes between himself and the promisor relating to the enforcement of the substantive term by the third party.

- (2) Where —
- (a) a third party has a right under section 2 to enforce a term providing for one or more descriptions of dispute between the third party and the promisor to be submitted to arbitration (referred to in this section as the arbitration agreement);
 - (b) the arbitration agreement is an agreement in writing for the purposes of the Arbitration Act or Part II of the International Arbitration Act; and
 - (c) the third party does not fall to be treated under subsection (1) as a party to the arbitration agreement,

the third party shall, if he exercises the right, be treated for the purposes of the Arbitration Act (Cap. 10) or the International Arbitration Act (Cap. 143A), as the case may be, as a party to the arbitration agreement in relation to the matter with respect to which the right is exercised, and be treated as having been so immediately before the exercise of the right.