

CONSULTATION PAPER ON PRIVACY OF CONTRACT

EXECUTIVE SUMMARY

The Sub-committee's approach to this topic is to consider the following questions:

- whether the anomalies of the doctrine of privity of contract are serious enough to warrant its reform (Chapters 1 and 2);
- if so, whether *ad hoc* reforms, either by the courts on their own initiative or by legislation, are adequate in the Hong Kong context, or whether an issue of this magnitude calls for comprehensive legislative reform (Chapter 3); and
- if comprehensive legislative reform is called for, what the main elements of the proposed legislative scheme should be (Chapter 4).

Chapter 1: The current law in Hong Kong

1. Chapter 1 examines the doctrine of privity as well as the common law and statutory principles which have the effect of circumventing the doctrine. 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.

2. 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 paper is therefore with this first aspect of the rule, and references to the doctrine of privity or the third party rule are to this.

3. The different effects of the existing privity doctrine and the recommended reform on everyday life are illustrated by some practical examples at the end of this summary. As illustrated in these examples, strict adherence to the existing 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 (such as agency, trust, the tort of negligence and collateral contracts) or because of specific statutory provisions which allow a third party to enforce a right conferred on him by the contracting parties. These common law and statutory principles circumvent the privity doctrine in some cases, but not generally. 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.

4. 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. Otherwise, he will only be entitled to nominal damages. This, when combined with the doctrine of privity, can lead to unjust results in some circumstances.

Chapter 2: Should the privity doctrine be reformed?

5. Arguments against reforming the privity doctrine (paras 2.2 to 2.11):
- *Third parties should not be able to sue in the absence of consideration*

A promisee must provide consideration in order to enforce the contract. Reforming the privity doctrine would enable a third party who has not provided consideration to enforce the contract. This would be unfair to a promisee who has not provided consideration.
 - *Contracts are personal transactions*

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.
 - *Undesirable to subject promisors to two actions*

If a third party can enforce the promise, the promisor will be liable to be sued by both the promisee and the third party.
 - *Unjust that a third party can sue on the contract but cannot be sued*

The privity doctrine 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.
 - *Freedom of the contracting parties to rescind or vary might be affected and a wide range of possible third party plaintiffs*
6. Arguments for reforming the privity doctrine (paras 2.12 to 2.24):
- *Frustrates parties' intention to benefit third parties*

It is 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.
 - *The privity doctrine is unduly complex, uncertain and artificial*

Strict adherence to the privity doctrine has long been criticised as contrary to the parties' intention. 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. 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. The need to circumvent the doctrine demonstrates that the doctrine causes injustice in particular 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.
 - *The person who has suffered the loss cannot sue, while the person who has suffered no loss can sue*

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.

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

It can be unjust to a third party who has, in relying on the promisor's promise, regulated his affairs in the expectation that he would benefit from the promise. That injustice would be particularly acute where a third party regulates his affairs to his own detriment.

It should be noted that the doctrine has been subject to widespread and continuous criticism, both judicially and by law reform bodies, in a number of common law jurisdictions, and has been abrogated by legislation in Australia (the Northern Territory, Queensland and Western Australia), England, New Zealand and Singapore.

7. The majority of the Sub-committee finds the arguments in favour of reform compelling (paras 2.25 to 2.30):

- 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;
- there should be a simple and clear mechanism whereby a third party can generally enforce a benefit intended to be conferred on him;
- 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 as described in this chapter and Chapter 1.

Recommendation 1

The majority of the Sub-committee recommends reform of the general rule that only the parties to a contract may enforce rights thereunder, but not the complete abolition of the doctrine.

8. The dissenting Sub-committee member points out that if the privity doctrine is to be reformed as proposed in Recommendation 1, adopting other recommendations made in this Paper should be the way forward.

Chapter 3: Options for reform of the privity doctrine

9. Chapter 3 examines a number of options for reform before concluding in favour of a detailed legislative scheme. Three of the four possible reform options are based upon a legislative scheme. The options are (paras 3.2 to 3.12):

- leaving matters to the courts to circumvent the doctrine in deserving cases (option 1);
- providing legislative exceptions to the doctrine in specific instances (option 2);
- 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 (option 3);
- reforming the law by means of a detailed legislative scheme (option 4).

10. Advantages and disadvantages of the options (paras 3.13 to 3.14):

Options 1 and 2:

- Both 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.
- For option 1, the courts would only be able to act when a suitable case arises. 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.
- 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. Any shortcomings in the legislation identified later could only be remedied by further legislative amendments, involving additional time and costs.

Option 3:

- It 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.

Option 4:

- 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.
- 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.
- This is also the approach adopted in a number of other jurisdictions, including Australia (the Northern Territory, Queensland and Western Australia), England, New Zealand and Singapore.

Recommendation 2

A clear and straightforward legislative scheme (the “recommended legislation”) should 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.

Chapter 4: The elements of the new legislative scheme

11. Chapter 4 examines the legislative schemes in other major common law jurisdictions and considers various options before making recommendations in respect of the following main elements of a detailed legislative scheme for Hong Kong:

- (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?

(i) Who is a third party? (paras 4.2 to 4.13)

12. There are two main 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. There are at least two 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); and (b) a third party can be designated by name, description, or reference to a class (as in England, New Zealand and Singapore). The provisions in the Northern Territory and Queensland are more akin to option (b).

13. 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. 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.

Recommendation 3

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.

(ii) What is the test of enforceability? (paras 4.14 to 4.46)

14. 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. There appear to be at least four options available to Hong Kong:

- the contract expressly in its terms purports to confer a benefit directly on a third party (Western Australia) (option 1).
- the parties intend a third party to receive the benefit of the promise and also intend to create a legal obligation enforceable by him (the Northern Territory and Queensland) (option 2).

- a third party can enforce a contract if the parties intend him to receive the benefit of the promise, unless on a proper construction of the contract the promise is not intended to create an obligation enforceable by the third party (New Zealand) (option 3).
- the “alternative” approach (as in England and Singapore): either (a) a 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, subject to the proviso that the promise is intended to create an obligation enforceable by the third party (option 4).

15. Before making its final recommendation, the Law Commission in England and Wales had considered other possible tests. These four tests were that a third party might enforce a contract:

- 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 5);
- 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 6);
- on which he justifiably and reasonably relies, regardless of the intentions of the parties (option 7); and
- which actually confers a benefit on him, regardless of the purpose of the contract or the intention of the parties (option 8).

Recommendation 4

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.

16. 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 provisions in the Northern Territory, Queensland and Western Australia amount to imposing obligations on third parties. On the contrary, the English provision only imposes conditions on a third party if he wants to enforce the benefits conferred on him.

17. Another issue is the remedies available to a third party. The provision in Queensland is general in nature: “such remedies and relief as may be just and convenient for the enforcement”. 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 are those that would have been available to a third party in an action for breach of contract if he had been a party to the contract.

Recommendation 5

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 a third party should be entitled to such remedies and relief as may be just and convenient for the enforcement of the promisor's duty.

(iii) Can the contracting parties vary or rescind the contract? (paras 4.47 to 4.60)

18. 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. 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.

19. Different tests are adopted in different jurisdictions. Five options can be considered in Hong Kong. It should be noted that these tests are not mutually exclusive, and they can be used in different combinations (as in England and Singapore):

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

Recommendation 6

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.

(iv) Can the parties vary or rescind the contract after crystallisation, or lay down their own crystallisation test? (paras 4.61 to 4.69)

20. 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). There are four options:

- disallowing the parties to reserve the right to vary or rescind the contract once the third party's benefit is crystallised (the Northern Territory, Queensland and Western Australia);
- allowing the parties to do so (England and Singapore);
- allowing the 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 (New Zealand);
- 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 a notice published in the press.

21. 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. 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.

Recommendation 7

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 or ought to have known of such provision before his rights are crystallised.

(v) Should there be any judicial discretion to authorise variation or cancellation? (paras 4.70 to 4.76)

22. 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 three options:

- no specific provisions on judicial discretion (the Northern Territory, Queensland and Western Australia);

- limited judicial discretion in specified circumstances, such as where a third party's consent cannot be obtained because his whereabouts cannot reasonably be ascertained or where he is mentally incapable of giving his consent (England and Singapore);
- a residual power for the court to dispense with third parties' consent whenever the court considers this "just and practicable" (New Zealand).

Recommendation 8

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.

(vi) Should consideration be an issue? (paras 4.77 to 4.86)

23. 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. 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 unlooked for, consequences. There are two different approaches in other jurisdictions:

- a third party's claim should not be refused merely because, as against the promisor, the third party is a volunteer (New Zealand, the Northern Territory, Queensland and Singapore);
- no specific provision is needed as the proposed statutory recognition of third party rights would necessarily imply reform of the consideration rule (England).

Recommendation 9

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.

(vii) What defences, set-offs and counterclaims should be available to promisors? (paras 4.87 to 4.103)

24. 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.

- Option 1- The Northern Territory, Queensland and Western Australia
 - a promisor can raise all defences which would have been available to him in an action brought by the promisee;
- Option 2- New Zealand
 - 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 (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,

provided 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;

- 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, and his liability on the counterclaim would not exceed the value of the benefit conferred on him by the promise.

- Option 3- England and Singapore

- a 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, subject to any express contractual term that expands or restricts the scope of defences or set-offs;
- a promisor can raise defences, set-offs and counterclaims (only those not arising from the contract) that are specific to the third party only, subject to any express contractual term that restricts the scope of defences, set-offs or counterclaims;
- where a third party seeks to enforce an exclusion or limitation clause in response to an action brought by the promisor, the 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;
- section 2(2) of the Unfair Contract Terms Act 1977 in England does not apply where a third party sues the promisor under the Contracts (Rights of Third Parties) Act 1999 for negligence which consists of the breach of a contractual obligation;

- Options 4 and 5

The Law Commission in England and Wales 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).

Recommendation 10

Defences, set-offs and counterclaims available to promisors:

- (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;

(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; and

(d) section 7(2) of the Control of Exemption Clauses Ordinance (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.

(viii) How should overlapping claims against promisors be dealt with? (paras 4.104 to 4.116)

25. Allowing third parties to enforce contracts between promisors and promisees raises a number of questions about promisors' liabilities. First, should promisors be liable to both promisees and third parties?

- in New Zealand, the Northern Territory and Queensland, nothing in the provision which enables third parties to enforce the contract against promisors affects any right or remedy which exists or is available apart from that provision (option 1);
- the fact that a third party has been given rights to enforce does not affect the promisee's rights to enforce any term of the contract (England and Singapore) (option 2).

Recommendation 11

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

26. Secondly, what should the promisors' position be upon performance of obligations to third parties? None of the jurisdictions discussed in the paper have specific provisions on this issue. The Law Commission in England and Wales 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. It nevertheless considers this to be self-evident and that a specific legislative provision on this principle is unnecessary. The Sub-committee thinks that this seemingly evident and sensible principle should be spelt out explicitly in the recommended legislation for the avoidance of doubt.

Recommendation 12

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.

27. Finally, a consequence of the recommendation to allow both the promisee and the third party to enforce the contract is that the promisor may face double liability for the same loss. Should promisors be shielded from double liability? If so, how? Of the jurisdictions studied in the Paper, only England and Singapore have provided for these situations.

Recommendation 13

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.

(ix) Should arbitration clauses and exclusive jurisdiction clauses be binding on third parties? (paras 4.117 to 4.128)

28. 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.

Arbitration agreements

29. Of the jurisdictions discussed in the Paper, only England & Wales and Singapore have a statutory provision on arbitration clauses. In both jurisdictions, 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 provision 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. 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 in England).

30. There are three options in respect of arbitration agreements. The first option is that arbitration agreements are to apply to third parties, regardless of the parties' intention. The second option is that arbitration agreements are *not* to apply to third parties. The third option is that an arbitration agreement would apply to a third party if it expressly covers the third party, but would otherwise not apply to him.

Recommendation 14

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 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.

Exclusive jurisdiction clauses

31. None of the jurisdictions discussed in the Paper have provided specifically for exclusive jurisdiction clauses. Some academics argue that the Contracts (Rights of Third Parties) Act 1999 in England already covers exclusive jurisdiction clauses. The Sub-committee is of the view that it is undesirable to leave the issue open, and recommends that its 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".

Recommendation 15

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.

(x) What should the scope of the present reform be? (paras 4.129 to 4.144)

32. There are two main issues under this heading. The first is whether the existing rights of third parties should be preserved. 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.

- in the Northern Territory and Queensland, the provision which enables third parties to enforce against promisors does not affect any right or remedy which exists or is available apart from that provision (option 1);
- in England and Singapore, the provision which enables third parties to enforce against promisors does not affect any right or remedy of a third party that exists or is available apart from that provision (option 2);
- in New Zealand, the provision which enables third parties to enforce against promisors does not affect or limit any right or remedy which exists or is available apart from that provision, and in particular it does not affect or limit the law of agency and the law of trusts (option 3).

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.

33. The second issue is whether there are contracts to which the recommended legislation should not apply. It seems that there are two categories of such contracts. The first is where a third party already has an enforceable right under existing rules: bills of exchange, contracts for the carriage of goods by sea and contracts for the carriage of goods by air. These separate regimes, built on their own underlying policies, should be preserved and should not be “tampered with” casually. Otherwise, those policies would be undermined.

Recommendation 17

A third party should not have any rights under the recommended legislation in respect of:

- (a) a bill of exchange, promissory note or other negotiable instrument;**
- (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; and**
- (c) a contract for the carriage of goods by air governed by the Carriage by Air Ordinance (Cap 500).**

34. The second category is where a third party has no rights of enforceability under existing rules, but there are sound policy reasons for maintaining that position. There are two types of contract which fall within this category. First, section 23 of the Companies Ordinance (Cap 32) 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. Secondly, where 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.

Recommendation 18

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.

Miscellaneous issues (paras 4.145 to 4.148)

35. 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. Hence, 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

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.

36. In England, section 7(4) of the 1999 Act provides that a third party will not be treated as a party to the contract for the purposes of any other statutory provisions merely because of the reference to treating him as if he were a party to the contract in respect of remedies (section 1(5) of the 1999 Act) and defences, etc (sections 3(4) and (6) of the 1999 Act). Similarly, the reforms proposed in this paper are not intended to have the effect of treating a third party as a party to the contract for all purposes. Thus, 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, 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.

Recommendation 20

A third party should not be treated as a party to the contract for the purposes of any 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.

Comparing the different effects of the existing privity doctrine and the recommended reform

37. The different effects of the existing privity doctrine and the recommended reform on everyday life can best be illustrated by some practical examples.

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

The underlying principle of the reform is to respect contracting parties' freedom of contract and, where appropriate, to give effect to their intention to benefit a third party. If the parties prefer, they will be able to make it clear in their contract that the proposed legislation is not to apply to their contract.