

Notes based on the lecture given by Professor Andrew Burrows* on the Contracts (Rights of Third Parties) Act 1999 at the first meeting in Oxford of the Society of Construction Law, on Thursday 25 May 2000, chaired by Tony Bingham.

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(Extracts have been taken from Professor Burrow's outline notes and from the Law Commission press release dated 29 July 1996 "Third Parties to have rights under contracts".)

Background to the Act

The rule of privity of contract has been subjected to more criticism by senior judges than any other rule of English contract law. For example Steyn LJ in *Darlington BC v. Wiltshier Northern Ltd* [1995] 1 WLR 68, 76, "*The case for recognising a contract for the benefit of a third party is simple and straightforward. The autonomy of the will of the parties should be respected. The law of contract should give effect to the reasonable expectations of contracting parties. Principle certainly requires that a burden should not be imposed on a third party without his consent. But there is no doctrinal, logical, or policy reason why the law should deny effectiveness to a contract for the benefit of a third party where that is the expressed intention of the parties. Moreover, often the parties, and particularly third parties, organise their affairs on the faith of the contract. They rely on the contract. It is therefore unjust to deny effectiveness to such a contract. I will not struggle with the point further since nobody seriously asserts the contrary*".

A major statutory reform was advocated in 1937 by the Law Revision Committee, but time was not found to implement it before the Second World War began. Reform has taken place in many other common law countries, and third party rights are widely recognised in other European countries, including Scotland.

The Act is based on proposals included in the Law Commission Report No. 242 (1996). The speaker commented that Law Commission Reports may be used to assist in interpretation of the Act. Clark LJ in *Yaxley v Gotts* [1999] 3 WLR 1217, 1232: "*Where a statute has been enacted as a result of the recommendations of the Law Commission, it is both appropriate and permissible for the court to consider those recommendations in order to help to identify the mischief which the Act is designed to cure and the public policy underlying it*". This probably also applies to the explanatory notes issued by the Lord Chancellor's Department, despite the warning in the introduction which says: "*They do not form part of the Act and have not been endorsed by Parliament.*" Reliance on such documents appears to be part of trend towards a more European purposive approach to interpretation in English law.

The main provisions of the act

The first test of enforceability of third party rights is straightforward. '1(1) .. a person who is not a party to a contract .. may in his own right enforce a term of a contract if (a) the contract expressly provides that he may, ..'.

The second test is more controversial and open to interpretation. The right exists if 1(1) '(b) ... the term purports to confer a benefit on him ..' subject to the proviso that this 'does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by a third party'. This test was included for various reasons. It mirrors the inclusion in contracts of both express and implied terms. Contracts may not be well drafted. A number of cases, *Beswick v Beswick* for example, would not have satisfied the requirements of the first test. The inclusion of this second test gives more flexibility in the

interpretation of contracts. The wording has also been used in the equivalent New Zealand act which has been in operation for over 10 years without significant problems in application. Those who are not happy with the implications of this test may easily override it. For example there may be a term in the contract which states that in a contract between A and B, C shall have no rights under the contract. Alternatively, certain rights will be regarded as not having been created if the contract prohibits assignment.

The wording calls for a normal interpretation of the contract, although of course the burden is reversed. Thus A or B may seek to demonstrate that there is no implied right for C.

The wording is designed not to cover consequential benefits which may arise to others out of the action of the contract. In an insurance contract the damages which might be payable to a third party victim arise out of the contract. However, the term in the contract would not have been designed to confer a benefit on a third party. Furthermore, the victim would not have been identified (*'1(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.'*)

Professor Burrows commended the part of analysis of the then bill in Treitel's "The law of Contract" 10th edition dealing with this issue. *'The term must, moreover, purport to confer the benefit on C, so that it is not enough for C to show that he would happen to benefit from its performance. The question of whether the term purported to confer on C would be one of construction. If, for example, A were employed by B to "cut my hedge adjoining C's land," performance by A might benefit C, but the term would not "purport to confer a benefit" on C. The question of construction could be particularly hard to answer where A was a sub-contractor employed by B to render services in relation the property owned by C. Assuming that the term does purport to confer a benefit on C, it is then necessary to construe the contract as whole to determine the nature and extent of C's right to enforce the term.'* (Treitel, 1999)

The possible application of the act to 'disappointed beneficiary' cases such as *White v. Jones* was also discussed. Quoting Treitel's on this point *'C would not get a right under the [Act] against A, the negligent solicitor, since the terms of the solicitor's retainer (even if they identified C) would not purport to confer a benefit on C: the intended benefit was to come, not from A, but from B.'* (Treitel, 1999)

Negative rights in the sense of clauses excluding liabilities for third parties would be a valuable possibility under the Act. For example the contract between A and B could specifically exclude any liability of C (e.g. in the tort of negligence) towards either party.

The question of unintended liabilities towards third parties arising under the second test was discussed and had clearly been a major cause of concern amongst those commenting during the consultation process prior to enactment. Unintended liabilities were a risk under any contract and of course required thought at the drafting stage.

Professor Burrows warned about exclusion clauses which were so broad that they excluded third party rights which had existed before the Act came into force and which a party might be relying on. Terms excluding new third party rights should refer specifically to the Act. The following was given as a model:

Standard term "excluding" the Act: *"A person who is not a party to this agreement shall have no right under the Contracts (Rights of Third Parties) Act 1999 to enforce any of its terms [except and to the extent that this agreement expressly provides for such Act to apply to any of its terms]"*.

Variation and Rescission By the Contracting Parties: Section 2

Section 2 deals with the situation where the parties to a contract change their minds about the terms of the contract or its existence. Some of those commenting on the Act were concerned that this section would cut across the provisions for variation orders included in most construction contracts. The Act does not cover these which are unilateral orders to change something using machinery provided within the contract. The terms of the contract do not change. Section 2 of the Act on the other hand deals with variation of the terms of the contract or rescission of the contract, by agreement between the parties. The analysis in Chitty on Contracts (28th ed. Hugh Beale, 1999) Chapter 37 paragraphs 88-95 was commended in this context.

Collateral Warranties

The Act provides the possibility of using clauses in contracts to do away with the need for collateral warranties, but the evidence is that, for the time being at least the system of collateral warranties established over the last dozen years or so will continue, at least in the short-term, despite its cost.

Arbitration provisions S. 8

Third parties with rights are tied into arbitration clauses of the contract and can take advantage of those provisions.

Other matters

The following headings in Prof. Burrows' notes were not covered in the lecture:

Defences Available to the Promisor: s. 3

Promisee's Rights: ss. 4, 5

Existing Exceptions: much of s. 6, s. 7 (1)

UCTA 1977: s. 7 (2)

Discussion/Questions

The following matters (amongst others) arose during the question time at the end of the lecture.

1) The JCT approach to exclusion of rights arising under the Act was raised. As mentioned above, this is possibly too broadly drafted:

"1.12 Notwithstanding any other provision of this Contract nothing in this Contract confers or purports to confer any right to enforce any of its terms on any person who is not a party to it." JCT Standard Form of Building Contract 1998 Edition, all versions, Amendment 2, January 2000 "Sundry amendments".

Frances Patterson commented that the JCT would be reconsidering the drafting of this clause. She also said that the JCT was already looking at how the Act might be used in relation to rights now conferred by means of collateral warranties.

2) A member of the audience commented that employers currently using collateral warranties to ensure that rights of action exist against subcontractors would not want to get involved with the drafting subcontracts, which would be a way of using the Act to achieve the same effect. However, there are examples of forms of subcontract already being subject to controls under the main contract. Under the Engineering and Construction Contract "26.3 The Contractor submits the proposed conditions of contract for each subcontract to the Project Manager for acceptance unless the NEC Engineering and Construction Subcontract or the NEC Professional Services Contract is to be used or the Project Manager has agreed that no submission is required. ...". Under the JCT nomination procedure the form of subcontract is also prescribed.

3) A questioner asked whether third parties had rights to use adjudication under the Housing Grants, Construction and Regeneration Act 1996. The speaker answered 'No' whereupon the chairman commented that he had tentatively reached a different conclusion. It was later agreed that there might be circumstances when a right to adjudication for a third party would exist, for example, when the contract terms included express adjudication provisions, provided these were not denied to the third party by the terms of the contract.

4) The Scottish experience was raised by another questioner. Since the sixteenth century Scottish law has recognised a *ius quaesitum tertio* (i.e. a right vested in a third party by a contract to which he was not privy). However, collateral warranties are used rather than using this possibility to confer rights on third parties. The speaker commented that he thought that the *ius quaesitum tertio* is not well understood and that a Scottish law commissioner had said to him that an act similar to the Contracts (Rights of Third Parties) Act would be of benefit in Scotland.

Some Examples Of Possible Application

The following come directly from the notes handed out by Prof. Burrows.

Insurance

- (1) Owner (B) takes out a liability insurance policy with insurer (A) whereby A agrees to indemnify B and B's subsidiary companies, contractors and sub-contractors in respect of liabilities incurred in the carrying out of construction work for B. (See *Trident General Insurance Co Ltd v. McNiece Bros Pty Ltd* (1988) 165 CUR 107).
- (2) Owner of a barge (B) takes out an insurance policy with insurer (A) insuring B against loss of, or damage to, the barge and including a term by which A waives subrogation rights against charterers of the barge. (See *Fraser River Pile & Dredge Ltd v. Can Dive Services Ltd* [2000] 1 Lloyd's Rep 199).
- (3) Employer (B) takes out personal accident/private health insurance with insurer (A) for the benefit of its employees.
- (4) B takes out life insurance with A for the benefit of a long-term cohabitee. (Married Women's Property Act 1882 is limited to spouses and children). But long-term cohabitee would need to establish an insurable interest under the Life Assurance Act 1774: see Hemsworth [1998] CU 55.
- (5) Cut-through clauses in reinsurance contracts: in the event of re-insured's (B's) insolvency, re-insurer (A) to pay original assured direct.

Construction

- (1) To replace collateral warranties given by architect or engineer or contractor to, e.g., subsequent purchaser or lending institution.
- (2) B (head-contractor) excludes or limits liability in negligence to A (employer) of B and B's "agents, servants, employees and sub-contractors". (See *Southern Water Authority v. Carey* [1985] 2 All ER 1077; *Norwich City Council v. Harvey* [1989] 1 WLR 828).
- (3) A (employer) agrees to indemnify B (head-contractor) and sub-contractors against liability to others in the carrying out of construction work for A.

Securities issues

- (1) To give "direct enforcement rights" to investors in global notes where the underlying contract is between issuer of global note and bank/clearing system. Such rights presently achieved by deed poll.

- (2) To give investors right to sue on information covenants (whereby issuer covenants to supply information to investors). Investors could be given third party rights in the subscription agreement rather than present mechanism of deed polls.
- (3) An indemnity in subscription agreement against liabilities if a prospectus is misleading can be made enforceable by subsidiary underwriters, officers and employees.

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