

LRC report on privity of contract released

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The Law Reform Commission today (25 October) released a report recommending that the doctrine of “privity of contract” should be reformed to allow a person who is not a party to a contract made for his benefit to enforce the contract if the parties to the contract intended that he should be able to do so.

Mr Benjamin Yu, SC, the chairman of the Commission’s sub-committee which examined this subject, explained that under the existing “privity” doctrine a person cannot acquire and enforce rights under a contract to which he is not a party.

For example, if A has an agreement with B that A would do something for C and A subsequently does nothing, C cannot enforce the contract against A because C is not a party (or “privity”) to the contract. “The doctrine of ‘privity’ requires a person to be ‘privity’ to a contract before he can sue on it,” said Mr Yu.

The Commission’s report points out that the doctrine of privity has been repeatedly criticised by judges, lawyers and academics as giving rise to much unfairness. In the Commission’s opinion, the doctrine frustrates contracting parties’ intention to benefit third parties, and can lead to unfairness.

The doctrine has accordingly been reformed in many common law jurisdictions, including Australia (the Northern Territory, Queensland and Western Australia) Canada, England and Wales, New Zealand and Singapore.

The LRC’s recommendations, if adopted, will bring Hong Kong’s law in line not just with the law in other parts of the common law world, but also with common sense. The result of the LRC’s proposals will be that third parties (persons not “privity” to a contract) should, subject to the intention of the contracting parties, be able to enforce agreements for their benefit.

“What we propose is a general and wide-ranging statutory exception to the privity doctrine,” said Mr Yu. He illustrated the way in which Hong Kong consumers might benefit from the reform by referring to the example of A buying a watch from B, which A makes clear at the time of purchase is intended as a gift for C. “Under the existing common law, C cannot sue B if the watch proves defective, as C is not a party to the contract. Under the LRC’s proposals, however, C is a party intended by A and B to be benefited by the purchase and he can sue B directly,” he said.

Other examples of the effect of the proposed reform on everyday life are:

- *Contracts for holiday packages* – A enters into an agreement with a tour company for a holiday package for his parents. The tour company fails to honour its promise under the contract. Since the contract was made for the benefit of A’s parents, they would, subject to the intention of the contracting parties, be entitled to claim in breach of contract against the tour company. The parents, however, cannot enforce the contract under the current law.
- *Building contracts* – A developer enters into a contract with a building contractor for the provision of labour and materials of a specified standard,

intending that the contract would benefit the purchaser who buys the unit in the development. If the building contractor fails to provide materials of the specified standard, the purchaser of the unit can, subject to the intention of the contracting parties, sue the building contractor for damages arising from the breach. The purchaser of the unit, however, cannot enforce the contract under the current law.

- *Insurance contracts* – B is a sub-contractor of A. B takes out an insurance policy with an insurer (C) to cover his and A's liability to employees' compensation. A is not joined as a party. One of B's employees is injured in the course of employment because of the negligence of one of A's employees. A pays the required compensation to B's employee. Under the existing law, A would have difficulties in seeking indemnity from C, since A is not a party to the insurance contract even though the parties intend to benefit him. In contrast, A would be able to seek indemnity from C under the report's proposals.

The report makes clear that the LRC does not recommend the complete abolition of privity, as the LRC believes that it is important to preserve the principle of freedom of contract. The contracting parties' freedom of contract should be respected and they should be able to opt out of any new statutory provisions giving rights of suit to third parties.

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

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