
**CONTRACTS (RIGHTS OF THIRD PARTIES) –
ACT 1999 - LEGISLATIVE REFORM OF THE
DOCTRINE OF PRIVY IN THE UNITED
KINGDOM**

I. Introduction

In the United Kingdom, the new millennium witnessed a revolution of some sort in the law of contracts. The century old doctrine of privity of contract, which prohibits a person who is not a party to the contract¹ from suing under the contract, has been modified with the enactment of the Contracts (Rights of Third Parties) Act 1999.²

At common law, only parties to the contract may enforce and seek remedies under the contract. A stranger to the contract³ cannot sue under the contract even though it was made for the sole purpose of granting a benefit to him. It flows therefrom that the third party cannot take any legal action to enforce any terms of the contract or avail himself of any remedy or remedies for any breach of contract.

The 1999 Act changes the common law position. The third party is now permitted to enforce the rights conferred on him under the said contract.

Since the 1999 Act has a profound effect on all commercial transactions subject to the laws of England, Wales or Northern Ireland,⁴ the Act did not come into force immediately. It came into

¹Hereinafter referred to as 'the third party'.

²Hereinafter referred to as 'the 1999 Act'. The long title of the 1999 Act reads "An Act to make provision for the enforcement of contractual terms by third parties".

³Hereinafter referred to as 'the third party'.

⁴Section 10(4) of the 1999 Act. Scotland recognises and enforces the rights conferred on the third parties under contracts.

force only at the expiry of 6 months from the day it was passed,⁵ that is, on 11 May 2000.

This article proposes to outline the development of the doctrine of privity and provide some examples of the injustice and inconvenience caused by it. The provisions and effects of the 1999 Act will also be studied.

II. History

In 1915, Viscount Haldane, when delivering the House of Lords decision in *Dunlop Pneumatic Tyre Co Ltd v Selfridge*,⁶ said "(I)n the law of England, certain principles are fundamental. One is that only a person who is a party to a contract can sue on it."⁷ However, as shown by Robert Flannigan in his article 'Privity - The End of An Era (Error)',⁸ the development of the so-called fundamental doctrine left much to be desired.

Until *Tweddle v Atkinson*,⁹ the authorities that supported a third party action were both voluminous and continuous.¹⁰ The first sign of reversal against third party action was in the 1669 case of *Bourne v Mason*¹¹ where the court, misled as to the facts of two authorities, held that a third party had no right to receive a benefit since no consideration moved from him. Subsequent thereto, there were many conflicting decisions on the rights of a third party under a contract.

In *Tweddle v Atkinson*,¹² the plaintiff's father and prospective father-in-law contracted to pay him a sum of money in consideration of his

⁵Section 10(2) of the 1999 Act. The Bill, in its original form, was first introduced in the House of Lords on 3 December 1998. As a result of intense debates, some provisions of the Bill were amended before it received the Royal Assent on 11 November 1999.

⁶[1915] AC 847.

⁷Note 6, at page 853.

⁸[1987] 103 LQR 564.

⁹121 ER 762.

¹⁰Note 8, at page 567.

¹¹86 ER 5.

¹²Note 9.

intended marriage. The father-in-law did not pay and the plaintiff sued his estate. The court held that "no stranger to the consideration can take advantage of a contract, although made for his benefit".¹³ Although the *ratio decidendi* of the case is not on the doctrine of privity, but that only a party who has provided consideration may sue on the contract, the courts in subsequent cases cited *Tweddle v Atkinson*¹⁴ as an authority against the third party action.¹⁵ This could be due to the confusion between the doctrine of privity and the doctrine of consideration,¹⁶ which in actual fact, are not the same as shown in the case of *Kepong Prospecting Ltd v Schmidt*.¹⁷ In that case, the Privy Council held that even where consideration moved from the third party,¹⁸ the third party could not sue under the contract. If both the doctrine of privity and doctrine of consideration were the same, neither the promisee nor the third party could enforce a contract where consideration moved from a third party. The third party cannot enforce it due to the doctrine of privity, whereas the promisee cannot enforce it since no consideration moved from him.

The House of Lords, in *Dunlop Pneumatic Tyre Co Ltd v Selfridge*,¹⁹ removed any uncertainty with respect to the doctrine of privity. In that case, the court affirmed that only parties to the contract may sue on the contract. However, this did not stop law reformers, commentators²⁰ and judges from criticising the doctrine.

¹³Note 9, at page 764.

¹⁴Note 9.

¹⁵Note 9, at page 571.

¹⁶Consideration must move from the promisee.

¹⁷[1968] 1 MLJ 170.

¹⁸As allowed by section 2(d) of Malaysia's Contracts Act 1950.

¹⁹Note 6.

²⁰However, at least three commentators defended the doctrine of privity. They are Peter Kinclaid in 'Third Parties: Rationalising A Right To Sue' [1989] *CLJ* 243 and 'The UK Commission's Privity Proposals and Contract Theory' [1994] 8 *JCL* 51; Simone Degeling in 'A Consideration Of The UK Law Commission's Consultation Paper, 'Privity of Contract'' [1993] 6 *JCL* 179 and Stephen Smith in 'Contracts For The Benefit Of The Third Party: In Defence Of The Third Party Rule' [1997] 17 *OJLS* 643.

The first renowned judge to criticise the doctrine was Lord Denning²¹ in the case of *Smith and Snipes Hall Farm LD v River Douglas Catchment Board*.²² His Lordship's views were initially questioned and criticised but subsequently there emerged supporters in the judicial circle. For example, Lord Scarman in the case of *Woodar Investment Development Ltd v Wimpey Construction UK Ltd*²³ said, "If the opportunity arises, I hope the House will reconsider *Tweedle v Atkinson* and the other cases which stand guard over this unjust rule."

III. Need for Reform

Why was it said that the doctrine of privity is an unjust rule? This article does not propose to go into the details of the injustice caused but to briefly highlight some of them.

For example, the doctrine of privity was created purportedly to allow contractual obligations to operate between the contracting parties. However, the doctrine has a contrary effect where the sole purpose of the contract is to confer enforceable rights on a third party. The third party will not be able to enforce the conferred rights. In fact, the promisor will be encouraged to break his contractual obligations, particularly where it is anticipated that the promisee will not suffer any economic loss due to the non-performance of the promise by the promisor. In such situations, the penalty imposed on the promisor will only be nominal damages. A person may recover damages to compensate him for his own loss, but not the loss of another person. Since the promisee did not suffer any loss, the court will, under the circumstances, order only nominal damages to be paid to him. Likewise, the court will not order restitution of the consideration received by the promisor if the promisor has partially performed the contract for there is no total failure of consideration.²⁴ Further injustice will be caused

²¹Tributes were paid to Lord Denning during the Parliamentary debates on the Bill. Unfortunately, Lord Denning did not witness the passing of the Act as he passed away on 6 March 1999 at the age of 100.

²²[1949] 2 KB 500.

²³[1980] 1 All ER 571, at page 591.

²⁴Rodney Newman, 'The Doctrine of Privity of Contract: The Common Law and the Contracts (Privity) Act 1982', 4 *AULR* 339, at page 341.

to the third party if the promisee is not able to sue²⁵ or does not want to sue for one reason or another.²⁶

The doctrine of privity also defeats the intention of the parties to give enforceable benefits to a third party. Though the parties to the contract intended the third party to sue under the contract upon a breach, the doctrine of privity will prevent it.

The doctrine is also said to be inefficient. Due to the non-availability of an action by the third party against the promisor, multilateral contracts may have to be made between the promisor and promisee and between the promisor and the third party. For example, A and B enter into a contract for the purpose of conferring enforceable rights to C. However, as a result of the consequences of the doctrine of privity, the promisor of the contract will have to enter into a separate contract with C to perform the first contract in favour of C. C will have to give a nominal consideration for the promise. The second contract between the promisor and C will incur additional costs. Hence, this will result in additional costs for the same outcome.²⁷

To circumvent the harsh consequences of the doctrine, a number of legal concepts²⁸ and enactment of statutory provisions were created or adopted. The UK Law Commission recognised this and in 1991, published a consultation paper on 'Privity of Contract: Contracts For The Benefit Of Third Parties'.²⁹ This was followed by the Law Commission Report No. 242 in July 1996 which recommended the legislature to take steps to reform the doctrine. The Contracts (Rights of Third Parties) Act 1999 is the end product.

²⁵For example, where the promisee becomes a bankrupt, is out of jurisdiction, dead or of unsound mind.

²⁶Andrew Burrows, 'Reforming Privity of Contract: Law Commission Report No. 242' [1996] *LMCLQ* 467, at pages 468-469.

²⁷Robert Flannigan, 'Privity - The End of an Era (Error)' [1987] 103 *LQR* 564, at page 589.

²⁸For example, the use of constructive trust, assignment, agency, collateral contracts and tortious liability.

²⁹In fact, its predecessor, the Law Revision Committee, in 1937, in its Sixth Interim Report, '*Statute of Frauds and the Doctrine of Consideration*' recommended the modification of the doctrine.

IV. Contracts (Rights of Third Parties) Act 1999

The 1999 Act, which came into force on 11 May 2000, allows parties to a contract to confer enforceable rights to a person other than themselves. It flows therefrom, a third party can now acquire enforceable contractual rights without being a party to the contract. Under such circumstances, two persons can enforce the same promise against the promisor. They are the promisee as a party to the contract³⁰ and the third party by virtue of the 1999 Act.³¹ It is to be noted that the third party is still not permitted to enforce the contract. What has been reformed is that a third party "may in his own right enforce a term of the contract".³²

A. The Scope

1. Are All Contracts Affected By the 1999 Act?

The 1999 Act will apply to all, except for the following contracts made on or after 11 May 2000 that are subject to the laws of England, Wales or Northern Ireland:

- (a) a contract where the parties thereto contract out of the application of the 1999 Act,³³ that is, the parties agree that the 1999 Act does not apply to the contract in question;
- (b) a contract that falls within one of the types of contract which are expressly excluded, such as:
 - (i) bills of exchange, promisory notes and other negotiable instruments.³⁴ Hence, apart from the rights given to a holder, holder for value and holder in due course under the Bills of

³⁰The promisee's rights to enforce the contract are preserved by section 4.

³¹This is subject to the double liability rule, which is discussed below.

³²This is the preferred view for there may be other benefits in the same contract but not meant for the third party and hence should not be enforceable by him. His rights should be restricted to the benefits conferred on him, and not the whole contract.

³³Section 1(2).

³⁴Section 6(1).

- Exchange Act 1882, the doctrine of privity will continue to apply to any endorsee or holder of the aforementioned instruments.
- (ii) Memorandum and Articles of Association of a company.³⁵ The principles as enunciated in the case of *Eley v Positive Government Life Assurance Co*³⁶ still stand.
 - (iii) a contract of employment insofar as a third party cannot enforce a term of the said contract against the employee.³⁷ With this exclusion, third parties such as the employer's customers will continue to be prevented from suing the employee in the event the employee takes part in a lawful industrial action that affects the third party's rights or causes him to suffer damage.³⁸
 - (iv) a contract for the carriage of goods by sea.³⁹ However, a third party, such as the independent contractors engaged in the loading and unloading process, may rely, in his defence, on the exclusion or limitation of the liability clause in the contract.⁴⁰
 - (v) a contract for the carriage of goods by rail, road or air which is subject to the rules of the relevant international transport convention.⁴¹ Like the contract for carriage of goods by sea, a third party can also rely on the exclusion or limitation of liability clause in the said contract;
- (c) any contract made pursuant to an obligation under a contract entered into before 11 May 2000. As an illustration, a contract made before 11 May 2000 might have stipulated that the parties execute another contract in the prescribed form and substance. The later contract, though made after 11 May 2000, will not be covered under the

³⁵Section 6(2).

³⁶(1876) 1 Ex D 88.

³⁷Section 6(3).

³⁸HL Hansard, 11 January 1999, Column 21.

³⁹Sections 6(5)(a), 6(6) and 6(7).

⁴⁰See the Explanatory Notes to the 1999 Act, at paragraph 26. Please also see the discussion below on 'Available Remedies' and 'What The 1999 Act Does Not Provide'.

⁴¹Section 6(5)(b) and 6(8).

1999 Act. However, if the parties were aware of the Act before it came into force and wished to confer enforceable rights to a third party in a later contract, they could do so;⁴² and (d) any right or remedy of the third party that exists or is available apart from the 1999 Act.⁴³ Hence, the courts may continue to use their creativity to develop and extend third party rights.

2. Who Are The Third Parties Who Benefit From the 1999 Act?

For easy reference, sections 1(1), 1(2) and 1(3) of the 1999 Act are reproduced below:

“S1(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 terms 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.”

It appears that before a third party can benefit from the 1999 Act, he must fulfill two conditions.

Firstly, he must have been expressly conferred the right to enforce a term of the contract in his own right⁴⁴ (“the first limb test”).

⁴²This was confirmed by the Minister who introduced the Bill to the House of Commons Standing Committee D on 15 July 1999. In this connection, please see the House of Lords decision in *Pepper (Inspector of Taxes) v Hart* [1993] 1 All ER 42.

⁴³Section 7(1).

⁴⁴Section 1(1)(a). Note that the phrase “expressly provides” is used.

Alternatively, the term which he wants to enforce merely "purports to confer a benefit on him".⁴⁵ In other words, the contract did not expressly confer an enforceable benefit on the third party but merely purported to confer a benefit on him. However, this alternative does not apply where "if on proper construction of the contract, it appears that the parties did not intend that the term to be enforceable by" him⁴⁶ ("the second limb test").

Hence, there arises a presumption that a benefit conferred or purported to be conferred on a third party under a contract will be enforceable.⁴⁷ It can be rebutted only if on the construction of the contract, it is shown that the parties did not intend the benefit to be enforceable by the third party. When the presumption is rebutted, the doctrine of privity will apply. Hence, in other words, the doctrine is not abolished but merely modified by the 1999 Act.

In view of the application of the 1999 Act by default to a contract conferring benefits to a third party, it is advisable for the parties to state expressly whether the benefits conferred on the third party are enforceable by the third party or otherwise. This is to ensure the true intention of the parties is given effect to and to avoid any unnecessary litigation.

Secondly, the third party must be expressly identified in the contract either by name or as a member of a class or description.⁴⁸

Identification by name is self-explanatory. Identifying members of a class can prove problematic as it means that the number and identities of the members are subject to change.⁴⁹ Some examples in this category are employees of a company, members of a club and residents of a condominium. Identification by answering a particular description will include the promisee's spouse, children, siblings and parents.⁵⁰

⁴⁵Section 1(1)(b).

⁴⁶Section 1(2).

⁴⁷Note that there is no need for the contract to expressly provide for the application of the 1999 Act.

⁴⁸Section 1(3). A third party who benefits from a contract but is not identified to the seller, such as a recipient of a gift and the owner of goods purchased on his behalf, will be excluded. See Meryll Dean, 'Removing a Blot on the Landscape - The Reform of the Doctrine of Privity' [2000] *JBL* 143, at pages 147-148.

⁴⁹Note 24, at page 345.

⁵⁰Note 24, at page 345.

The 1999 Act also permits the enforceable rights be given to a third party who was not in existence at the time of the contract.⁵¹ Hence, a person may now confer benefits on his future spouse, unborn child and even a yet to be incorporated company.⁵² Likewise, the future employees of a company, members of a club and residents of a condominium may also be included.

It is submitted that the 1999 Act has attempted to codify the law prior to the 1861 case of *Tweddle v Atkinson*:

“If a promise in a simple contract was made expressly for the benefit of a third person in such circumstances that it was intended to be enforceable by him, then the common law would enforce the promise at his instance, although he was not a party to the contract.”⁵³

However, most contracts today are no longer simple but rather complex and complicated. The phrases used, such as “purports to confer” and “on proper construction of the contract it appears that the parties did not intend the terms to be enforceable by the third party”, are subjective and ambiguous. The reform that intended to give effect to the intention of the parties may just do the reverse. It may result in the court reading more than was originally intended by the parties to the contract. Situations may arise where parties who did not intend or even

⁵¹Section 1(3) and note 40, at paragraph 8.

⁵²Section 35(2) of Malaysia's Companies Act 1965 recognises this right.

⁵³Per Denning LJ in *Drive Yourself Hire Co (London) Ltd v Strut* [1954] 1 QB 250, at page 272.

contemplate giving benefits to a third party end up being sued by him. Unintentionally, a floodgate may be opened.⁵⁴

Admittedly, the first limb test, where the contract expressly provides the third party with legally enforceable rights, is more certain than the second limb test. But a reform confined to the first limb test will be too rigid and not cover many situations⁵⁵ and hence will continue to cause injustice to the third party. The intentions of the parties will still be thwarted.

According to the Law Commissioner, the phrase "purport to confer a benefit" plays a crucial role in limiting the presumption to where the contract is designed to benefit the third party "directly". Moreover, the presumption may also be rebutted by an express term which negates the third party's legal rights or is inconsistent with the third party having legally enforceable rights. It was also noted by the Law Commissioner that New Zealand, which adopted a similar test, did not experience much uncertainty.⁵⁶

It is now left to be seen how the courts in England will interpret the second limb test which is found in section 1(1)(b) read together with subsection (2).

⁵⁴In America, the third party rule was used as a vehicle for social change. The rule was used to enforce statutory duties or plead in contract what was essentially a tort claim. Two cases are illustrated below to highlight the risks:

- (i) In *Filardo v Foley* 78 N.E. 2d 480, a worker successfully sued his employer for overtime pay under a contract between the employer and the U.S. government. In the contract, there was a clause requiring the employer to obey all applicable laws of the country, which includes the law on the overtime payment.
- (ii) In *Doyle v South Pittsburgh Water Co* 199 A 2d 875, a house owner, whose house was destroyed by fire, sued the defendant for failure to supply water for fire hydrants for the purpose of fighting fire under a contract between the defendant and the city.

See Francis Dawson, 'New Zealand Privity of Contract Bill' (1982) 2 *OJLS* 448 and Rodney Newman, 'The Doctrine of Privity of Contract: The Common Law and the Contracts (Privity) Act 1982', 4 *AULR* 339.

⁵⁵Note 26, at page 475.

⁵⁶Note 26, at page 473. A check in the New Zealand Law Reports from 1982 to 1999 (Volumes 1 and 2) revealed that there were only five cases decided on the Contracts (Privity) Act 1982. Four of the cases were on section 4, which is quite similar to sections 1(1), 1(2) and 1(3) of the 1999 Act.

3. What Are the Rights of the Third Party?

As discussed above, the purpose of the 1999 Act is to allow parties to a contract to confer enforceable rights on a stranger to the contract. It does not affect any right or remedy that exists or is available to the third party apart from the Act. This is clearly stated in section 7(1). Apart therefrom, it also confers on the third party the following additional rights:

(a) Variation of Rights

Once the parties to the contract give enforceable rights to the third party, section 2 comes into play.

Essentially, section 2 provides that the parties cannot, by agreement, take steps to rescind or vary the contract in such a way as to extinguish or alter the third party's entitlement under that right. The parties can do so only if they have reserved their rights or where the third party's right has yet to crystallise. Upon the happening of any of the aforesaid events, the parties cannot extinguish or alter the third party's right, unless his prior consent has been obtained.

The 1999 Act laid down two alternative tests to determine when the right given to the third party is said to have crystallised ("the crystallisation tests").

Firstly, the third party's right crystallises when he relies on the term which confers the benefit on him and either the promisor is aware of the reliance⁵⁷ or the promisor can reasonably be expected to have foreseen that the third party will rely on the said term.⁵⁸ When is it said that the third party has relied on the term? According to the Law Commission Report No. 242:

"Reliance on a promise, in our view, means conduct induced by the belief (or expectation) that the promise will be performed ... The reliance need not be detrimental; that is, the conduct need not make the plaintiff worse off than before the promise was made."⁵⁹

⁵⁷Section 2(1)(b).

⁵⁸Section 2(1)(c).

⁵⁹Paragraph 9.14.

Following therefrom, the third party is said to have relied on the term when he has acted on it in the belief that the promise made to him under the term will be performed.

Secondly, the third party's right crystallises upon communication of his acceptance of the term to the promisor.⁶⁰ He can communicate his acceptance either verbally or by conduct. Alternatively, he can send his acceptance by post or other means. In the second alternative, the acceptance is deemed communicated only when the promisor receives it.⁶¹ We are to note that, unlike the first test, whether the third party has relied on the term is not relevant.

In line with the Law Commission's basic commitment in respecting the intentions of the contracting parties,⁶² section 2(3) provides that the prior consent of the third party is waived (notwithstanding the crystallisation of the right) if the parties expressly reserved their right to vary or rescind the contract. Likewise, the contracting parties can expressly provide for a different set of crystallisation tests. It is to be noted that any waiver or modification of the crystallisation tests must be expressly stated in the contract. This is to give notice to the third party that his right can be varied or extinguished with a snap of his fingers.

There can also arise situations where the parties to the contract wish to rescind or vary the contract in such a way as to extinguish or alter the third party's rights thereunder but the third party cannot be located. Section 2(4) of the 1999 Act provides that under such circumstances, the parties to the contract can apply to the court to dispense with the consent. Likewise, an application can also be made to the court to dispense with the third party's consent where "he is mentally incapable of giving his consent".

The court also has the power to dispense with the consent "if it is satisfied that it cannot reasonably be ascertained whether or not the third party has in fact relied on the term."⁶³ It is submitted that this

⁶⁰Section 2(1)(a).

⁶¹Section 2(2). Note the variation from the general postal rule that acceptance is deemed communicated to the offeror when the letter is posted.

⁶²Note 26, at page 476.

⁶³Section 2(5).

can arise only where there is a dispute between the parties and the third party as to whether the third party has relied on the promise⁶⁴ before his right was extinguished or altered. If the third party could not be located and the parties to the contract are uncertain as to whether the third party has relied on the promise, they may apply to the court under section 2(4)(a), instead of under section 2(5).

A point to note is that the dispensation of the third party's consent by the court may be subject to such conditions as the court deems fit. This will include payment of compensation to the third party.⁶⁵ It is submitted that where the third party cannot be located, the court may also order a deposit be made to the court to meet the third party's anticipated damages.

It is also to be noted that the above restriction seems to be limited to rescission or variation by agreement. The relevant portion in section 2(1) reads:

"... 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...".⁶⁶

It appears not to restrict any unilateral rescission or variation of the third party's rights. Such unilateral variation will be pursuant to the contract, otherwise the variation will be invalid and ineffective. Since the parties have contracted to permit one party to vary a term of the contract without the consent of the other, it follows that the prior consent of the third party should be waived or dispensed with.

(b) Available Remedies

Section 1(5) of the 1999 Act provides that the third party may avail himself of any remedies available for breach of contract, such as damages, specific performance and injunction, as if he is a party to the

⁶⁴For a discussion on what constitutes reliance, please see above.

⁶⁵Section 2(6).

⁶⁶Own emphasis.

contract. He will also be subject to all the normal rules applicable to the said remedies.

The 1999 Act recognises that a term excluding or limiting liability ("exclusion clause") is also a form of benefit. It may be extended to a third party.⁶⁷ Hence, where there is an exclusion clause in a contract which is expressly stated for the benefit of an identified third party, the third party may avail himself of the exclusion clause when sued by the promisee-plaintiff for negligence.⁶⁸ However, such defence may prove to be limited as the promisee-plaintiff may attack the exclusion clause on the ground of unreasonableness.⁶⁹ The conferred benefit will be similar to the promisor's. What can be challenged on the ground of unreasonableness in the case against the promisor can also be subject to the same treatment in a case against the third party.

However, we are to note that the third party enjoys the above benefits and rights "subject to and in accordance with the other relevant terms of the contract".⁷⁰ Hence, the parties to the contract may, expressly, restrict the remedies available or the application of some exclusion clauses to the third party. The third party cannot complain, as what is given to him is more than what he is entitled to under the doctrine of privity. The parties to the contract have the discretion not to give him any right. It follows that where they have given him a right, they have the discretion to impose such restrictions as they deem fit.

4. What Are the Defences Available To the Promisor In An Action By the Third Party?

Strictly, the third party should not enjoy a better right than the promisee for he derived his right from the promisee. Following therefrom, section 3(2) provides that in an action by the third party, the promisor may avail himself of any defence or set-off that arises from or in connection with the contract and is relevant to the term as if the plaintiff is the

⁶⁷Section 1(6).

⁶⁸The third party cannot be sued under a contract, as the 1999 Act does not impose any obligation on third parties.

⁶⁹Section 2(2) of the Unfair Contract Terms Act 1977.

⁷⁰Section 1(4).

promisee. Hence, all defences, such as that the contract is void or voidable, discharged by breach or frustration, will also be available to the promisor in an action by the third party.

However, according to section 3(5), this is subject to any contractual reservation by the parties. The parties may limit any of the defences or set-off available to the promisor in an action by the third party against him. Under such circumstances, the third party will have a better right compared to the promisee. An illustration given in the Explanatory Note to the 1999 Act is as follows. The Promisee enters into a contract to purchase a painting from the Promisor. The painting is to be delivered to the Third Party, who was given enforceable rights. The Promisee has yet to settle his bills for other paintings purchased from the Promisor. The Promisor and Promisee may provide in the contract that the Promisor cannot raise it as a defence in an action instituted by the Third Party.⁷¹

It is submitted that the illustration used in the Explanatory Notes is more applicable to section 3(3). There may be cases where the promisor and promisee also have dealings outside the contract in dispute ("the outside dealings"). Where an action is brought against the promisor by the promisee, the promisor may, under normal circumstances, raise a defence or set-off which arises from the outside dealings. Section 3(3) provides that whether or not the promisor may avail himself to such a defence or set-off in an action by the third party depends on whether he is given such a right under the contract.

Is there a drafting error in section 3(5)? Should "Subsections (2) and (4)" in the opening sentence of section 3(5) read as "Subsections (3) and (4)"? It is submitted that section 3(5) cannot refer to section 3(3). The defences and set-off stated in the latter are made available to the promisor only if the parties contracted for it. Hence, it is redundant to repeat this condition in both provisions.

However, it is not logical that the parties to the contract be allowed to contract out of section 3(2). A void contract is a void contract. A contract cannot be void to stop the promisee from enforcing it but valid for the third party's enforcement. In other words, a void contract

⁷¹Note 40, at paragraph 19(1).

cannot be revived for the third party's action. A provision giving this effect will give the third party, who is a stranger to the contract, a better right than the promisee.

To find out the intention of the legislature, one may find guidance in the document, which proposed the provision, that is, The Law Commission Report No. 242. As emphasised above, the underlying theme of the reform is that "the third party can only be entitled to what the contracting parties have agreed what it should be entitled." Hence, if the parties want to, they can always give better rights to the third party compared to the promisee. To support this line of argument, the Law Commission Report gave a practical illustration of where a contractor takes out an insurance policy to cover itself and all subcontractors for a project. Any claim by the contractor will be defeated if there was non-disclosure of any material facts by him. Following therefrom, any claim by the subcontractor under the insurance contract will also be defeated as he derives his rights from the same insurance contract. This will cause injustice to the subcontractor especially if he did not know about it when he relied on the benefit⁷² and hence, did not obtain a separate coverage. Hence, the insurer and contractor, if they wish to, may restrict the insurer from using it as a defence in a suit brought by the third party. The argument of the Law Commission granted, such wide benefit conferred on the third party tantamounts to an indemnity.

We must bear in mind that the provision in section 3(5) can also be used as a license to ruin the promisor financially.⁷³ It can be subject to abuse beyond the imagination of the Law Commission. Hence, the promisor should consider with care before agreeing to narrow any defences or set-off available to him in an action by the third party.

That blemish aside, section 3(4) envisages situations where the promisor and the third party also have dealings outside the contract in question ("third party dealings"). It is provided that the promisor may also raise as a defence, set-off or counterclaim any matter that arises

⁷²Paragraph 10.15.

⁷³Although the promisor may have an indemnity from the promisee, he can still be financially ruined, especially where the promisee is insolvent.

from such third party dealings. Here, it is obvious that more defences may also be made available to the promisor if the third party is to institute an action, compared to a situation where the promisee is instituting the action. However, as in the preceding paragraphs, the parties to the contract may expressly narrow such defences, set-off or counterclaim.⁷⁴ The Explanatory Note again gave an example to illustrate such a situation. The Promisor promises the Promisee that he will pay 5,000 pounds to the Third Party. Although the Third Party owes the Promisor a sum of money, the Promisor and the Promisee may contract that the Promisor is not entitled to raise it as a counterclaim or set-off or defence against an action from the Third Party to enforce the Promisor's obligations to pay the 5,000 pounds to him.⁷⁵

We are to note here that the counterclaim available to the promisor in an action by the promisee is on a matter which does not arise from the contract. Instead, the counterclaim is on a matter between the promisor and the third party, which is outside the contract in dispute. If it is on a matter between the promisor and the promisee, the third party will not only be conferred enforceable rights under the 1999 Act but also be subject to obligations under a contract in which he is a stranger.⁷⁶

5. What Are the Controls Given To the Promisor and Promisee By the 1999 Act?

As highlighted earlier, the purpose of the 1999 Act is to give effect to the intention of the parties. With the 1999 Act, the gate is opened to a third party to enforce rights given to him under the contract. This part will analyse the controls given to the parties of the contract by the said Act.

⁷⁴Section 3(5).

⁷⁵Note 40, at paragraph 19(2).

⁷⁶Contrast with section 9 of the New Zealand's Contracts (Privity) Act 1982. Please also see the discussion below on 'What The 1999 Act Does Not Provide'.

(a) Benefits But Not Enforceable

As discussed above, a benefit granted to a third party under a contract is presumed to be enforceable.⁷⁷ However, this presumption can be rebutted 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". Hence, it is possible for the promisor and promisee to confer a benefit, albeit a non-enforceable benefit, to a third party. To avoid any unnecessary litigation, parties to such contract should expressly state their intention.⁷⁸ With this, the position is similar to the position prior to the enactment of the 1999 Act. Under such circumstances, a third party, though conferred a benefit, cannot enforce it. Only the parties to the contract may enforce the contract or any term thereunder.

(b) Freedom to Contract

Section 1(4) provides:

"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."

Following therefrom, first and foremost, it is clear that the parties to the contract may contract out of the 1999 Act even where a benefit is conferred on a third party. As discussed above, where a benefit is conferred, it can remain unenforceable. Under such circumstances, the doctrine of privity will continue to apply.

The parties to the contract may also limit or place conditions on the third party's conferred rights; for example, if he wishes to enforce the right, he is to do so by way of arbitration and not litigation.⁷⁹

Apart from that, the parties to the contract may also widen the defences available to the promisor where the third party sues him. This

⁷⁷Upon reading section 1(1)(b) together with subsection (2).

⁷⁸This will also apply where the parties intend to confer an enforceable benefit on a third party, for the court can construe the term otherwise.

⁷⁹Note 40, at paragraph 9.

is provided for in section 3(4). Likewise, the parties to the contract may expressly narrow the defences available to the promisor when the third party seeks to enforce the term beneficial to him. This is provided for in section 3(5).⁸⁰

We are also to note that section 2 protects the third party. Once a crystallisation event takes place, the parties to the contract cannot rescind the contract or vary it in such a way as to extinguish or alter the third party's conferred right of enforcement unless with his prior consent. However, such protection conferred is far from absolute. The parties to the contract may, at the onset, contract to dispense with his consent.⁸¹ The contract may also provide for a different set of crystallisation events, other than those set out in the 1999 Act.⁸²

(c) Statutory

Even though the 1999 Act provides for the enforcement of a contractual term by the third party, it does not neglect the rights of the promisee. Section 4 expressly stipulates that the promisee's right of enforcement is not abrogated. This includes the term which confers a benefit on the third party. Hence, the promisor is obliged to two persons for the same promise. They are the promisee under the contract and the third party under the rights given by the 1999 Act.

However, the issue of the promisor being subjected to double liability, that is, liable to both the promisee and the third party, is only partially taken care of. Section 5 provides that where the promisee has recovered from the promisor damages for the third party's loss or the promisee's expenses in making good the promisor's default, the court will take into account the amount so recovered by the promisee. Unfortunately, there is no provision to cover the situation where the

⁸⁰Please see above for the discussion on sections 3(4) and 3(5).

⁸¹Section 2(3)(a) provides that the parties may, if they wish to, expressly provide for the reservation of their rights to rescind or vary the contract without the third party's prior consent.

⁸²Section 2(3)(b).

third party initiated action and recovered damages from the promisor prior to the promisee's action.⁸³ The Law Commission did not think that there would be a risk of double liability as under such circumstances, the promisee would be left with no corresponding loss outstanding.⁸⁴ However, we are to note that the promisee may still be entitled to nominal damages. There may also be situations where both the promisee and the third party share the same benefit and the third party first initiated and recovered damages from the promisor. Under such circumstances, the promisor will still be subject to the risk of double liability.

Hence, it is advisable for the parties to the contract to provide for the later situation⁸⁵ where the third party initiates the legal action first. The absence of such provision will put the promisor at risk for double liability.

B. What the 1999 Act Does Not Provide

The 1999 Act does not empower the parties to the contract to impose any obligation on a third party. Hence, the privity doctrine in this aspect is not reformed. It still jealously guards the third party from being sued under the contract. This is different from the New Zealand's Contracts (Privity) Act 1982 which allows the promisor to counterclaim against the third party as if the third party is a party to the contract.

Where there is an exclusion clause in a contract, which is expressly stated for the benefit of a third party, he may avail himself of the exclusion clause when sued by the promisee for negligence. The promisee is permitted to attack the exclusion clause on the ground of unreasonableness under section 2(2) of the Unfair Contract Terms Act 1977 ("UCTA"). However, where the promisor uses the exclusion clause to shield himself from liability in an action by the third party, section 7(2) of the 1999 Act clearly provides that the third party cannot rely on section 2(2) of UCTA to challenge such a term. In other words,

⁸³Where both the promisee and third party take simultaneous actions against the promisor, the promisor may apply to join the actions.

⁸⁴The Law Commission Report No. 242, at paragraph 11.16.

⁸⁵Note section 1(4).

only parties to the contract can avail themselves of the protection of section 2(2) of UCTA.⁸⁶ When questioned on the discrimination during the Second Reading, the Minister replied that the 1999 Act gives rights to the third party. The Act does not take away any of his existing statutory rights. However, he did not dismiss the possibility of amending the Act later to 'tackle rather more complex issues as regards the ambit of consumer protection'.⁸⁷

V. Conclusion

Judges, law reformers and commentators alike have criticised the doctrine of privity. It not only prevents a third party to a contract from being subjected to obligations imposed on him but is also capable of defeating the sole purpose of a contract by prohibiting a third party who has been conferred rights under a contract from enforcing his rights.⁸⁸

However, with the passing of the 1999 Act, a floodgate may be opened unless the contract is worded carefully. Third parties may attempt to enforce the benefits of a contract even though the promisor and promisee have no intention whatsoever to grant them any rights, enforceable or otherwise⁸⁹ or do not have the third party in contemplation when they negotiate and execute the contract.

To avoid unwarranted and unnecessary litigation, it is advisable for the parties to the contract to expressly contract out of the application of the 1999 Act. Where a right is to be conferred on a third party, the parties to the contract should ask themselves the following questions:

- (a) Do they have the intention to allow the third party to enforce the rights against the promisor in his (the third party's) own name? If the answer is in the affirmative, then it should be so provided. Where possible, the third party should be named. If not, clear and

⁸⁶See Meryll Dean, 'Removing A Blot On The Landscape - The Reform Of The Doctrine Of Privity' [2000] *JBL* 143, at page 149.

⁸⁷HL Hansard, 2 February 1999, Columns 1433-1434. See also HL Hansard, 11 January 1999, Columns 31-32.

⁸⁸The Law Commission Consultation Paper No. 121, 'Privity of Contract: Contracts for the Benefit of Third Party', at paragraph 1.2.

⁸⁹See note 53.

- unambiguous words should be used to identify the class to which the third party belongs or to describe him. It has been held by the New Zealand's Court of Appeal in *Field vs Filton*⁹⁰ that "the mere addition of the words 'or nominee' without more, is not sufficient."
- (b) Would they like to reserve their rights to vary or rescind the contract without the consent of the third party or under specified circumstances? Again, if the answer is in the affirmative, the contract should make express provisions therefor.
 - (c) Would they like to limit or restrict the remedies available to the third party? Again, if the answer is in the affirmative, the contract should make express provisions therefor.
 - (d) Would they like to narrow⁹¹ or widen any defences, set-off or counterclaim available to the promisor in the event the third party enforces the right? If the answer is in the affirmative, the contract should also make express provisions therefor.

Would the commercial world in Malaysia be affected by the 1999 Act?⁹² As stated above, the 1999 Act applies to contracts which are subject to the laws of England, Wales or Northern Ireland. Hence, if any contract is subject to any of the said laws, as is the norm for international contracts where one of the parties is a Malaysian and the other a foreigner, care should be taken. Some contracts that come to mind are the international sale of goods contracts, irrevocable documentary credits, loan agreements, due diligence reports and construction contracts. The list is not exhaustive.

Chan Wai Meng*

* Lecturer
Faculty of Business and Accountancy
University of Malaya

⁹⁰[1988] 1 NZLR 482, at page 494.

⁹¹As discussed above, the promisor should bear in mind the financial and other consequences before agreeing to narrow the defences available to him.

⁹²Although section 2(d) of Malaysia's Contracts Act 1950 recognises that consideration may move from a third party, the third party cannot enforce the contract. This is confirmed by the Privy Council in the case of *Kepong Prospecting Ltd v Schmidt* [1968] 1 MLJ 170. Subject to statutory exceptions and certain legal concepts, the doctrine of privity still applies in Malaysia.

STAUNCH SHIPS – DUE DILIGENCE EQUALS ABSOLUTE OBLIGATION?

A shipper's rights against the carrier of his goods will normally be contained in the contract evidenced by the bill of lading issued by the carrier upon accepting the shipper's goods for carriage. Where the Hague Rules¹ (hereinafter referred to as 'the Rules') come into the picture², the rights of the shipper for a minimum care regime is guaranteed if the following elements are fulfilled:

1. That the shipper ships his goods under a contract of carriage evidenced by a bill of lading or any similar document of title.³
2. That the carriage of his goods is in a ship carrying goods from any port in Malaysia.⁴
3. That the shipper is shipping any article of every kind whatsoever except live animals.
4. That the shipper's goods is not carried on deck and is so stated.⁵

¹Rules made by the International Conference on Maritime Law held at Brussels in October 1922 (amended 1923). These rules were incorporated in an international convention signed in Brussels on 25th August 1924 by major maritime nations. Before being applied throughout the Federation, the Rules were applied exclusively in the former Federated Malay States, Johore and the Straits Settlements.

²As they will in Peninsular Malaysia, by virtue of section 2 of the Carriage of Goods by Sea Act 1950; in Sabah, by virtue of the Merchant Shipping (Applied Subsidiary Legislation) Regulations 1961, and in Sarawak, by virtue of the Merchant Shipping (Implementation of Conventions Relating to Carriage of Goods by Sea and to Liability of Shipowners and others) Regulations 1960.

³However, in the case of *Sarawak Electricity Supply Corp v MS Shipping Sdn Bhd* [2000] 5 MLJ, Ian Chin held that the Hague Rules also applied to a shipping order as it could also amount to a document of title.

⁴Section 2 of the Carriage of Goods by Sea Act 1950.

⁵Article 1(c) of the Hague Rules.