



**LAW REFORM**  
COMMISSION/COIMISIÚN UM  
ATHCHÓIRIÚ AN DLÍ

REPORT

# **PRIVITY OF CONTRACT AND THIRD PARTY RIGHTS**

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## THE LAW REFORM COMMISSION'S ROLE

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The Law Reform Commission is an independent statutory body established by the *Law Reform Commission Act 1975*. The Commission's principal role is to keep the law under review and to make proposals for reform, in particular by recommending the enactment of legislation to clarify and modernise the law. Since it was established, the Commission has published over 130 documents containing proposals for law reform and these are all available at [www.lawreform.ie](http://www.lawreform.ie). Most of these proposals have led to reforming legislation.

The Commission's role is carried out primarily under a Programme of Law Reform. Its *Third Programme of Law Reform 2008-2014* was prepared by the Commission following broad consultation and discussion. In accordance with the 1975 Act, it was approved by the Government in December 2007 and placed before both Houses of the Oireachtas. The Commission also works on specific matters referred to it by the Attorney General under the 1975 Act. Since 2006, the Commission's role includes two other areas of activity, Statute Law Restatement and the Legislation Directory.

Statute Law Restatement involves the administrative consolidation of all amendments to an Act into a single text, making legislation more accessible. Under the *Statute Law (Restatement) Act 2002*, where this text is certified by the Attorney General it can be relied on as evidence of the law in question. The Legislation Directory - previously called the Chronological Tables of the Statutes - is a searchable annotated guide to all legislative changes. After the Commission took over responsibility for this important resource, it decided to change the name to Legislation Directory to indicate its function more clearly.

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Full responsibility for the contents of the Report rests, however, with the Commission.



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# INTRODUCTION

## A Background

1. This Report forms part of the Commission's Second Programme of Law Reform 2000-2007<sup>1</sup> and follows the publication in 2006 of a Consultation Paper on Privity of Contract: Third Party Rights.<sup>2</sup>

2. A contract is usually described as an agreement between two parties, whether corporate entities or individuals. The agreement is legally enforceable if it is based on genuine consent and involves an exchange of economic value, usually called consideration. For example, if A and B agree that A will paint B's fence and that in return B will pay A €100, both parties have provided consideration and the agreement will be enforced by the courts. Closely related to the requirement of consideration is the concept of privity of contract. In essence, privity means that only the parties to a contract – those "privity" to it – have enforceable rights and obligations under that contract.

3. This Report is concerned with identifying the role of privity of contract in the modern law of contract. Its purpose is to analyse whether the needs of those affected by privity would be best served by its reform and whether third parties should be able to enforce rights under contracts made for their benefit. In the Consultation Paper, the Commission provisionally recommended statutory reform and this Report contains the Commission's final views and recommendations. It takes into account developments since the Consultation Paper was published, comments made in submissions to the Commission and the views expressed at the seminar held by the Commission on 14<sup>th</sup> March 2007.

## B Outline of the Report

4. In Chapter 1 the Commission outlines the current law on third party rights in Ireland. It provides an overview of the privity rule, the

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<sup>1</sup> Item 19 in the Commission's *Second Programme of Law Reform 2000–2007* (available at [www.lawreform.ie](http://www.lawreform.ie)) commits the Commission to examining privity of contract and third party rights. The topic was included in the Minister for Justice's 1962 *Programme of Law Reform* (Pr.6379), but this is the first time it has been examined in depth in the State with a view to its reform.

<sup>2</sup> LRC CP 40-2006, referred to in this Report as "the Consultation Paper."

exceptions to it and the means of circumventing it. The Commission also discusses how under the current law a contracting party can enforce a contract, or term of a contract, which was intended to benefit a third party.

5. In Chapter 2, the Commission examines the arguments for and against reform of the privity of contract rule to allow third parties to enforce rights under contracts made for their benefit. The Commission confirms the view expressed provisionally in the Consultation Paper that the rule should be reformed. The Commission also confirms that this is best done by means of legislation as this can deal in advance with many of the issues that arise in connection with third party rights and also increase certainty. The Commission then outlines the main principles and considerations which should guide any legislative reform of the privity rule. These are that the reforms: give effect to the intentions of the contracting parties; be as certain as possible; facilitate the commercial interest of the parties; clarify the limits of the rights of third parties; protect the third party's expectations, not merely what they have relied on; and protect the third party where he or she is to gain a benefit from the contract and seeks to rely on the contract to avoid a loss.

6. In Chapter 3, the Commission examines the specific issues that must be addressed to formulate a comprehensive scheme of third party rights. The Commission's key recommendation is that a third party should be able to enforce a term of a contract when the term expressly confers a benefit on the third party. The third party should not be able to enforce the term if it appears on a proper construction of the contract that the contracting parties did not intend the term to be enforceable by the third party. The contract should be interpreted in accordance with the ordinary rules of contractual interpretation, but surrounding circumstances should only be taken into account if they are reasonably available to the third party.

7. Chapter 3 also contains the detailed recommendations which the Commission considers should form part of the recommended new statutory regime. These include the following. The third party should be identified in the contract either by name or by description. The third party should be able to enforce a term of a contract even though they have not provided consideration. The contracting parties should not be able to cancel or vary the contract in such a way as to affect the rights of the third party once either contracting party is aware that the third party has assented to the contract, either by word or by conduct. The contracting parties should remain free to include in the contract an express term providing for variation or termination of the contract. The rights of the third party should be subject to the usual defences and remedies (including set-off and counterclaim) which would be available to the promisor if the promisee had taken the action. The Commission also recommends that existing common law and statutory exceptions to the privity rule should be retained but be kept under review.

The proposed legislation should not apply to certain contracts, such as employment contracts and certain contracts involving companies.

8. The Commission also recommends that contracting parties should be able to exclude or “contract out” of the proposed legislation. This reflects the Commission’s overall view that the legislative scheme should be facilitative and not prescriptive. This is comparable to the approach taken in the scheme introduced in England and Wales by the *Contracts (Rights of Third Parties) Act 1999*, which followed from the 1996 Report of the Law Commission for England and Wales, *Privity of Contract: Contracts for the Benefit of Third Parties*.<sup>3</sup> As the Commission notes in Chapter 2 of this Report,<sup>4</sup> there has been a growing “opting-in” approach taken in recent years to the 1999 Act, particularly in the context of the standard form contracts associated with major commercial projects. This would appear to support the facilitative approach favoured by the Commission.

9. The Appendix to this Report contains a draft *Contract Law (Privity of Contract and Third Party Rights) Bill 2008*, which gives effect to the Commission’s recommendations.

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<sup>3</sup> Law Com No.242, 1996.

<sup>4</sup> See paragraphs 2.16 – 2.25, below.



## CHAPTER 1 THE CURRENT LAW IN IRELAND

### A Introduction

1.01 The privity rule means that only the parties to a contract (those privity to it) have enforceable rights and obligations under the contract. An individual or corporate entity who is not a party to the contract is called a “third party”. A third party does not have enforceable rights or obligations under the contract.

1.02 In this Chapter the Commission outlines the current law on third party rights in Ireland. Part B of this Chapter provides an overview of the privity rule. In Part C the exceptions to, and means of circumventing, the privity rule are outlined. In Part D the Commission discusses how a contracting party can enforce a contract, or term of a contract, which was intended to benefit a third party.

### B Overview of the privity rule

1.03 Privity of contract involves two ideas. First, only a party to a contract can have any burdens from the contract enforced on them. A third party cannot be sued for breach of the contract. Second, only a party to a contract can enforce the contract or a term of the contract. A third party cannot sue to enforce the contract, even if the contract was intentionally made for their benefit.

1.04 The first aspect of the rule of privity, namely the idea that a third party can not have any burdens from the contract enforced on them, is generally accepted as good law.<sup>1</sup> It would be plainly unfair, and contrary to the idea of freedom of contract, if two parties could impose contractual obligations on a third party without the latter’s consent. The Commission is thus not concerned with this aspect of the privity rule. Rather, the Report

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<sup>1</sup> There are a number of exceptions to this rule. For example, section 47 of the *Land and Conveyancing Law Reform Bill 2006*, which is currently before the Oireachtas (and which would implement the Commission’s *Report on Reform and Modernisation of Land Law and Conveyancing Law* (LRC 74-2005)), proposes to make freehold covenants fully enforceable by and against successors in title. Hence, successors in title to land can gain responsibilities under a contract to which they were not a party. See paragraph 1.61 below.

deals with the situation where a contract is made for the *benefit* of a third party.

1.05 The effect of the privity rule can be seen in a number of everyday situations.

1.06 Example 1: Mary contracts with a builder for the construction of an extension to Mary's mother's home. The contract is clearly intended to benefit Mary's mother. However, if the builder refuses to complete the building, or provides a defective service, Mary's mother is not entitled to sue the builder for breach of contract.

1.07 Example 2: Ross promises his father, Joseph, that in return for the family farm, Ross will pay a sum of €200,000 to his sister Niamh. Joseph transfers the farm to Ross but Ross does not pay Niamh. Niamh is unable to bring an action against Ross for the money, as she is not a party to the contract between Ross and Joseph.

1.08 Example 3: A hires B to construct a new building. B subcontracts part of the building work to C. If C's work is defective, or if C fails to complete the work, A can not sue C for breach of contract. Similarly, if B fails to pay C, C can not look to A for payment. There is no direct contract between A and C. This example is slightly different to the first two examples, in that here there is one contract between A and B, and another between B and C, whereas in the first two examples the third party had not entered into any contract.

1.09 In each of these examples, the contracting party who promised to perform (the promisor) can be sued by the other contracting party (the promisee). However, the promisee may be unwilling or unable to bring an action, and even if they do so it is unclear whether an appropriate remedy will be available to them. This is discussed in more detail in Part D below.<sup>2</sup>

## **C The exceptions to, and means of circumventing, the privity rule**

1.10 As discussed in the Consultation Paper, there are many common law and statutory exceptions to the privity rule, and it is often circumvented in practice.<sup>3</sup>

### **(I) Agency**

1.11 Agency is the relationship that exists when one person (the agent) is appointed by another person (the principal) to act as their representative.<sup>4</sup>

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<sup>2</sup> See paragraphs 1.62 to 1.68 below.

<sup>3</sup> See Consultation Paper, paragraphs 1.27 to 1.67.

Contracts entered into by the agent on behalf of the principal will be legally binding on the principal.<sup>5</sup> For example, an employee such as a shop assistant may be an agent of their employer (the shop owner) for the purpose of selling goods, and thus any contract of sale concluded between the employee and a customer will be binding on the employer. The agent/employee will not be liable on the contract of sale.

1.12 The terminology traditionally used to explain the relationship between the three parties in an agency scenario can cause confusion. In the example given, the employer is the principal, the employee is the agent and the customer is usually described as the “third party”. However, the customer is really a “third party” to the contract between the principal and the agent, i.e. the contract of agency or, in this example, the contract of employment. The contract with which we are concerned is the contract between the agent/employee and the customer. The principal/employer is a “third party” to this contract, and can sue and be sued on it because of the agency exception to the rule of privity.

1.13 One contracting party (X) may assume the other contracting party is acting on their own behalf, and may not be aware that they are in fact contracting as an agent of the principal. In this situation, the principal is an “undisclosed principal”. If X discovers the existence of the undisclosed principal, X can enforce the contract against either the agent or the principal. The undisclosed principal can enforce the contract against X even though X was unaware of the latter’s existence.<sup>6</sup> Thus, even an undisclosed principal can obtain a right of enforcement under a contract that was made for their benefit.

1.14 Agency is thus a major exception to the privity rule. It is necessary to facilitate business transactions, particularly where the principal

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<sup>4</sup> See Reynolds *Bowstead and Reynolds on Agency* (18<sup>th</sup> ed Sweet & Maxwell 2006); White *Commercial Law* (Thomson Round Hall 2002) Chapters 4 – 7; Ellis *Modern Irish Commercial and Consumer Law* (Jordans 2004) Chapters 38 and 39. Agency “of necessity” arises by operation of law, rather than by appointment by the principal, when the agent is forced to act in an emergency situation in which the property of another is in “imminent jeopardy”: *Bowstead and Reynolds on Agency* Article 33, paragraph 4-001.

<sup>5</sup> The agent will legally bind the principal when the agent acts within its “actual authority”, or where the principal represents that the agent has the authority to bind it (“apparent authority”), or where someone in the agent’s position would normally have the ability to legally bind the principal (“usual authority”). Even when the agent does not have authority to bind the principal, the principal may later ratify the agent’s actions if certain conditions are met, and will thus be legally bound.

<sup>6</sup> See White *Commercial Law* (Thomson Round Hall 2002) at 120 – 124. The agent may also enforce the contract against X where the principal is undisclosed.

is unable to attend the negotiation and conclusion of contracts entered into in the course of their business.

1.15 The legislative reforms proposed in Chapter 3 are not intended to affect the rules of agency, and agency will continue to have a vital role to play as a means of creating binding legal relationships.<sup>7</sup>

## (2) *Trusts*

1.16 A third party can enforce a contract if a completely constituted trust was created in their favour by the contract.<sup>8</sup> Although in some earlier cases the courts have appeared willing to imply the existence of a trust to give rights to third parties,<sup>9</sup> this has been criticised as a “cumbrous fiction”,<sup>10</sup> and today courts are reluctant to find that there is a trust unless it is clear that this was the intention of the parties.<sup>11</sup> This approach is taken because the creation of a trust is a serious undertaking with different consequences to a contract. The parties cannot rescind or vary the agreement without the consent of the third party beneficiary,<sup>12</sup> and a trustee may owe various special duties to the third party beneficiary.<sup>13</sup> Such duties may be more onerous than a party’s normal contractual duties. This has been pointed out in the Australian High Court:

“[T]here are other consequences which flow from recognising the existence of a trust. It may circumscribe the freedom of action of the parties to the contract, especially the promisee, to a greater extent than the existence of a right to sue on the part of the third party. How can the promisee terminate the trust once it is created? Lest it be overlooked, we should mention that the creation of a third party trust rests on ascertaining the intention of the promisee, rather than on the intention of the contracting parties. And in the ultimate analysis it seems incongruous that we should be

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<sup>7</sup> See paragraphs 3.80 to 3.88 below.

<sup>8</sup> See Clark *Contract Law in Ireland* (5<sup>th</sup> ed Thomson Round Hall 2004) at 475 – 478; Delany *Equity and the Law of Trusts in Ireland* (4th ed Thomson Round Hall 2007) at 58 - 60; Yates “Trusts, Contracts and Attornment” (1977) 41 Conv 49.

<sup>9</sup> See for example *Tomlinson v Gill* (1756) Amb 330; *Drimmie v Davies* (1899) 1 IR 176; *Kelly v Larkin* [1910] 2 IR 550.

<sup>10</sup> Lord Wright (1939) 55 LQR 189 at 208.

<sup>11</sup> See for example *Cadbury (Ireland) Ltd v Kerry Co-op Creameries Ltd* [1982] ILRM 77; *Inspector of Taxes Association v Minister for the Public Service* High Court 24 March 1983.

<sup>12</sup> See *Re Schebsman* [1944] Ch 83.

<sup>13</sup> See Delany *Equity and the Law of Trusts in Ireland* (4th ed Thomson Round Hall 2007) Chapter 12.

compelled to import the mechanism of a trust to ensure that a third party can enforce the contract if the intention of the contracting parties is that he should benefit from performance of the contract.”<sup>14</sup>

1.17 Thus, although the creation of a trust may be a means of circumventing the privity rule, it is not always a suitable solution. Contracting parties may wish to create third party rights without becoming trustees.

### (3) *Assignment*

1.18 Suppose X and Y enter into a contract whereby X agrees to confer a benefit on Y. Y may be able to assign (transfer) the benefit of the contract to a third party (T). T is then entitled to sue X on the contract and Y loses the right to enforce or vary the contract. The transfer of contractual benefits is called assignment; Y is called the assignor; T is called the assignee; and X is called the debtor. X’s consent is not necessary for the assignment of contractual benefits from Y to T. Assignment is governed by judge-made<sup>15</sup> and statutory rules.<sup>16</sup>

1.19 Section 28(6) of the *Supreme Court of Judicature (Ireland) Act 1877* provides that an “absolute assignment”<sup>17</sup> by the assignor of any debt or other legal chose in action<sup>18</sup> can pass the legal right to the debt or chose in action to the assignee. The assignment must be in writing by the assignor

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<sup>14</sup> *Trident General Insurance Co v McNiece Bros Pty Ltd* (1988) 165 CLR 107 per Mason CJ.

<sup>15</sup> Historically, the common law courts would not generally allow the assignment of contractual rights, but the equity courts would allow it. The common law courts and equity courts were fused together in the *Supreme Court of Judicature (Ireland) Act 1877*, and the equitable rules (i.e. those developed in the equity courts) were said to prevail over the common law rules. Courts today still distinguish between common law and equitable rules, although in this context this is of little practical significance. Any reference to the “judge made” rules on assignment in this section is really a reference to the equitable rules on assignment.

<sup>16</sup> See Treitel *The Law of Contract* (11<sup>th</sup> ed Thomson Sweet & Maxwell 2003) Chapter 16; McDermott *Contract Law* (Butterworths 2001) at 965 – 974; Tolhurst “Equitable Assignment of Legal Rights: a Resolution to a Conundrum” (2002) 118 LQR 98; Zweigert and Kötz, *An Introduction to Comparative Law* (3<sup>rd</sup> ed Oxford University Press 1998 Translation by Weir) at 442 – 455.

<sup>17</sup> This means that the assignor must not retain an interest in the subject matter of the assignment. Thus, assignment of part of a debt, assignment by way of charge, and conditional assignments are not covered by section 28(6) of the 1877 Act.

<sup>18</sup> A “chose in action” is the right to proceed in court to recover a sum of money or damages for non performance of a contract. Although the 1877 Act refers to a “legal” chose of action, in England this has been broadly defined as including equitable choses in action: *Re Pain* [1919] Ch 38.

and the debtor must be given express notice in writing of the assignment. A statutory assignment does not need valuable consideration (i.e. any form of payment) to be valid. The assignee can then sue the debtor in their own name, without joining the assignor as a party to the action.

1.20 The 1877 Act did not abolish the judge-made rules on assignment, which can still be relied upon if the conditions for a statutory assignment are not met.<sup>19</sup> An assignment of an existing debt does not need valuable consideration to be valid.<sup>20</sup> There is no need to give notice of the assignment to the debtor, although it is recommended to prevent the debtor paying the assignor, and to give the assignee priority over other assignees.<sup>21</sup> If the assignee brings an action against the debtor in such circumstances the assignor is joined as a co-claimant if he is willing to cooperate with the assignee, and as a co-defendant if he is not, for example, if he wishes to dispute the validity of the assignment.<sup>22</sup>

1.21 The debtor can rely on any defences he would have had against the assignor at the time when he received notice of the assignment, and an assignee can not recover more than the assignor could have done if there was no assignment. For example, in *Dawson v Great Northern & City Railway Co*<sup>23</sup> the assignee was not able to claim for damage to trade stock, because the assignor did not carry on such a trade and would not have suffered this loss. This rule has caused difficulties in the past. For example, a developer may sell a building, and validly assign its contractual rights against the builders to the new owner. If there is a defect in the building, the new owner then has the right to sue the developer for breach of contract. However, the builders may attempt to rely on the fact that as the assignor no longer owns the building, they suffer no loss from the breach of contract, and if they still had the right to sue for breach they would only be awarded nominal damages. It could thus be argued that the assignee too is only entitled to nominal damages. However, this argument has been rejected by the Court of Appeal in England, which has recently stated that the rule in *Dawson*

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<sup>19</sup> Other legislative requirements may still have to be met. For example, section 6 of the *Statute of Frauds (Irl) 1695* provides that an assignment of a trust must be in writing.

<sup>20</sup> See *Law Society of Ireland v O'Malley* [1999] 1 IR 162, 172 per Barron J. Consideration may be necessary to support an assignment of a future debt, or where the assignor merely promises to make the assignment in the future.

<sup>21</sup> *Brandt's (William) Sons & Co v Dunlop Rubber Co Ltd* [1905] AC 454; *Three Rivers District Council v Bank of England* [1995] 4 All ER 312. See Ong Chin-Aun "Notice in Equitable Assignment of Choses in Action: Divergence in the Common Law and its Impact" 2002 JCL LEXIS 5.

<sup>22</sup> Treitel *The Law of Contract* (11<sup>th</sup> ed Thomson Sweet & Maxwell 2003) at 675.

<sup>23</sup> [1905] 1 KB 260.

simply means that the assignee cannot claim losses which do not flow from the original breach, but which he has separately introduced.<sup>24</sup> Thus, in the example given, the assignee could recover “no more damages than the assignor could have recovered if there had been no assignment *and* if the building had not been transferred to the assignee”.<sup>25</sup>

1.22 The purported assignment of rights under a contract which expressly forbids the assignment of rights will not be effective against the debtor.<sup>26</sup> Nor will the assignment of rights under a contract that involves a personal confidence in the other contracting party be enforceable against the debtor. For example, the owner of a house who hires a cleaner cannot assign their contractual rights to another party, so that the cleaner must clean for a different owner. Similarly, the holder of a motor insurance policy cannot assign the benefits under the policy, as the insurer relies on the insured’s skill and record as a driver.<sup>27</sup>

1.23 It is not possible to assign a contractual obligation, as opposed to a benefit, to a third party without the consent of all parties involved. In reality in this situation the “third party” is a party to a new agreement, which must be supported by consideration. It would appear to be possible to make the assignment of benefits conditional on the assignee assuming certain burdens under the contract, provided the burden is relevant to the benefit.<sup>28</sup>

1.24 Specific legislative provisions provide for the formal assignment of contractual rights in particular situations. For example, the *Policies of Assurance Act 1867* allows for the assignment of life insurance policies and section 50 of the *Marine Insurance Act 1906* provides that a marine insurance policy is assignable unless it contains a term expressly prohibiting assignment.

1.25 Assignment is an important means of avoiding the effects of the privity rule, and the assignment of contractual rights is common in business transactions. The reforms proposed in this Report are not intended to affect the rules on assignment, but they could reduce the need for assignment as a means of giving rights to third parties.

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<sup>24</sup> *Technotrade Ltd v Larkstore Ltd* [2006] EWCA Civ 1079; [2006] 42 EG 246. See Murdoch “A doubt that has at last been quietened” *Estates Gazette* 21 October 2006.

<sup>25</sup> Per Staughton LJ in *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* (1992) 57 BLR 57, 81 (Court of Appeal) (emphasis changed).

<sup>26</sup> *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85 (House of Lords).

<sup>27</sup> Treitel *The Law of Contract* (11<sup>th</sup> ed Thomson Sweet & Maxwell 2003) at 694.

<sup>28</sup> See *O & E Telephones Ltd v Alcatel Business Systems Ltd* High Court 17 May 1995.

#### (4) *Collateral Contracts and Collateral Warranties*

1.26 A collateral contract or - as it is often called - a collateral warranty is “a contractual promise from one party to a contract to a third party which relates in some way to the terms of the original contract”.<sup>29</sup> In this situation the third party is strictly speaking only a “third party” in relation to the main contract; they are a contracting party as regards the collateral contract. The legal consideration for a collateral warranty is often the making of the principal contract, or a promise to nominate a party as a sub-contractor or supplier.<sup>30</sup> Collateral warranties may be implied,<sup>31</sup> but are more likely to be express.

1.27 Collateral warranties are used extensively to circumvent the privity rule, particularly in the construction industry. It is normal for many companies and individuals to be involved in large construction and civil engineering projects. These include the employer/client/developer, contractors, sub-contractors, consultants, funders and subsequent tenants and purchasers. Many of these companies and individuals are reliant on each other, and could suffer a loss if another party involved in the project failed to perform on time or to a certain standard. However, the privity rule means that it is not possible to sue on a contract unless you are a party to that contract. As a result, it is normal for any party who might be at risk if another party fails to perform, but who would not ordinarily have a direct contract with that party, to seek a collateral warranty from them.

1.28 For example, in a major construction project, a bank may lend to a developer who hires contractors, but there will be no direct contractual link between the bank and the contractors. If the contractor fails to perform, the bank may suffer a loss but will have no contractual remedy against the contractor. As a result, the bank will insist that the contractor enters into a separate contract with the bank, in which the contractor warrants (agrees) that it will complete its obligations under its main agreement with the developer. The bank will then be able to bring an action in contract against the contractor, if necessary. Similarly, prospective purchasers or tenants of a development may wish to have warranties from the builders entitling them to bring a direct contractual action against the builders if defects are later discovered.<sup>32</sup>

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<sup>29</sup> Holmes and MacGregor “Collateral Warranties” in Ramsey (ed) *Construction Law Handbook* (Thomas Telford 2000) Chapter 2.5/3.

<sup>30</sup> Furst and Ramsey *Keating on Construction Contracts* (8<sup>th</sup> ed Sweet & Maxwell 2006) at 181, para 6-026.

<sup>31</sup> See for example *Shanklin Pier Ltd v Detel Products Ltd* [1959] 2 KB 854.

<sup>32</sup> See “Collateral Duties to Third Parties” *Mondaq Business Briefing* 25 April 2005.

1.29 Despite the prevalence of collateral warranties,<sup>33</sup> there are a number of difficulties associated with them. The number of collateral warranties needed for any one project can be high, and they are expensive and time consuming to negotiate and draft. It is the view of the Commission that a legislative scheme allowing third parties to enforce contracts made for their benefit will reduce the need for collateral warranties. This is discussed in more detail in Chapter 2.<sup>34</sup>

## **(5) Tort of Negligence**

### **(a) Introduction**

1.30 If a person suffers a loss as a result of another person's negligence, that person may be able to sue in the tort of negligence. To succeed in a negligence action you do not need to show the existence of a contract,<sup>35</sup> but you must show the following:

“(1) A duty of care, that is, the existence of a legally recognised obligation requiring the defendant to conform to a certain standard of behaviour for the protection of others against unreasonable risks.

(2) A failure to conform to the required standard.

(3) Actual loss or damage to recognised interests of the plaintiff.

(4) A sufficiently causal connection between the conduct and resulting injury to the plaintiff.”<sup>36</sup>

1.31 Third parties who are prevented by the privity rule from suing in contract may attempt to rely on the tort of negligence. For example, in *Donoghue v Stevenson*<sup>37</sup> a woman who became sick after drinking a bottle of ginger beer which contained a dead snail was unable to bring an action in contract against the manufacturer of the beer, because she had no contract with the manufacturer. However, she was able to bring an action in the tort of negligence as she could show that the manufacturer had breached his duty of care to her.

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<sup>33</sup> See Keane “Contractual Relations in Design and Construction” available at <http://www.rcmck.com/uploads/Contractual.pdf>.

<sup>34</sup> See paragraph 2.16 below.

<sup>35</sup> See *Donoghue v Stevenson* [1932] AC 562; *Kirby v Burke* [1944] IR 207.

<sup>36</sup> McMahon and Binchy *Law of Torts* (3<sup>rd</sup> ed Tottel Publishing 2005) at 111.

<sup>37</sup> [1932] AC 562.

**(b) Pure Economic Loss**

1.32 When a plaintiff brings an action in the tort of negligence for “pure economic loss”, that is, wholly financial loss which is independent of any personal injury or injury to property, this action can closely resemble an action for breach of contract. In the English case *Junior Books Ltd v Veitchi Co Ltd*<sup>38</sup> the plaintiff entered into a contract with X, who then entered into a sub-contract with the defendant. The defendant sub-contractor laid down defective flooring in the plaintiff’s factory. The plaintiff could not sue the defendant in contract, as it did not have a direct contract with it, but it successfully sued in the tort of negligence to recover its financial losses.<sup>39</sup> The English courts have since ruled out the possibility of such an action in tort for pure economic loss,<sup>40</sup> being instead of the view that “financial losses are better regulated by terms of [contracts] that are specifically agreed in advance and that demarcate the parties’ rights, duties and possible future liability.”<sup>41</sup> Courts in other common law jurisdictions have reflected this policy by being more willing to allow a claim in tort for pure economic loss when the parties could not have regulated their financial position by means of contract, and are less likely to do so in a commercial situation involving chains of contracts, such as that in *Junior Books*.<sup>42</sup>

1.33 In *Ward v McMaster*,<sup>43</sup> the High Court had approved the decision in *Junior Books*, but in *Glencar Exploration plc v Mayo County Council*<sup>44</sup> the Supreme Court refused to allow an action for pure economic loss on the facts, and Keane CJ “expressly reserved for another occasion” the question of whether *Junior Books* should be followed in Ireland.<sup>45</sup> Thus, although

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<sup>38</sup> [1983] 1 AC 520.

<sup>39</sup> The damages were for pure economic loss because, although the flooring was defective, it did not cause personal injury or damage to any other property of the plaintiffs.

<sup>40</sup> See *Murphy v Brentwood District Council* [1991] 1 AC 69; *D & F Estates Ltd v Church Commissioners* [1989] AC 117.

<sup>41</sup> Healy *Principles of Irish Torts* (Clarus Press, 2006) at 123.

<sup>42</sup> See for example the approach of the Australian High Court in *Bryan v Maloney* (1995) 182 CLR 609 and *Woolcock Street Investments Pty Ltd v CDG Pty Ltd* (2004) 216 CLR 515, where the Court focused on the plaintiff’s “vulnerability,” that is, the plaintiff’s “inability to protect itself from the consequences of a defendant’s want of reasonable care” (Gleeson CJ, Gummow, Hayne and Heydon JJ (2004) 216 CLR 515 at 530, citing Stapleton “Comparative Economic Loss: Lessons from Case-Law-Focused “Middle Theory”” (2002) 50 UCLA Law Review 531 at 558 – 559).

<sup>43</sup> [1988] IR 337.

<sup>44</sup> [2002] 1 IR 84.

<sup>45</sup> In *Betty v The Rent Tribunal* [2006] 1 ILRM 164 at 173 Geoghegan J stated that the law on this question “has not been finally determined in Ireland”.

there are particular circumstances where recovery for pure economic loss will be allowed,<sup>46</sup> beyond this it is unclear whether recovery for pure economic loss is more generally available, and its future in Ireland is uncertain.<sup>47</sup>

**(c) Professional Negligence**

1.34 A third party may seek to rely on the tort of negligence when they suffer an injury and/or financial loss because of the negligence of a professional such as a solicitor, doctor or auditor. The absence of a contract with the professional will not prevent such a claim, provided the other requirements of an action in negligence are met. For example, in *Wall v Hegarty*<sup>48</sup> a person expecting £15,000 in a will that turned out to be invalid could sue the solicitor who negligently drew up the will, even though they had not entered into a contract with the solicitor.<sup>49</sup>

**(d) Statutory Torts**

1.35 In addition to development of the tort of negligence by the courts, the *Liability for Defective Products Act 1991* gives consumers rights of action in tort where they suffer an injury caused by a defect in a product, even if they did not buy the product themselves. Thus the plaintiff in *Donoghue v Stevenson* could now bring an action against the producer of the ginger beer under the 1991 Act.<sup>50</sup>

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<sup>46</sup> For example, an action in tort for pure economic loss is available (a) when the plaintiff suffers a financial loss as a result of a negligent misstatement by another, in circumstances where the provider of the information owes a duty of care to the plaintiff: *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465; *Wildgust v Norwich Union Life Insurance Society* [2006] IESC 19; (b) when a solicitor's negligence in drafting a will causes financial loss to a third party who was to benefit from the will: *Wall v Hegarty* [1989] ILRM 124.

<sup>47</sup> See generally McMahon and Binchy *Law of Torts* (3<sup>rd</sup> ed Tottel 2000) Chapter 10.

<sup>48</sup> [1989] ILRM 124.

<sup>49</sup> In this case recovery was allowed even though the claim was for pure economic loss, discussed above.

<sup>50</sup> The 1991 Act would allow her to bring an action against the producer of the product, its component parts, or raw materials, or any party who holds himself out to be a producer of the product, for example by putting his name on the product, or an importer of the product into the EU. The supplier of the product may also be the producer under particular circumstances outlined in section 2(3) of the 1991 Act. The 1991 Act provides a mechanism which ensures that a consumer can obtain a remedy against a contractor along a chain of contracts for the injury caused to him/her by a defective product.

**(6) Contracts for the benefit of a spouse or child**

1.36 Section 8 of the *Married Women's Status Act 1957* states that any contract entered into by a person that confers a benefit on their spouse and/or their children can be enforced by the spouse and/or the children.

1.37 Section 8 of the 1957 Act only confers third party rights on the spouse and children of the contracting party, and not, for example, on unmarried cohabitants or other relatives. The definition of a “child” includes a stepchild, illegitimate child, adopted person and a person to whom the contracting party is in *loco parentis*.<sup>51</sup> It is not limited to minors under the age of 18.

1.38 Section 8 of the 1957 Act only applies where the contract *expressly* confers a benefit on the spouse or children. In *Burke v Dublin Corporation*<sup>52</sup> a boy’s asthma condition was aggravated due to his unfit living conditions, and he attempted to sue for breach of the tenancy agreement entered into between his parents and Dublin Corporation. He claimed that because the rent was calculated by reference to the number of children living in the premises, the contract was expressed to be for the benefit of those children. The Supreme Court rejected this argument and decided that he could not rely on section 8 of the 1957 Act as the contract did not expressly confer a benefit on the minor. The case was thus decided on the basis of housing legislation and negligence principles, rather than on contract.

1.39 Section 8 of the 1957 Act does not apply to a policy of life assurance or endowment expressed to be for the benefit of, or by its express terms purporting to confer a benefit upon, the spouse or child of the insured. Section 7 of the 1957 Act specifically deals with this situation and is discussed in the next section.

**(7) Insurance**

1.40 Insurance arrangements are often made by the insurer and insured for the benefit of a third party. However, at common law that third party beneficiary is not entitled to claim under the insurance contract.<sup>53</sup> This could cause serious injustice, and so legislation has been enacted to allow the third party beneficiaries of certain insurance contracts to claim under the insurance policy.

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<sup>51</sup> Section 8(5) of the 1957 Act.

<sup>52</sup> [1991] 1 IR 341.

<sup>53</sup> *Vandepitte v Preferred Accident Insurance Corporation of New York* [1933] AC 70; *Williams v Baltic Insurance Co* [1924] 2 KB 282.

1.41 For example, section 7 of the *Married Women's Status Act 1957* provides that a policy of life assurance or endowment which is expressed to be for the benefit of, or by its express terms purports to confer a benefit upon, the spouse or child of the insured, is enforceable by that spouse or child.<sup>54</sup>

1.42 Section 76(1) of the *Road Traffic Act 1961* provides that a person who is claiming against an insured motorist will have certain limited remedies against the motorist's insurer.

1.43 Section 62 of the *Civil Liability Act 1961* states that where an individual who has effected a policy of insurance in respect of liability or a wrong becomes a bankrupt or dies, moneys payable to the insured under the policy are only applicable in discharging valid claims against the insured. No part of the insurance money is to be applicable to the payment of the other debts of the insured. The section also applies to insured companies and partnerships which are wound up or dissolved, so that, for example, insurance money cannot be used by a liquidator in an insolvency situation but must be paid to the injured party. Section 62 of the 1961 Act represents a policy decision to separate insured debts from insolvency proceedings.<sup>55</sup> Although it does not expressly confer a positive right of action on those entitled to an award of damages against the insured, it has been decided that this section gives an entitlement to an injured party to sue the insurers of a bankrupt party to ensure compliance with the section.<sup>56</sup>

1.44 The legislative provisions discussed above do not cover every type of insurance contract or every third party beneficiary of an insurance contract. The privity rule can still therefore cause injustice and uncertainty in relation to insurance contracts. This is discussed in more detail in Chapter 2.<sup>57</sup>

## **(8) Consumer Law**

1.45 A number of important exceptions to the privity rule exist in relation to consumer contracts.

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<sup>54</sup> The policy is said to create a trust in favour of the spouse or child which is enforceable either by named trustees or the beneficiary themselves.

<sup>55</sup> The equivalent legislative provision in England is found in the *Third Parties (Rights Against Insurers) Act 1930*. It has been the subject of criticism, and the Law Commission for England and Wales and the Scottish Law Commission have produced a joint Report recommending reform: *Third Parties – Rights Against Insurers* (LC 272, SLC 184, 2001).

<sup>56</sup> *Dunne v PJ White* [1989] 1 ILRM 803.

<sup>57</sup> See paragraphs 2.27 to 2.31 below.

1.46 For example, when a consumer enters into a hire purchase agreement, the consumer's contract is with the hire purchase company and not the seller of the goods. If the privity rule applied the consumer could not sue the seller of goods for any breach of contract or misrepresentation.<sup>58</sup> However, section 80 of the *Consumer Credit Act 1995* offers protection to consumers by providing that where a consumer<sup>59</sup> enters into a hire purchase agreement, the consumer has a remedy against both the seller and the hire purchase company in the event of a breach of the hire purchase agreement or a misrepresentation made by either the seller or the hire purchase company.

1.47 Section 14 of the *Sale of Goods and Supply of Services Act 1980* similarly provides that where goods are sold to a consumer under an arrangement with a finance house, the finance house and the seller are jointly answerable to the buyer for breach of the contract of sale and for any misrepresentations made by the seller with respect to the goods.

1.48 Section 13 of the *Sale of Goods and Supply of Services Act 1980* provides that there is an implied condition in a contract for the sale of a motor vehicle that at the time of delivery the vehicle is free from any defect that would render it a danger to the public, including people travelling in the vehicle.<sup>60</sup> The parties to the contract of sale are the buyer and seller, but third parties who use the vehicle with the consent of the buyer and suffer a loss because of a breach of this condition may maintain an action for damages against the seller. However, this exception to the privity rule is limited, because a third party who brings this action must do so within two years, whereas the buyer of the car can avail of the normal limitation period for contractual actions, which is six years.

1.49 Section 2 of the *Package Holidays and Travel Trade Act 1995* defines a consumer as including any person on whose behalf the principal contractor agrees to purchase the package, or any person to whom the principal contractor (the buyer) or another beneficiary transfers the package. This ensures that the protections provided to consumers in the Act extend not only to the person who purchases the holiday, but also to third parties who benefit from the contract.

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<sup>58</sup> *Dunphy v Blackhall Motors* (1953) 87 ILTR 128.

<sup>59</sup> Section 2 of the *Consumer Credit Act 1995* defines a consumer as "a natural person acting outside his trade, business or profession". However, section 33 of the *Central Bank and Financial Authority of Ireland Act 2004* provides that the Minister for Finance may declare any specified person or specified class of persons to be a consumer for the purposes of the 1995 Act.

<sup>60</sup> Section 82 of the *Consumer Credit Act 1995* provides for a similar condition in hire purchase agreements.

1.50 The Commission has identified a number of situations where third parties who are consumers are not currently protected by any exception to the privity rule. For example, where someone buys a present for a friend, the friend cannot enforce the contract of sale against the retailer because they are not privy to the contract of sale.<sup>61</sup> It is often the case in Ireland that retailers will offer some sort of remedy without too much concern about the identity of the original parties to the contract, but this is discretionary and the third party cannot insist on it as a legal right. The Commission considers this issue in more detail in Chapter 3.<sup>62</sup>

**(9) Negotiable Instruments**

1.51 Cheques, bills of exchange and promissory notes are examples of negotiable instruments. Cheques and bills of exchange order the payment of money, whereas promissory notes contain a promise to pay money.

1.52 Ownership of the rights contained in the instrument can be transferred to and enforced by a third party, referred to as the “holder in due course”.<sup>63</sup> Section 38(2) of the *Bills of Exchange Act 1882* provides that the holder in due course may take an action against not only the original debtor on the instrument if he fails to pay, but also against any other previous signatories of the instrument who have had the debt negotiated to them. This makes negotiable instruments an important exception to the privity of contract rule.

**(10) Carriage of Goods by Sea**

1.53 When goods are carried by sea, the person who wishes to send the goods (the shipper) enters into a contract with a carrier, and this contract is evidenced in a transport document called a bill of lading. The shipper then sends the bill of lading to the person who is to collect the goods (the consignee). The consignee must present the bill of lading to the carrier to have the goods released to them.<sup>64</sup>

1.54 The contract of carriage, as evidenced in the bill of lading, is entered into by the shipper and the carrier of the goods, and the consignee is not a party to this contract. A strict application of the privity rule would prevent the consignee from suing the carrier of the goods in contract if the

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<sup>61</sup> They may have a claim for injury caused by the product under the law of tort or the *Liability for Defective Products Act 1991*.

<sup>62</sup> See paragraphs 3.125 to 3.135 below.

<sup>63</sup> A holder is defined in section 2 as “the payee or indorsee of a bill or note who is in possession of it, or the bearer thereof.”

<sup>64</sup> See *White Commercial Law* (2002 Thomson Round Hall) at 627 to 645. Other transport documents which are used to facilitate the carriage of goods by sea include waybills and delivery orders.

goods are lost or damaged. However, section 1 of the *Bills of Lading Act 1855* provides that every consignee of goods named in a bill of lading, and every endorsee of it, to whom the property of the goods described in it shall pass upon or by reason of such consignment or endorsement,<sup>65</sup> will have transferred to them all rights of action, and be subject to the same liabilities, in respect of such goods as if the contract contained in the bill of lading had been made with them. In this way, the consignee of the goods obtains rights and liabilities under the contract of carriage entered into between the shipper and the carrier of the goods.

1.55 Alternatively, a contract may be implied between the consignee and the carrier when a consignee takes delivery of goods from the carrier. Such a contract may be implied if the holder of the bill has some interest in the property and the court can find some form of offer, acceptance and consideration.<sup>66</sup>

1.56 Despite section 1 of the *Bills of Lading Act 1855* and the possibility that an implied contract may exist, third parties may still have difficulties in bringing contractual claims against carriers. The position of these third parties has been criticised, and there have been calls for reform.<sup>67</sup> This is discussed in more detail in Chapter 3.<sup>68</sup>

## **(11) Employment Law**

1.57 The *Transfer of Undertakings Regulations 2003*<sup>69</sup> provide that where an employer transfers its undertaking, the entity taking over the business enters into all the employment contracts subsisting at the time of the takeover.

1.58 In England, *Bernadone v Pall Mall Services Group Ltd*<sup>70</sup> has shown that, under the comparable British legislation, the new employer may not just obtain rights and obligations under the contract of employment under these Regulations, but may also obtain rights under connected contracts. In this case, the court held that the new employer was bound by an implied term in the original employment contract that the employer would insure the employee for accidents at work, and that the new employer could

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<sup>65</sup> See *The Delfini* [1990] 1 Lloyd's Rep 252.

<sup>66</sup> *Brandt v Liverpool, Brazil and River Steam Navigation Co Ltd* [1924] 1 KB 275. See *White Commercial Law* (2002 Thomson Round Hall) at 641 to 642.

<sup>67</sup> *White Commercial Law* (2002 Thomson Round Hall) at 645.

<sup>68</sup> See paragraphs 3.105 to 3.111 below.

<sup>69</sup> *European Communities (Protection of Employees on Transfer of Undertakings) Regulations 2003* (SI No 131 of 2003) implementing Directive 2001/23/EC *Transfer of Undertakings and the Safeguarding of Employees' Rights*.

<sup>70</sup> (1999) *The Times* 2<sup>nd</sup> August.

bring an action against the first employer's insurance company to recover under the first employer's liability insurance. The new employer was thus entitled to the benefit of the insurance contract which the first employer had taken out.

### **(12) Company Law**

1.59 A number of specific exceptions to the privity rule can be seen in company law. For example, section 25 of the *Companies Act 1963* provides that the memorandum and articles of association form a contract between the company and its shareholders and also between the individual shareholders. As a result, one shareholder can sue another shareholder on the basis of, for example, the articles of association.

1.60 Another exception relates to contracts entered into by pre-incorporation companies. When a contract is entered into by a company that has yet to be incorporated, a strict interpretation of the rule of privity means that the post-incorporation company is not a party to the contract and cannot enforce it. However, section 37 of the *Companies Act 1963* provides that a contract entered into by a pre-incorporation company may be ratified by the company once it is formed. The effect of this is that all rights and obligations arising from the transaction are enforceable by and against the newly formed company.

### **(13) Covenants Running with Land**

1.61 Covenants concerning land may be enforced against subsequent owners of the land, even though they were not party to the original covenant. At common law, this only applied where the covenant was "negative", i.e. when there was an agreement *not* do so something.<sup>71</sup> Section 47 of the *Land and Conveyancing Law Reform Bill 2006*, which is currently before the Oireachtas, proposes to make freehold covenants, positive and negative, fully enforceable by and against successors in title.<sup>72</sup>

## **D Remedies available to the promisee**

1.62 If John agrees to give his computer to Aoife, in return for which Aoife agrees to pay €1,000 to a third party Gearóid, but Aoife subsequently refuses to pay Gearóid, the privity rule means that Gearóid is unable to bring an action against Aoife. However, John will still be able to sue Aoife for

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<sup>71</sup> *Tulk v Moxhay* (1848) 2 Ph 774. The covenant could not be enforced against a *bona fide* third party purchaser who did not have notice of the covenant.

<sup>72</sup> Bill No. 31 of 2006. The 2006 Bill passed Seanad Éireann in November 2006 and is, at the time of writing (February 2008), at Committee Stage in Dáil Éireann. The Bill implements recommendations in the Commission's *Report on the Reform and Modernisation of Land Law and Conveyancing Law* (LRC 74-2005).

breach of contract, as John entered into the contract with Aoife. Thus, the promisee may be able to assist the third party, either by claiming damages for the loss suffered by the third party or by requesting “specific performance”, that is, by requesting that the promisor perform as he promised. However, even if the promisee is willing and able to sue, it may still be difficult to obtain an appropriate remedy. The Commission now turns to discuss in detail the remedies available to the promisee.

**(1) Damages for Third Party Loss**

1.63 As a general rule it is not possible to recover damages in contract for the loss suffered by a third party. A party is only entitled to an award which reflects their own loss, and not the loss of a third party. Thus, using the example above, if John sues Aoife for breach of contract, he will not be able to recover the €1,000 in damages, as this loss was suffered by Gearóid and not by John.

1.64 There are some exceptions to this rule. For example, an agent can claim damages for the loss suffered by an undisclosed principle, and a trustee can claim damages on behalf of a beneficiary. Sometimes the courts will give a broad interpretation to the loss suffered by the contracting party. For example, if Tom books a holiday for a group of people, and there is a breach of contract, Tom may be able to recover damages to represent the loss suffered by the group. This can be done either on the basis that Tom is entitled to damages for his disappointment that the holiday was spoiled, or on the basis that the courts should award damages to protect Tom’s “performance interest”, that is, his interest in the provision of a benefit to the group. Such a broad measure of damages may be easier to obtain where the contract is a consumer transaction.<sup>73</sup>

1.65 One important exception to the general rule arises when “loss is suffered in consequence of a breach of contract, but the contract-breaker's position is that no-one is legally entitled to recover substantial damages from him”.<sup>74</sup> The contracting party may be able to claim damages to represent the loss of a third party because otherwise the claim for damages would fall into a “legal black hole”. The rule developed in the context of the carriage of goods by sea<sup>75</sup> but it has been extended to other types of contracts, including construction contracts.<sup>76</sup> In the construction context, the “legal black hole” can occur, for example, when a contractor contracts with A to carry out work

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<sup>73</sup> See *Burke v Dublin Corporation* [1991] 1 IR 341, 353 where Finlay CJ said that such cases may call for “special treatment” in the relation to the measure of damages.

<sup>74</sup> *Technotrade Ltd v Larkstore Ltd* [2006] EWCA Civ 1079, para 3 per Mummery J.

<sup>75</sup> See *Dunlop v Lambert* (1839) 6 Cl & F 600, 7 ER 824.

<sup>76</sup> See for example *Darlington BC v Wiltshier Northern Ltd* [1995] 3 All ER 895.

on B's land. If the work is defective, A may be the only party with the right to sue for breach of contract, but B will in fact have suffered the loss. In this situation, the courts may allow A to recover damages to represent the loss suffered by B. The exception does not however apply when the third party (B) itself has a right to claim damages. Thus, using the construction example given, the "legal black hole" would not be created if A assigned its contractual rights to B, or if it was contemplated by the contracting parties that A would do so.<sup>77</sup> Also the usual rules of foreseeability of contract damages would apply, so a loss which could not have been foreseen by the defendant or a loss suffered by a third party of whom the defendant was unaware, will not normally be recoverable.

1.66 If damages for loss to a third party are awarded to a contracting party one issue which could arise is whether the third party can then claim the sum awarded from the contracting party. The answer to this question may depend on the basis for the award of damages. For example, if damages are awarded "for the use and benefit" of the third party, then the third party should be able to claim the sum, on the basis of an action known as the action for money had and received.<sup>78</sup> If, however, damages are awarded for the contracting party's personal disappointment that the contract was not performed, then the third party may not have such a claim. The third party may alternatively be able to obtain an award on the basis of a fiduciary or contractual relationship between the third party and the contracting party.

## (2) *Specific Performance*

1.67 In certain instances, where the award of damages does not offer adequate compensation, the promisee may seek an order of specific performance. This means the promisor will be compelled to perform their end of the bargain. This can be useful where the obligation of the third party was to confer a benefit on a third party.<sup>79</sup> However, an order of specific

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<sup>77</sup> See for example *Panatown Ltd v Alfred McAlpine Construction* [2000] 4 All ER 97 (a form of collateral warranty gave the third party the right to sue the contractor so the exception didn't apply); *The Albazero* [1977] AC 774 (exception does not apply in context of carriage of goods by sea where the contract contemplated that the shipowner would enter into a separate bill of lading with the future owner of the goods). In *Chia Kok Leong v Prosperland Pte Ltd* [2005] 2 SLR 484 the Singapore Court of Appeal stated that there could be a "legal black hole" and the exception could apply even if the third party had a right of action in tort against the defendant contracting party. To avoid difficulties of "double liability" the Court of Appeal suggested that a court should stay the action brought by the contracting party until satisfied that the third party is content to allow its claim to be discharged by payment to the contracting party. See Loke "The 'Broad Ground' and the Not-so-narrow Ground in Singapore: *Chia Kok Leong v Prosperland Pte Ltd*" 2007 JCL LEXIS 8.

<sup>78</sup> See the comments of Lord Diplock in *The Albazero* [1977] AC 774 at 845–846.

<sup>79</sup> An order of specific performance in favour of a third party was granted in *Beswick v Beswick* [1968] AC 58.

performance is at the discretion of the court and will not always be available. For example, an order for specific performance will not be given to compel the performance of personal services.<sup>80</sup>

**(3) Discussion**

1.68 Two issues arise in the context of reform of the promisee's remedies. The first is the extent to which reform of the remedies available to the promisee could solve the problems associated with the rule of privity. For example, legislation could provide that where a contract is for the benefit of a third party, a promisee could recover damages in contract for any loss suffered by that third party, on behalf of the third party. The second is the extent to which there is a more general need to reform the remedies available to the promisee, in particular to clarify when damages will be available to represent the loss suffered by a third party. It could be argued that the law in this area is underdeveloped in Ireland, and that such clarification is necessary. The Commission discusses these issues in more detail in Chapter 2.<sup>81</sup>

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<sup>80</sup> See for example *Ryan v Mutual Tontine Westminster Chambers Association* [1893] 1 Ch 116. See generally Delany *Equity and the Law of Trusts in Ireland* (4<sup>th</sup> ed Thomson Round Hall 2007) Chapter 14.

<sup>81</sup> See paragraphs 2.74 to 2.79 below.

## CHAPTER 2 GUIDING PRINCIPLES FOR REFORM

### A Introduction

2.01 In this Chapter the Commission discusses, in Part B, the arguments for and against reform of the privity rule, concluding that the arguments in favour of reform outweigh those against. In Part C, the Commission discusses the best means of reform. In Part D, the Commission concludes by discussing the principles which should guide any such reform.

### B The need to reform the privity rule

2.02 In the Consultation Paper, the Commission provisionally recommended that the privity of contract rule should be reformed to allow third parties to enforce rights under contracts made for their benefit. In this section, the Commission outlines the arguments in favour of this position.

#### *(I) The intentions of the contracting parties*

2.03 The privity rule can thwart the intentions of the contracting parties.<sup>1</sup> As the law currently stands, a third party cannot enforce a contract made for their benefit, even if the contracting parties agreed that they should be able to do so. The refusal of the courts to give full effect to the contract could be said to undermine the principle of freedom of contract, i.e. the principle that parties are free to enter into whatever kind of contract they like, provided the contract was freely and voluntarily entered into. There are certain exceptions to this principle, so that, for example, some contracts may be unenforceable on grounds of illegality or public policy. There is, however, no public policy reason why the courts should refuse to allow a third party to enforce a contract, or term of a contract, when the contracting parties intended for the third party to have this right. Rather, the contractual intention of the parties should be enforced in the most effective way possible by the courts.

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<sup>1</sup> It has been argued that only the intentions of the promisee, and not the intentions of both contracting parties, are thwarted by the operation of the rule of privity, as if the original promisor “wishes to comply with his original promise all he needs to do is keep it”: Stevens “The Contracts (Rights of Third Parties) Act 1999” (2004) 120 LQR 292 at 293. However, this misstates the point, as generally in any contractual analysis it is the intention of the contracting parties at the time of contracting which is important, and not their intention when performance is due.

**(2) *The third party who suffers a loss cannot sue, while the contracting party who can sue has not suffered a loss***

2.04 The rule of privity can produce the bizarre result that the third party who suffers a loss cannot sue, while the contracting party who can sue has not suffered a loss, and thus may only be entitled to nominal damages.

2.05 As a general rule it is not possible for the promisee to recover damages in contract for the loss suffered by a third party, although the facts of the case may fall into one of the exceptions to this rule, or an order of specific performance may be available in limited circumstances. This is discussed in more detail in Chapter 1.<sup>2</sup>

2.06 Even if the promisee can obtain a remedy, the promisee may not wish to sue. It has been pointed out that “the stress and strain of litigation and its cost will deter many promisees who might fervently want their contract enforced for the benefit of third parties”.<sup>3</sup> Also, in a situation where the promisee has died, their personal representatives may decide that it is not in the interests of the estate to bring an action.

**(3) *The injustice to the third party***

2.07 Where a third party cannot sue for breach of contract, and the promisee is either unwilling to sue, or unable to obtain a remedy on behalf of the third party, it could cause injustice to the third party, who may have had a reasonable expectation that the contract would be enforced. This injustice is particularly clear where the third party has relied on the contract to its detriment, but it is the view of the Commission that detrimental reliance should not be a prerequisite for the third party’s right to enforce the contract, as injustice can also be seen simply where the third party has a reasonable expectation that a contract, or term of a contract, made for its benefit would be enforced.<sup>4</sup>

**(4) *The effect of the exceptions to the privity rule***

2.08 The privity rule is subject to a large number of common law and statutory exceptions. These exceptions have developed in a piecemeal fashion to deal with specific problems which were caused by the privity rule. Some of these exceptions are quite complex, and there are various difficulties associated with them. However, more fundamentally, it is clear that the current exceptions do not, and will not, cover every situation where an unjust or illogical result is caused by the privity rule. It could be argued

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<sup>2</sup> See paragraphs 1.63 to 1.66 above.

<sup>3</sup> Law Commission for England and Wales *Privity of Contract: Contracts for the Benefit of Third Parties* (Law Com No 242, 1996) at paragraph 3.4.

<sup>4</sup> See paragraph 2.94 below.

that further specific exceptions could be created to deal with such situations, but it is the Commission's view, for reasons discussed below,<sup>5</sup> that this would not be an appropriate measure of reform. Rather, the non-comprehensive nature of an already long list of exceptions supports the need for a more general rule in favour of third party rights.

2.09 A further difficulty caused by the variety of exceptions to the rule is that it can be unclear whether the courts will apply the privity rule or an exception to the rule. For example, in *Glow Heating Ltd v Eastern Health Board*<sup>6</sup> there was a standard form construction contract between an employer and the main contractor, and another contract between the main contractor and a sub-contractor. The main contract contained a clause requiring the employer to make a direct payment to the sub-contractor in the event that the main contractor could not or would not do so. Costello J noted that the privity rule had not been relied on in court, and remarked that "the privity of contract rules should not bar a court from granting a sub-contractor relief in circumstances like the present one".<sup>7</sup> This shows judicial recognition that third parties should be able to enforce contract terms made for their benefit, but it is unclear on what basis the court could have enforced the term as no obvious exception to the privity rule applied.

2.10 In the past this uncertainty could be seen in cases involving trusts, where the courts would sometimes, but not always, imply the existence of a trust in order to grant rights to third parties. Today the courts will not imply a trust unless it is clear that the parties intended to create one.<sup>8</sup> It has been suggested that the courts could today make use of devices such as constructive trusts or estoppel to allow a third party to bring an action in a suitable case.<sup>9</sup> However, again there is no assurance that the courts would do this, and there would still be an unacceptable uncertainty as to whether the courts will apply the privity rule or whether they will refuse to do so. Further, with regard to the use of estoppel in this context it has been stated that it is doubtful whether it "provides an adequate protection of the legitimate expectations of [third parties] and, even if it does, the rights of

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<sup>5</sup> See paragraphs 2.80 to 2.83 below.

<sup>6</sup> [1988] IR 110.

<sup>7</sup> [1988] IR 110, 117.

<sup>8</sup> See *Cadbury (Ireland) Ltd v Kerry Co-op Creameries Ltd* [1982] ILRM 77; *Inspector of Taxes Association v Minister for the Public Service* High Court 24 March 1983.

<sup>9</sup> Byrne and Binchy *Annual Review of Irish Law 2006* (Thomson Round Hall, 2007) at 430, commenting on the Consultation Paper.

persons under a policy of insurance should not be made to depend on the vagaries of such an intricate doctrine.”<sup>10</sup>

2.11 The Commission is of the view that if a more general exception was created it would increase certainty in cases such as this.

**(5) Commercial inconvenience and expense**

2.12 Legal practitioners and others who draft contracts have developed methods of circumventing the privity rule, for example by using assignments and collateral warranties. It could thus be said that the rule of privity does not cause real difficulties in practice. However, a considerable amount of commercial inconvenience and unnecessary expense is still caused by the privity rule. One commentator, carrying out an economic analysis of the privity of contract rule, has stated:

“Even if parties are fully informed of the rule and its effects, structuring their contracts to circumvent the rule entails wasteful transaction costs that a different rule could eliminate... [an] efficient rule should minimize the transaction costs necessary for most parties to achieve their preferred outcomes...”<sup>11</sup>

2.13 Another commentator has stated that the argument that the privity rule causes little difficulty in practice fails to take into account three important elements:

“(1) Unless the circumstances are identical with those of a decided case, it will always be open to unfavourable reconsideration by a court. (2) The cost of restructuring a transaction solely to avoid the doctrine of privity of contract may be excessive in relation to the benefit achieved (3) The fact that so many cases have been heard by the [English] appeals courts reflects the fact that the effect of any legal devices to avoid the privity rule is far from sufficiently clear to make such devices worthwhile.”<sup>12</sup>

2.14 It is the Commission’s view that many of the commercial contractual arrangements which are currently entered into could be simplified by the creation of a general exception to the privity rule which allows third parties to enforce contracts which are entered into for their benefit. Reforms could facilitate a different means of conducting transactions so that those who wish to enter into contracts for the benefit of

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<sup>10</sup> *Trident General Insurance Co v McNiece Bros Pty Ltd* (1988) 165 CLR 107 per Mason CJ.

<sup>11</sup> Trebilcock “The Doctrine of Privity of Contract: Judicial Activism in the Supreme Court of Canada” (2007) 57 *Univ of Toronto LJ* 269 at 271 – 272.

<sup>12</sup> Henley “Insurance” in Merkin (ed) *Privity of Contract: The Impact of the Contracts (Rights of Third Parties) Act 1999* (LLP 2000) at 213.

third parties will be able to do so, in the knowledge that such contracts will be enforceable by the third parties.

2.15 The Commission now turns to look at specific examples where the privity rule has been avoided by techniques which have caused commercial inconvenience and difficulties. These include the use of collateral warranties and end user licence agreements.

**(6) *The use of collateral warranties***

2.16 The use of collateral warranties is a particular example of the commercial inconvenience caused by the privity rule. As discussed in Chapter 1, collateral warranties are used extensively in the construction industry to circumvent the privity rule.<sup>13</sup> However, large, complex projects may require the individual drafting of hundreds of separate collateral warranties.<sup>14</sup> The negotiation and signing of so many collateral warranties can be difficult and time-consuming, and can generate a lot of paperwork. This is all very costly, and it has been estimated that for a typical development scheme, about a third of the legal fees can be attributed to the cost of putting collateral warranties in place.<sup>15</sup>

2.17 In England, one of the main advantages of the statutory reform of the privity rule effected by the *Contracts (Rights of Third Parties) Act 1999* was said to be the reduction in the need for collateral warranties. However, the initial reaction of the construction industry was to exclude the 1999 Act, by providing that no person other than a party to the contract had the right to enforce any express or implied term in the contract.

2.18 In recent years, standard form contracts used by the construction industry have started to apply the *Contracts (Rights of Third Parties) Act 1999*.<sup>16</sup> One commentator has recently said that the use of third party rights

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<sup>13</sup> See paragraphs 1.26 to 1.29.

<sup>14</sup> See Erwin “What’s wrong with simple” *Building* (2002, Issue 45) where the author estimates that for a simple construction management development involving a construction manager, 5 professionals and about 10 significant trade contractors, which is funded by a bank, let to 7 tenants and eventually sold on to an investment purchaser, almost 150 warranties would be needed.

<sup>15</sup> See Cockram “Drafting a new system” *Legal Week* 8 September 2005.

<sup>16</sup> See generally: Minogue “Know your rights” *Building* (2007, issue 47); “The *Contracts (Rights of Third Parties) Act* revised” *Contract Journal* 9 August 2006; Erwin “An ambitious attempt” *Estates Gazette* 1 October 2005; Cockram “Drafting a new system” *Legal Week* 8 September 2005; Cockram “A farewell to all that” *Estates Gazette* 27 August 2005; Collinson “Collateral Warranties – Time for Change?” *Mondaq Business Briefing* 18 July 2005; Elias “know your rights” *Building* (2005, issue 21); Erwin “What’s wrong with simple?” *Building* (2002, Issue 45).

under the 1999 Act has spread out “from the [London] City market to become the norm on large development projects throughout the country”.<sup>17</sup>

2.19 For example, the Joint Contracts Tribunal (JCT) 2005 *Major Project Construction Contract* uses the 1999 Act “as a means of avoiding a proliferation of separate warranties and other collateral agreements”.<sup>18</sup> The rights of funders, purchasers and tenants are set out in a “Third Party Rights Schedule”.<sup>19</sup>

2.20 In a major construction project, a funder may lend to a developer who hires contractors, but there will be no direct contractual link between the funder and the contractors.<sup>20</sup> The “Third Party Rights” Schedule in the JCT *Major Project Construction Contract* gives the funder the benefit of a warranty from the contractor that he will comply with the contract. If the contractor fails to do so, the funder can directly bring an action in contract against him. The funder will also get the benefit of “step in” rights.<sup>21</sup> In this situation the funder can give notice in writing to the contractor that the contractor must take instructions from the funder and not the employer. The funder must in turn accept liability for the employer’s contractual obligations, including the payment of any fees owing to the contractor. Step in rights can be of particular importance when the employer fails to perform a contractual obligation, and thus gives the contractor a right to terminate the contract. The contractor agrees that it will not exercise any right it may have to terminate the contract without first giving the funder at least 7 days’ notice in writing. The right to terminate ceases if within the period of notice the funder gives notice in writing to the contractor that it intends to “step into” the place of the employer. The funder also has step in rights when it terminates its finance agreement with the employer.

2.21 Turning to the rights of purchasers and tenants, any first purchaser or first tenant of either the whole or any part of the project receives the benefit of an undertaking from the contractor that he has executed the contract in accordance with the contract. If the contractor is in breach of this

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<sup>17</sup> Minogue “Reflections and Predictions” *Building* (2007, issue 1).

<sup>18</sup> Joint Contracts Tribunal *Major Project Construction Contract Guide* (2005) para 122. The *Major Project Construction Contract 2005* is the new version of the Joint Contract Tribunal’s *Major Project Form 2003*, which also made use of the 1999 Act. For a brief overview of standard form contracts in construction, civil engineering and public works, see the Commission’s *Consultation Paper on Privity of Contract: Third Party Rights* (LRC CP 40-2005) paras 1.69-1.90.

<sup>19</sup> See Joint Contracts Tribunal *Major Project Construction Contract Guide* (2005) paras 122 – 127.

<sup>20</sup> See paragraph 1.28 above.

<sup>21</sup> The Commission discusses the operation of such step in rights at paragraph 3.48 below.

warranty his liability is normally limited to the reasonable costs of repair, renewal and/or restatement. There is an optional provision whereby the contractor can accept responsibility for other losses, such as the cost of renting alternative premises, up to a limit defined by the contract. The rights of purchasers and tenants are subject to the employer serving a notice on the contract identifying the purchaser or tenant and their interest in the project.

2.22 The funders, purchasers and tenants are able to enforce these rights directly against the contractor. Both the funder and any purchaser or tenant acquiring rights under the Schedule can assign their rights a maximum of twice. Clause 4 of the Contract provides that other than the rights in the Schedule, nothing in the Contract is intended to confer any right to enforce any of its terms on any person who is not a party to it.

2.23 The *Contracts (Rights of Third Parties) Act 1999* is also used in other JCT forms. For example, the 2005 *Design and Build Contract* and the 2005 *Standard Building Contract*<sup>22</sup> both make provision for third party rights under the Act for purchasers, tenants and funders, while leaving open the possibility of having collateral warranties.<sup>23</sup> More recently, the 2007 *JCT-Constructing Excellence* contract uses a single contract to regulate all the relationships involved in a construction project, and it too makes use of the 1999 Act.

2.24 Other standard form contracts for the construction industry which make use of the *Contracts (Rights of Third Parties) Act 1999* to reduce the need for collateral warranties include the 2005 *New Engineering and Construction Contract* (NEC3), which is being used, for example, for the construction contracts for the 2012 London Olympics,<sup>24</sup> and the 2005 British Property Federation's *Consultancy Agreement*. Professional indemnity insurers have also indicated that they have no objections to contractors and developers using the 1999 Act.<sup>25</sup>

2.25 There are several advantages to this new approach.

- Much of the administration, cost, time and inconvenience associated with the provision of warranties is reduced.
- Third party rights could be provided for in the main contract, without the need to go through the lengthy process of negotiating

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<sup>22</sup> See Williamson "The JCT Standard Form of Building Contract (2005 Edition)" in Furst and Ramsey *Keating on Construction Contracts* (8<sup>th</sup> ed Sweet & Maxwell 2006).

<sup>23</sup> In the case of sub-contractors, provision is made only for the grant of collateral warranties.

<sup>24</sup> See Option Y(UK)3.

<sup>25</sup> Cockram "Drafting a new system" *Legal Week* 8 September 2005.

and obtaining many separate warranties. It has been pointed out that this could have the potential side effect of reducing the ability of third parties to negotiate individually the terms currently contained in collateral warranties.<sup>26</sup> However, it is unlikely that the current bargaining positions of various parties would be adversely affected. For example, contractors currently give collateral warranties to funders because without such a warranty funders would not agree to fund the entire project. Under a reformed third party rights rule, such as in the British 1999 Act, funders would not agree to fund projects unless their rights are clearly set out in the main contract between the developer and the contractor. The substance of the rights of third parties would not be changed, but third party rights would be facilitated and delivered in a different manner.

- The rights of third parties would be easier to ascertain and manage, as all the rights would be contained in the one document and not across several different warranties.
- As with collateral warranties, under a reformed third party rights regime, such as in the British 1999 Act, it would be possible to limit the extent to which third parties can rely on the main contract.<sup>27</sup> For example, in England the JCT's 2005 *Major Project Construction Contract* limits the remedy available to third party purchasers and tenants to the reasonable costs of repair and reinstatement in the case of defects to the property.
- Under a reformed regime it would be possible to make the provision of third party rights subject to other terms of the contract.<sup>28</sup>
- Similarly, the wording of a collateral warranty may be such that the contractor or consultant would have a greater responsibility to the third party than to the client with whom they entered into the main contract. For example, the contractor's obligation in the main contract might be to exercise reasonable skill and care, while their obligation in the collateral warranty may be that the completed works will be fit for their purpose.<sup>29</sup> Currently collateral warranties may contain "no greater liability" clauses to attempt to avoid this

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<sup>26</sup> See "The *Contracts (Rights of Third Parties) Act* revised" *Contract Journal* 9 August 2006.

<sup>27</sup> See paragraphs 3.46 to 3.49 below.

<sup>28</sup> See paragraphs 3.46 to 3.49 below.

<sup>29</sup> See Holmes and MacGregor "Collateral Warranties" in Ramsey (Ed) *Construction Law Handbook* (Thomas Telford 2000) Chapter 2.5/3.

but these have caused difficulties of interpretation and their effect is uncertain. Under a third party rights regime, the risk that the obligations of the contractor to the third party would be greater or different than its obligations under the main contract would be reduced, as all of these obligations would be contained in the one document.

- This mechanism already applies in other countries, including the United Kingdom, most member states of the European Union, the United States, Australia and New Zealand.<sup>30</sup>

#### **(7) *Software licences***

2.26 When a customer purchases a software programme from a retailer, either online or from a shop, the contract of sale is between the customer and the retailer, and not between the customer and the producer of the software. Thus, if the producer of the software wishes to protect their interest in the software programme they must attempt to enter into a collateral copyright licence with the customer. However, if third party rights were generally enforceable, the software producer could rely on the licence agreement in the contract of sale between the retailer and customer. This has been the approach taken in other jurisdictions,<sup>31</sup> and it could be seen as a preferable way of managing software licences.<sup>32</sup>

#### **(8) *Insurance contracts for the benefit of third parties***

2.27 The Commission has already discussed how the legislature has intervened to grant third party beneficiaries of insurance contracts enforceable rights.<sup>33</sup> However, there are still a number of situations where the privity rule can operate to prevent a third party from enforcing an insurance contract. It is the view of the Commission that where this occurs it can be contrary to the intentions of the third parties and can cause an injustice.

2.28 For example, Section 7 of the *Married Women's Status Act 1957* provides that a policy of life assurance which is expressed to be for the benefit of, or by its express terms purports to confer a benefit upon, the spouse or child of the insured, is enforceable by that spouse or child. However, this section only applies to give rights to the spouse and children

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<sup>30</sup> The various legislative schemes are discussed in detail in Chapter 3, below. See also Bateman "You can lead a horse to water" *Mondaq Business Briefing* 19 July 2002; Fiebig "Auf wiedersehen, warranties?" *Building* (2002, issue 1).

<sup>31</sup> See for example the Scottish case *Beta Computers (Europe) Ltd v Adobe Systems (Europe) Ltd* [1996] FSR 367.

<sup>32</sup> See Haigh *Contract Law in an E-Commerce Age* (2001 Roundhall Ltd) at 311 – 312.

<sup>33</sup> See paragraphs 1.40 to 1.44, above.

of the insured and does not apply to give rights to relatives or to other cohabitants under a contract of insurance. Third parties who do not fall under the legislative exception would either have to rely on the good will of the insurance company or show that they come under an exception to the privity rule, for example by showing that a completely constituted trust was formed in their favour.<sup>34</sup> It is the view of the Commission that this is unnecessarily complicated and uncertain. Third party beneficiaries of life insurance policies should be able to enforce the contract when the contracting parties intended for them to be able to do so.

2.29 Another example of the application of the current privity rule can be seen in the context of employment insurance. An employer may take out an insurance policy on behalf of its employees, to cover the employees in case of a workplace accident. The employee has no right to claim the insurance money directly from the insurance company as they are not party to the insurance contract.<sup>35</sup> Of course, the insurance contract is taken out to protect the employer's interest arising from a potential claim, but is also arguable that the privity rule operates unfairly here, and courts in other jurisdictions have had to address this.

2.30 In Australia, the courts have created an exception to the privity rule in the context of insurance contracts.<sup>36</sup> In *Trident Insurance Co Ltd v McNiece Bros Pty Ltd*<sup>37</sup> a construction company, Blue Circle, entered into a contract of insurance with Trident General Insurance. The policy defined the assured as Blue Circle, its subsidiaries and "all contractors and sub-contractors." McNiece was Blue Circle's principal contractor. It was held liable when sued by a crane driver for injuries he sustained on site. It was held in the High Court of Australia that McNiece was entitled to claim under

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<sup>34</sup> In *Vandepitte v Preferred Accident Insurance Corp of New York* [1933] AC 70 the Privy Council recognised (at 79) that the common law rules are qualified by the equitable principle that a party to a contract can constitute himself a trustee for a third party of a right under a contract but, Lord Wright went on to say (at 79-80) that "the intention to constitute the trust must be affirmatively proved: the intention cannot necessarily be inferred from the mere general words of the policy".

<sup>35</sup> See *McManus v Cable Management (Ireland) Ltd* High Court 8 July 1994.

<sup>36</sup> This exception is also found in legislative form in section 48 of the *Insurance Contracts Act 1984* (Cth). It provides, subject to a number of conditions, that where a person who is not a party to a contract of general insurance is specified or referred to in the contract, whether by name or otherwise, as a person to whom the insurance cover provided by the contract extends, that person has a right to recover the amount of the person's loss from the insurer in accordance with the contract notwithstanding that the person is not a party to the contract. The Commission will examine insurance contracts in project 34 of its *Third Programme of Law Reform 2008-2014*. See *Report on the Third Programme of Law Reform 2008-2014* (LRC 86-2007), available at [www.lawreform.ie](http://www.lawreform.ie).

<sup>37</sup> (1988) 165 CLR 107.

the insurance policy entered into by Trident and Blue Circle. Mason CJ, Wilson and Toohey JJ were in favour of abolishing the privity rule in the insurance context. Mason CJ stated:

“In the ultimate analysis the limited question we have to decide is whether the old rules apply to a policy of insurance. The injustice which would flow from such a result arises not only from its failure to give effect to the expressed intention of the person who takes out the insurance but also from the common intention of the parties and the circumstance that others, aware of the existence of the policy, will order their affairs accordingly.... In the nature of things the likelihood of some degree of reliance on the part of the third party in the case of a benefit to be provided for him under an insurance policy is so tangible that the common law rule should be shaped with that likelihood in mind. This argument has even greater force when it is applied to an insurance against liabilities which is expressed to cover the insured and its sub-contractors. It stands to reason that many sub-contractors will assume that such an insurance is an effective indemnity in their favour and that they will refrain from making their own arrangements for insurance on that footing. That, it seems, is what happened in the present case.”<sup>38</sup>

2.31 A further difficulty that can arise regarding third parties and insurance contracts concerns the subrogation rights of insurers, that is, the right of insurers to take over all the rights of the insured with regard to the claim. For example, if a landlord takes out insurance to protect against damage to its property, such insurance may be of benefit to tenants living in the property. Despite this, if damage occurs, an insurer might use its right of subrogation to bring an action against the tenant if, for example, the damage was caused by the tenant’s negligence or if the tenant was in breach of a covenant to repair. To avoid this situation the insurer may agree in the policy to waive its rights of subrogation against the tenant. However, because this agreement not to bring an action against the tenant is contained in the insurance policy, to which the tenant is a third party, it is not clear whether the tenant could rely on it if the insurer did in fact bring an action. In *Fraser River Pile & Dredge Ltd v Can Dive Services Ltd*<sup>39</sup> the Supreme Court of Canada allowed a third party to rely on a clause in an insurance contract in which the insurer waived its right of subrogation against the third party. The third party thus had a defence when the insurer attempted to exercise its subrogation rights against the third party by bringing an action in

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<sup>38</sup> (1988) 165 CLR 107 per Mason CJ.

<sup>39</sup> [1999] 3 SCR 108. See paragraphs 2.35 to 2.45 below.

tort for the loss caused to the insured. However, it is unclear whether a similar conclusion would be reached in Ireland.

**(9) Recovery in Tort for Economic Loss**

2.32 A third party who cannot bring an action in contract may attempt to bring an action in the tort of negligence. When this action is for “pure economic loss”, that is, wholly financial loss, independent of any personal injury or injury to property, it can closely resemble an action for breach of contract. In Chapter 1 the Commission discussed the initial expansion<sup>40</sup> and ultimate rejection<sup>41</sup> of this form of recovery in England, and pointed out that the law in Ireland is uncertain in this regard.<sup>42</sup>

2.33 It has been suggested that this expansion of tort law - with its resultant confusion and uncertainty - occurred because contract law is too rigid in its refusal to recognise the rights of third parties.<sup>43</sup> Some authors have argued that, rather than develop a cause of action which allows third parties to recover for pure economic loss in tort, it would make more sense to develop a clear system of third party rights in contract law:

“Before resorting to tort, in order to correct the perceived inadequacies of contract law, should we not ask whether the privity requirement itself should be modified?”<sup>44</sup>

2.34 The development of a system of third party contractual rights would not hinder any future judicial development of a tort of economic loss, but it would facilitate a situation where parties could regulate for themselves their future financial rights, obligations and liabilities.

**(10) Risk allocation and exemption clauses**

2.35 An exemption clause in a contract seeks to exclude or limit the liability of the parties to a contract. This can include liability for breach of contract or liability in tort or under statute. An exemption clause may state that it is to apply to a third party, or a category of third party, such as employees, sub-contractors or agents of the contracting parties, but a strict application of the privity rule would mean that any third parties would not be able to rely on such a clause, as they were not a party to the contract in which it was contained.<sup>45</sup>

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<sup>40</sup> See *Junior Books v Veitchi Co Ltd* [1983] 1 AC 520.

<sup>41</sup> See *Murphy v Brentwood District Council* [1991] 1 AC 69; *D & F Estates Ltd v Church Commissioners* [1989] AC 117.

<sup>42</sup> See paragraphs 1.32 to 1.33 above.

<sup>43</sup> Markesinis “An Expanding Tort Law – The Price of a Rigid Contract Law” (1987) 103 LQR 354.

<sup>44</sup> Fleming “Comparative Law of Torts” (1986) OJLS 235 at 241.

<sup>45</sup> See *Adler v Dickson* [1955] 1 QB 158.

2.36 In *Scruttons Ltd v Midland Silicones Ltd*<sup>46</sup> it was stated that such a clause could be relied upon by a third party if the following elements were met:

- (i) The contract should display a clear intention that the third party should receive the protection of the clause.
- (ii) The contract must indicate that the main contractor contracted as an agent of the third party as well as on his own behalf.
- (iii) The main contractor must have had authority to act as an agent for the third party, although the third party may be able to ratify the main contractor's act after the contract is formed.
- (iv) The third party must be able to establish that he provided some consideration, i.e. some form of payment or performance, if he is to obtain the benefit of the clause.<sup>47</sup>

2.37 In subsequent cases, courts have taken a wide interpretation of these requirements, and have been willing to allow third parties to rely on exemption clauses where to do so “is to give effect to the clear intentions of a commercial document”.<sup>48</sup> However, this approach has been described as a mere “partial solution”,<sup>49</sup> which “raises ... more problems than it solves”.<sup>50</sup> For example, it must be shown that the contractor was acting as the third party's agent in obtaining the limitation of liability. It has been argued that ensuring that this requirement is satisfied “imposes additional transaction costs and may present special difficulties where the subcontractors are not identified at the time the head contract is entered into and hence cannot be said to have authorized the head contractor to act on their behalf.”<sup>51</sup>

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<sup>46</sup> [1962] AC 446.

<sup>47</sup> See [1962] AC 446 at 474, per Lord Reid. In this case these conditions related specifically to a situation where the clause is contained in a bill of lading and a carrier of goods intends to extend the protection of the clause to a stevedore. See also Quill “Sub-contractors, Exclusion Clauses & Privity” (1991) ILT 211 at 211.

<sup>48</sup> *New Zealand Shipping Co Ltd v A M Satterthwaite & Co Ltd; The Eurymedon* [1975] AC 154 at 169, per Lord Wilberforce. See also *Port Jackson Stevedoring v Salmond & Spraggon (The New York Star)* [1980] 3 All ER 257.

<sup>49</sup> Trebilcock “The Doctrine of Privity of Contract: Judicial Activism in the Supreme Court of Canada” (2007) 57 Univ of Toronto LJ 269 at 280.

<sup>50</sup> Tetley “The Himalaya Clause – Revisited” (2003) JIML 40.

<sup>51</sup> Trebilcock “The Doctrine of Privity of Contract: Judicial Activism in the Supreme Court of Canada” (2007) 57 Univ of Toronto LJ 269 at 280. It is possible for the subcontractor to ratify the head contractor's actions after the fact, but this may involve a further increase in transaction costs.

2.38 The law in Ireland is unclear as to whether a third party could rely on an exemption clause which is intended to extend to them.<sup>52</sup> Section 34(1)(b) of the *Civil Liability Act 1961* provides that a defence “arising under a contract” is available in respect of a negligence action, but it is unclear whether this refers to a defence in *any* contract, or merely a contract to which the defendant is privy.

2.39 Such uncertainty is undesirable, and instead it should be made clear that third parties can rely on exemption clauses which seek to shield them from liability, subject to the normal rules on the incorporation and construction of exemption clauses.<sup>53</sup>

2.40 In modern commercial transactions, contracting parties use exemption clauses in order to allocate the risk of certain events. For example, if A hires B to store his goods, a clause in the contract between A and B may exclude B’s liability to compensate A for in the event that the goods are damaged in storage.<sup>54</sup> Hence, A takes the risk that he may suffer a loss. This will be reflected in the price of the contract between A and B: A will have to either insure against the risk of loss, or self-insure, and thus the price payable to B will be reduced. If A wants to enter into a contract with B under which he has a right of recourse to B if the goods are damaged, i.e. a contract where B takes the risk of damage to the goods, then the price payable to B will increase. Now imagine that A and B are aware that B intends to sub-contract the storage of the goods to a third party C, and an exclusion clause in the contract provides that the liability of B “and its sub-contractors” is excluded if the goods are damaged in storage. Here, again, the parties would intend that A is to take the risk that he may suffer a loss, and again this would be reflected in a reduced contract price between A and B. However, if the privity rule prevents C from relying on this exclusion clause, A<sup>55</sup> may be able to bring an action in tort against C for A’s loss, even

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<sup>52</sup> See Quill “Sub-contractors, Exclusion Clauses & Privity” (1991) ILT 211.

<sup>53</sup> Exclusion clauses are subject to judicial control and scrutiny at common law and under the *Sale of Goods and Supply of Services Act 1980* and the *European Communities (Unfair Terms in Consumer Contracts) Regulations 1995* (SI No.27 of 1995). See Clark *Contract Law in Ireland* (5<sup>th</sup> ed Thomson Round Hall 2004) at Chapter 7.

<sup>54</sup> If such a clause wished to protect B from liability even in the event of B’s negligence, it would have to be clearly expressed: *Canada Steamship Lines v The King* [1952] AC 192. It is not necessarily economically efficient for A to exempt B entirely in the event of B’s negligence, as to do so gives B little incentive to not be negligent. However, there have been cases where such exemption clauses have been entered into and the principles outlined here apply equally when A and B agree to limit B’s liability.

<sup>55</sup> Or A’s insurers, exercising their subrogation rights.

though A agreed that it would take the risk of this loss and that B and its subcontractors, C, would not be liable.

2.41 The problem has been summarised in the Canadian Supreme Court as follows:

“[A]n application of the [privity rule] so as to prevent a third party from relying on a limitation of liability clause which was intended to benefit him or her frustrates sound commercial practice and justice. It does not respect allocations and assumptions of risk made by the parties to the contract and it ignores the practical realities of insurance coverage. In essence, it permits one party to make a unilateral modification to the contract by circumventing its provisions and the express or implied intention of the parties. In addition, it is inconsistent with the reasonable expectations of all the parties to the transaction, including the third party beneficiary who is made to support the entire burden of liability.”<sup>56</sup>

2.42 The problem described above is compounded by the fact that tort law has been extended so as to increase the potential liability in tort of third parties such as C to contracting parties such as A. However, such expansion “has not been accompanied by a matching expansion of the ability to limit that liability through contract, creating a logical gap in the law that could be opportunistically exploited.”<sup>57</sup>

2.43 In England, this problem was resolved by section 1(6) of the *Contracts (Rights of Third Parties) Act 1999*, which allows third parties to enforce a term of a contract which excludes or limits the liability of the third party, provided that was the intention of the parties.

2.44 The Supreme Court of Canada has taken a very wide approach to this issue, and has allowed third parties to rely on an exemption clause even when the clause did not expressly benefit them. In *Fraser River Pile & Dredge Ltd v Can Dive Services Ltd*<sup>58</sup> the Court said that such a third party could rely on such a clause provided two conditions were met:

(a) The parties to the contract must intend to extend the benefit of the clause in question to the third party seeking to rely on the clause.

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<sup>56</sup> *London Drugs v Kuehne & Nagel International Ltd* [1992] 3 SCR 299 at 423 per Iacobucci J.

<sup>57</sup> Trebilcock “The Doctrine of Privity of Contract: Judicial Activism in the Supreme Court of Canada” (2007) 57 *Univ of Toronto LJ* 269 at 291.

<sup>58</sup> [1999] 3 SCR 108. See also *London Drugs v Kuehne & Nagel International Ltd* [1992] 3 SCR 299.

(b) The activities performed by the third party seeking to rely on the contractual provision must be the very activities contemplated as coming within the scope of the contract, as determined by reference to the intention of the parties.<sup>59</sup>

In that case, the third party successfully relied on a clause in an insurance contract in which the insurer waived its right of subrogation against the third party. The third party thus had a defence when the insurer attempted to exercise its subrogation rights against the third party by bringing an action in tort for the loss caused to the insured.

2.45 This is a sensible approach which allows the courts to give effect to the allocation of risk and the contractual arrangements entered into by the contracting parties. A contracting party who agrees to take on certain risks, or who has agreed that their rights to bring an action against a third party will be limited, should not be able to circumvent this agreement merely because it is the third party and not the contracting party who seeks to rely on it. To the extent that the law currently prevents third parties from relying on such clauses, it is clearly in need of reform.<sup>60</sup>

## **(II) Comparative analysis**

### **(a) Europe**

2.46 The legal systems of most member states of the European Union recognise third party contractual rights.<sup>61</sup> For example, third party contractual rights are recognised in the Civil Codes of France,<sup>62</sup> Italy,<sup>63</sup> Spain,<sup>64</sup> Portugal,<sup>65</sup> Germany,<sup>66</sup> Austria,<sup>67</sup> Netherlands,<sup>68</sup> and Greece.<sup>69</sup>

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<sup>59</sup> [1999] 3 SCR 108 at 126.

<sup>60</sup> See paragraphs 3.15 to 3.18 below.

<sup>61</sup> See Zweigert and Kötz *An Introduction to Comparative Law* (3<sup>rd</sup> ed Oxford University Press 1998 Translation by Weir) at 456 – 469.

<sup>62</sup> Article 1121 of the French Civil Code allows a third party to enforce a stipulation for their benefit if the promisor promises to benefit the contracting party as well as the third party, or if the contracting party makes the promisor some gift in connection with the transaction. The French courts have, however, interpreted these conditions very widely, so the contract is enforceable by the third party if the contracting party has any interest in the third party being benefited (a ‘moral profit’) or if there is any economic transfer to the promisor. This effectively reduced the requirements in the Code to nil, “for no one in his right mind will contract for a benefit to be conferred on a third party in whose welfare he does not have even a moral interest.” Nicholas *The French Law of Contract* (2<sup>nd</sup> ed Clarendon Press Oxford 1992) at 186. See Zweigert and Kötz *An Introduction to Comparative Law* (3<sup>rd</sup> ed Oxford University Press 1998 Translation by Weir) at 462 – 463 and Nicholas *The French Law of Contract* (2<sup>nd</sup> ed Clarendon Press Oxford 1992) at 181 - 193.

2.47 The recognition of third party rights is not limited to European countries with Civil Law systems. In England and Wales, the *Contracts (Rights of Third Parties) Act 1999* was introduced following the recommendations of the Law Commission in their 1996 Report *Privity of Contract: Contracts for the Benefit of Third Parties*.<sup>70</sup> The 1999 Act provides that a third party can enforce a contract, or a term of a contract, which is made for their benefit if the contract expressly states that they may, or if the term purports to confer a benefit on them and the contracting parties cannot show that they did not intend the term to be enforceable by the third party. The 1999 Act provides for matters such as how the third party is to be identified, the rights of third parties to vary or discharge the contract, and the defences available to the promisor.

2.48 The 1999 Act applies with some modifications to Northern Ireland. It was thought unnecessary to extend its application to Scotland, as in that jurisdiction the right of a third party to enforce contracts made for their benefit has been long since recognised.<sup>71</sup>

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<sup>63</sup> Article 1141 of the Italian Civil Code provides that a stipulation in favour of a third party is valid if the promisee has an interest, including a moral interest, in the third party being benefited.

<sup>64</sup> Article 1257 of the Spanish Civil Code.

<sup>65</sup> Article 443 of the Portuguese Civil Code.

<sup>66</sup> §328 of the German Civil Code (*Bürgerliches Gesetzbuch*) provides that a contract may stipulate for performance to a third party, so that the third party (and not the other contracting party) acquires a right to demand performance. In the absence of an express stipulation, the judge can infer such a third party right from the circumstances, especially the object of the contract. §§329 to 333 give some guidance as to how this rule operates. For example, §331 provides that if the performance to the third party is due after the death of the promisee, in case of doubt the third party is to acquire the right to the performance upon the death of the promisee.

<sup>67</sup> Article 881 of the Austrian General Civil Code.

<sup>68</sup> Book 6, article 253 of the Dutch Civil Code.

<sup>69</sup> Article 411 of the Greek Civil Code.

<sup>70</sup> Law Com No 242, 1996. See also the English Law Revision Committee *Sixth Interim Report, Statute of Frauds and the Doctrine of Consideration* (1937) Cmd 5449 in which the Committee called for the reform of the rule of privity.

<sup>71</sup> This right of enforcement is called a *ius quaesitum tertio*. In 1977, the Scottish Law Commission proposed legislation to reform aspects of this right, but this remains unimplemented: *Constitution and Proof of Voluntary Obligations: Stipulations in Favour of Third Parties* (Scot Law Com Memo No 38, 1977). See generally McBryde *The Law of Contract in Scotland* (2<sup>nd</sup> ed Green & Son Ltd 2001) at 239 – 252; MacQueen “Third Party Rights in Contract: English Reform and Scottish Concerns” (1997) 1 Edin L R 489.

2.49 Third party rights are also recognised in Article 6:110 of the Principles of European Contract Law. These Principles were completed in 1999 by the Commission on European Contract Law (the Lando Commission) and they may be compared with the Restatements of Law prepared in the United States by the American Law Institute (ALI), discussed below. The Principles of European Contract Law do not, therefore, have the status of law and are not binding. Should contracting parties adopt the Principles they operate only as terms of the contract. However, the Principles are designed to reflect basic principles of contract law across the European Community and indicate that the favoured approach in European Community Member States is to enforce the rights of third parties to a contract.

2.50 It is also important to take into account the continuing work of the European Commission on the Common Frame of Reference of Contract Law. This is a long-term project which aims to provide a “toolbox” or a handbook to be used for the revision of existing legislation and the preparation of new legislation in the area of contract law. This toolbox could contain fundamental principles of contract law, definitions of key concepts and model provisions.<sup>72</sup> The *Second Progress Report on the Common Frame of Reference*<sup>73</sup> states that the rights of third parties is one of the topics under consideration by the drafters of the Common Frame of Reference. It is likely that the view taken in the Common Frame of Reference will be similar to that taken in the Principles of European Contract Law.

**(b) *United States of America***

2.51 In the United States of America, it is generally accepted that third parties are able to enforce contracts made for their benefit.<sup>74</sup> One commentator has stated that the American experience with third party contracts “represents a triumph of judicial and legislative initiative over an inhibiting anachronism”.<sup>75</sup>

2.52 The third party rule is reflected in section 304 of the ALI’s *Restatement (Second) of Contracts*,<sup>76</sup> which states:

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<sup>72</sup> See [http://ec.europa.eu/consumers/rights/cons\\_acquis\\_en.htm#history](http://ec.europa.eu/consumers/rights/cons_acquis_en.htm#history).

<sup>73</sup> Com (2007) 447 final.

<sup>74</sup> See, for example, *Lawrence v Fox* (1859) 20 NY 268; *Choate, Hall & Stewart v SCA Services Inc* (1979) 378 Mass 535; *People ex re Resnik v Curtis and Davies* (1980) 78 Ill. 2d 381.

<sup>75</sup> De Cruz “Privity in America: A Study in Judicial and Statutory Innovation” (1985) 14 *Anglo-American L Rev* 265 at 281.

<sup>76</sup> The Restatements published by the American Law Institute (a voluntary body of legal practitioners and academics) are not binding and do not have legislative status. Nonetheless, many of the key elements of Restatements have been implemented by

“A promise in a contract creates a duty in the promisor to any intended beneficiary to perform the promise, and the intended beneficiary may enforce the duty.”

2.53 Section 302 clarifies that a beneficiary of a promise is an “intended” beneficiary “if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties” and either (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or (b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.

(c) ***Common Law Jurisdictions***

2.54 The privity rule has been subject to criticism in several common law jurisdictions, and has been the subject of legislative and judicial reform. The Commission has already mentioned that in England and Wales the *Contracts (Rights of Third Parties) Act 1999* gives rights of enforcement to third parties.<sup>77</sup> Similar legislative reforms have occurred in other common law jurisdictions.

2.55 In Western Australia, section 11(2) of the *Property Law Act 1969* provides that, subject to a number of limitations:

“where a contract expressly in its terms purports to confer a benefit directly on a person who is not named as a party to the contract, the contract is ... enforceable by that person in his own name.”<sup>78</sup>

2.56 The reform in Western Australia was followed in Queensland by section 55 of the *Property Law Act 1974*<sup>79</sup> and in the Northern Territory by section 56 of the *Law of Property Act 2000*.

2.57 In New Zealand the Contracts and Commercial Law Reform Committee recommended reform of the privity rule after failing to find “a solid basis of policy justifying the frustration of contractual intentions”.<sup>80</sup> Section 4 of the New Zealand *Contracts (Privity) Act 1982* states:

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state legislatures and, even where this has not occurred, they have been cited in cases as persuasive precedents.

<sup>77</sup> See paragraph 2.47 above.

<sup>78</sup> See *Westralian Farmers' Co-operative Ltd v Southern Meat Packers Ltd* [1981] WAR 241; *Visic v State Government Insurance Co Ltd* (1990) 3 WAR 122.

<sup>79</sup> See *Northern Sandblasting Pty Ltd v Harris* (1997) 188 CLR 313; *Hyatt Australia v LTCV Australia Ltd* [1996] 1 Qd R 260.

<sup>80</sup> New Zealand Contracts and Commercial Law Reform Committee *Privity of Contract* (1981).

“Where a promise contained in a deed or contract confers, or purports to confer, a benefit on a person, designated by name, description, or reference to a class, who is not a party to the deed or contract (whether or not the person is in existence at the time when the deed or contract is made), the promisor shall be under an obligation, enforceable at the suit of that person, to perform that promise:

Provided that this section shall not apply to a promise which, on the proper construction of the deed or contract, is not intended to create, in respect of the benefit, an obligation enforceable at the suit of that person.”

2.58 In Canada, section 4 of the New Brunswick *Law Reform Act 1993* and Article 1444 of the Quebec Civil Code provide for third party rights. In addition the Canadian courts have developed a “principled exception” to the privity rule.<sup>81</sup>

2.59 In Singapore the *Contracts (Rights of Third Parties) Act 2001* was enacted following the recommendations of the Law Reform and Revision Division of the Attorney General’s Chambers in Singapore.

**(d) Conclusion**

2.60 It is clear from this comparative analysis that Ireland is one of the few jurisdictions which does not provide for a general scheme of third party rights. Reform of the privity rule would thus bring Ireland into line with the law in most countries in the European Union (including the United Kingdom) and the law in the United States, Canada, Singapore and parts of Australia.

2.61 The globalisation of international trade and the increase in cross border transactions means that uniformity of laws affecting commerce is of increasing importance. This is the underlying policy behind UNIDROIT (the International Institute for the Unification of Private Law) which researches and encourages methods for modernising, harmonising and co-ordinating private and commercial law between States and groups of States.<sup>82</sup> The work of UNIDROIT includes the formulation of the UNIDROIT Principles of International Commercial Contracts, a Restatement of the law on international contracts. These Principles are not binding, and if parties adopt the Principles they operate only as terms of the contract. However, the international trend of recognition of third party rights

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<sup>81</sup> *Fraser River Pile & Dredge Ltd v Can Dive Services Ltd* [1999] 3 SCR 108. See paragraph 2.30 above.

<sup>82</sup> See [www.unidroit.org](http://www.unidroit.org).

is reflected in Articles 5.2.1 – 5.2.6 of the Principles, which provide for third party rights.

2.62 The Commission is aware that different jurisdictions have different historical and policy reasons for allowing third parties to enforce rights.<sup>83</sup> The Commission is also aware that the schemes of third party rights in various jurisdictions are different and all individually suited to the needs of those jurisdictions. The rights of third parties in different jurisdictions cannot be viewed in a vacuum, but rather as part of the overall framework of law existing in those jurisdictions. It would not be possible or desirable to attempt to directly replicate the third party laws existing in other jurisdictions, or to attempt to “transplant” those laws into the Irish legal system.

2.63 However, the Commission is of the view that it is commercially convenient and desirable that the same fundamental principles should underline contract law in different jurisdictions. The principle that a third party should be able to enforce a contract made for their benefit is one such principle and which should be recognised in Irish law.

## **(12) Conclusion**

2.64 Over the years, there have been many calls to reform the privity rule. Before the introduction of reforms in England, Lord Diplock described the rule as “an anachronistic short-coming that has for many years been regarded as a reproach to [the] law”<sup>84</sup> and Lord Steyn stated:

“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 . . . [T]here 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 ... 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.”<sup>85</sup>

2.65 In light of the many arguments in favour of reform of the privity rule in Ireland, the Commission is of the view that the privity rule should be reformed to allow third parties to enforce rights under contracts made for their benefit.

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<sup>83</sup> See Consultation Paper paragraphs 1.161 to 1.162.

<sup>84</sup> *Swain v The Law Society* [1983] 1 AC 598 at 611.

<sup>85</sup> *Darlington Borough Council v Wiltshier Northern Ltd* [1995] 1 WLR 68 at 76.

2.66 *The Commission recommends that the privity of contract rule should be reformed to allow third parties to enforce rights under contracts made for their benefit.*

## **C Options for Reform**

2.67 In the Consultation Paper, the Commission outlined a number of options for reform.<sup>86</sup> These included leaving the development of the rule of privity to the courts; reform of the promisee's remedies to give more protection to a third party; legislative reform to create further exceptions to the privity rule in specific instances; and the introduction of legislation entitling third parties to enforce contracts for their benefit. The Commission provisionally recommended that the rule of privity of contract should be reformed by means of detailed legislation.<sup>87</sup>

### **(1) Judicial development of the rule of privity**

2.68 It could be argued that legislative reform of the rule of privity is unnecessary, and that the courts in Ireland could simply develop a new rule of third party rights. As was discussed in Chapter 1, the courts have already developed exceptions to the rule of privity by using concepts such as trusts, agency and assignment. Courts in other jurisdictions, for example, the United States<sup>88</sup> and Canada<sup>89</sup>, have developed the law of third party rights in such a way that third parties can, as a general rule, enforce contracts made for their benefit.

2.69 However, as was noted in the Consultation Paper, judicial development of the law can be a slow process.<sup>90</sup> The common law system of precedent generally requires the courts to follow previous decisions of the higher courts. For the rule of privity to be reformed in a general way, the higher courts would need to be presented with a case which highlights the injustices of the rule. It is by no means certain that an appropriate case will come before the Supreme Court and there is no guarantee that the judges sitting would choose to carry out a major review and reform of the law.

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<sup>86</sup> Consultation Paper, Chapter 2.

<sup>87</sup> Consultation Paper, paragraph 2.93.

<sup>88</sup> See *Lawrence v Fox* (1859) 20 NY 268; *Choate, Hall & Stewart v SCA Services Inc* (1979) 378 Mass 535.

<sup>89</sup> See *London Drugs v Kuehne & Nagel International Ltd* [1992] 3 SCR 299; *Fraser River Pile & Dredge Ltd v Can Dive Services Ltd* [1999] 3 SCR 108. There is also legislative provision for third party rights in New Brunswick (section 47 of the *Law Reform Act*, SNB 1993 c L-12) and in the Québec Civil Code (1991, c.64, article 1444).

<sup>90</sup> Consultation Paper paragraphs 2.20 – 2.23.

2.70 Judicial reform of the privity rule would be an uncertain path to take. Judicial opinion can change over time, and those that are affected by the rule of privity could be unsure of where they stand in relation to their rights under the contract. It is unlikely that the courts would decide all of the issues that arise in relation to third party rights in the one case, and substantial doubt could remain. In contrast, legislative reform could address multiple issues regarding third party rights, and would result in greater certainty than judicial reform.

2.71 The Commission therefore remains of the view that legislative reform of the rule of privity is more appropriate than judicial reform. The mere possibility of judicial reform in the future does not reduce the need for legislative reform.

2.72 The Commission nonetheless considers that the role of the judiciary will be vital when applying the proposed legislation, and in solving future difficulties that may arise in relation to third party rights. The judiciary will thus still have an essential role to play in the development of third party rights, and legislative reform of the privity rule should not constrain judicial development of third party rights.

2.73 *The Commission recommends that legislative reform of the rule of privity is more appropriate than judicial reform. The Commission also recommends that legislative reform of the privity rule should not constrain judicial development of third party rights.*

**(2) *Legislative reform of the promisee's remedies to give more protection to a third party***

2.74 In Chapter 1 the Commission discussed the remedies which are available to the promisee when the promisor is in breach of its promise to a third party.<sup>91</sup> The promisee may wish to assist the third party, either by claiming damages for the loss suffered by the third party or by requesting specific performance, that is, by requesting that the promisor perform as they promised. However, the Commission noted the general rule that a party is only entitled to an award of damages which reflects their own loss, and not the loss of a third party.

2.75 Two issues arise in the context of reform of the promisee's remedies. The first is the extent to which reform of the remedies available to the promisee could solve the problems associated with the rule of privity. For example, legislation could provide that where a contract is for the benefit of a third party, a promisee could recover damages in contract for any loss suffered by that third party, on behalf of the third party.

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<sup>91</sup> See paragraphs 1.62 to 1.68 above.

2.76 It is the Commission's view that such extension of the promisee's remedies would be a limited reform which not be sufficient to solve the problems associated with the privity rule. Reform of the promisee's remedies would only assist third parties in a limited number of cases where the promisee is willing and able to bring an action on behalf of the third party. It would not be of use where a promisee is unwilling to bring an action, or where a third party is seeking to rely on an exemption clause contained in a contract to which they are not a party.

2.77 The second issue which arises in relation to the promisee's remedies is the extent to which there is a more general need to reform the remedies available to the promisee, in particular to clarify when damages will be available to represent the loss suffered by a third party. It could be argued that the law in this area is underdeveloped in Ireland, and that such clarification is necessary.

2.78 It is the Commission's view, however, that the Irish courts are well equipped to develop principles relating to the award of damages for third party loss. The Commission acknowledges that reform of the privity rule should not affect judicial development of principles relating to the award of damages. If in the future legislative reform of the principles relating to damages for third party loss should be deemed necessary, it should form part of a wider reform relating to the law on damages.<sup>92</sup> Also, as mentioned above, the "legal black hole" exception only applies if the third party is not able to sue for damages, or if it was not contemplated that they would be able to do so.<sup>93</sup> If there is legislative reform extending the ability of third parties to sue for damages in their own name then the significance of this exception would most likely be reduced.

2.79 *The Commission recommends that legislative reform of the promisee's remedies should not form part of the proposals to reform the rule of privity. The Commission acknowledges that reform of the rule of privity should not prevent judicial development of the principles relating to the award of damages or specific performance.*

### **(3) *Legislative reform to create further exceptions***

2.80 To date, many specific difficulties caused by the privity rule have been dealt with by the creation of further exceptions to the rule. For example, sections 7 and 8 of the *Married Women's Status Act 1957*, section 76(1) of the *Road Traffic Act 1961* and section 80 of the *Consumer Credit*

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<sup>92</sup> The reform of the law of damages in contract and tort law forms part of the Commission's *Third Programme of Law Reform 2008 – 2014*. See Law Reform Commission *Report on Third Programme of Law Reform 2008 – 2014* (LRC 86-2007) at 17.

<sup>93</sup> See paragraph 1.65 above.

*Act 1995* all provide solutions to particular problems caused by the privity rule.

2.81 It is the Commission's view that although this method of reform has been effective in tackling pressing needs in specific instances, there is a need for a more general legislative reform of the privity rule. The Commission has identified many difficulties with the privity rule, and many types of contractual arrangements which are adversely affected by the rule. If these were all to be dealt with separately it would require many separate legislative provisions, and could lead to increased complexity in the law. It would be very difficult to individually deal with every injustice caused by the privity rule, and inevitably there would be unacceptable gaps in the protection given to third parties.

2.82 The addition of further specific exceptions, without the creation of a general scheme of third party rights, would ignore many of the shortcomings of the privity rule. It is the view of the Commission that the difficulties posed by the privity rule are such that the rule itself is in need of general reform.

2.83 *The Commission recommends that reform of the privity rule should not be by the creation of further exceptions to the privity rule in specific instances.*

**(4) *Detailed legislative reform to create a general scheme of third party rights***

2.84 In the Consultation Paper, the Commission considered the merits of introducing third party rights by means of a general legislative provision which simply provides that contracts for the benefit of third parties should not be unenforceable because of a lack of privity. It was the Commission's view that, while such a general clause had the advantage of simplicity, it could lead to uncertainty and confusion, and that without legislative guidance many issues would have to be teased out by the judiciary and legal practitioners. This would make it difficult for lawyers to advise clients, and would not encourage people to make use of third party rights.

2.85 The Commission further noted that the enactment of detailed legislation creating third party rights has been the favoured method of reform in other common law jurisdictions. Such detailed legislation can be seen, for example, in New Zealand,<sup>94</sup> and England and Wales.<sup>95</sup>

2.86 The Commission thus provisionally recommended that the privity of contract rule should be reformed by means of detailed legislation.

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<sup>94</sup> The *Contracts (Privity) Act 1982*.

<sup>95</sup> The *Contracts (Rights of Third Parties) Act 1999*.

2.87 The Commission is still of the view that detailed legislation is appropriate to reform the privity rule, as it can deal in advance with many of the issues that arise in relation to third party rights, and increase certainty.

2.88 *The Commission recommends that the privity of contract rule should be reformed by means of detailed legislation.*

## **D Guiding Principles for Reform**

2.89 In this section the Commission outlines the main principles and considerations which should guide any legislative reform of the privity rule.

2.90 First, it is vital that any reforms are designed to give effect to the intentions of the contracting parties. The failure of the courts to give effect to the intentions of the contracting parties was identified by the Commission as one of the major failings of the privity rule, and any reform should seek to address this point. This means that the contracting party's freedom of contract should be respected, and that a third party should not have a right to enforce a contract where the contracting parties did not intend to give the third party this right. Rather, any reforms should facilitate contracting parties who wish to give rights to third parties.

2.91 Second, any reforms should be as certain as possible. One of the problems associated with the privity rule is lack of certainty. In particular it is sometimes unclear whether the courts will apply the privity rule or an exception to the rule. Any reforms would need reduce this uncertainty, and not add to it. Further, the Commission recognises that parties to a dispute need clear solutions to resolve their problems quickly and effectively. If the law is certain, the outcome of a dispute may be predicted and the parties may resolve it themselves without resort to litigation.

2.92 Third, the reforms should facilitate and give effect to the commercial interest of the parties. It has been noted that the role of commercial law is "to facilitate trade, not to regulate it",<sup>96</sup> and although any reform of the privity rule would relate to contract law as a whole and not be limited to the commercial context, this principle is still relevant and important. At the same time, any reform should not reduce the protection which is currently available to consumers or other vulnerable contracting parties.

2.93 Fourth, the limits of the rights of third parties must be clearly marked. Contracting parties should not become liable to an indeterminate number of third parties merely because the contract incidentally benefits those third parties. Rather, there should be strict limits on which third parties have a right to sue. Thus, the reforms should deal with issues such as

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<sup>96</sup> White *Commercial Law* (Thomson Round Hall 2002) at 9.

when a third party has a right to sue, how the third party is to be identified and the defences available to the promisor. The Commission is of the view that the intentions of the parties should be a guiding factor in all of this, and that the third party's right should be subject to the other terms and conditions of the contract.

2.94 The first four guiding principles concern the Commission's need to protect the interests of the contracting parties. The Commission also aims to protect the interest of the third party. The fifth guiding principle, therefore, is that the reforms should protect the third party's expectation interest, and not merely their reliance interest. In other words, provided all the other conditions are met, the third party should be able to enforce the contractual provision which benefits it regardless of whether or not the third party has relied on the provision. The injustice to the third party is caused when the third party's reasonable expectations that the contract will be performed are disappointed.<sup>97</sup> This should be reflected, for example, in the remedy that is available to the third party.<sup>98</sup>

2.95 The sixth principle is that the Commission is of the view that the reforms should protect the third party not only where the third party is to gain a benefit from the contract, but also where the third party seeks to rely on the contract to avoid a loss. The reforms should expressly deal with a situation where someone wishes to rely on an exemption clause contained in a contract to which they are not a party.

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<sup>97</sup> See Law Commission for England and Wales *Privity of Contract: Contracts for the Benefit of Third Parties* (Law Com No 242, 1996) at paragraph 9.19.

<sup>98</sup> See paragraphs 3.63 - 3.68 below.

## **CHAPTER 3      SPECIFIC ISSUES FOR REFORM**

### **A            Introduction**

3.01        In Chapter 2 the Commission recommended that reform of the privity rule should take the form of detailed legislation and outlined the guiding principles for those reforms. In this Chapter the Commission examines the specific issues that must be addressed to formulate a comprehensive scheme of third party rights. A fundamental issue in this respect is to what extent a third party should be able to enforce a term of a contract. The Commission also discusses the detailed elements of the proposed statutory scheme. These include the following: to what extent the third party must be identified in the contract either by name or by description; whether the contracting parties should be able to cancel or vary the contract in such a way as to affect the rights of the third party; whether the contracting parties should remain free to include in the contract an express term providing for variation or termination of the contract; whether the rights of the third party should be subject to the usual defences and remedies (including set-off and counterclaim) which would be available to the promisor if the promisee had taken the action; exclusions of certain contracts from the proposed scheme (such as employment contracts and certain contracts involving companies); and to what extent contracting parties should be able to exclude or “contract out” of the proposed legislation.

### **B            When a third party can enforce their rights under a contract**

3.02        The Commission is of the view that there must be limits to when and how a contract can be enforced by a third party. In the Consultation Paper the Commission discussed the circumstances in which a third party should be able to enforce a contract, and compared the tests which apply in other jurisdictions.<sup>1</sup> The Commission is of the view that a third party can enforce their rights under a contract in the following three situations.

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<sup>1</sup> See Consultation Paper, paragraphs 3.04 to 3.42.

**(1) *The presumption in favour of third party enforcement when a term of the contract expressly benefits the third party***

3.03 The Commission is of the view that a third party should be able to enforce a term of a contract when the term expressly confers a benefit on the third party, provided it was the intention of the contracting parties that the third party should be able to enforce this term. Thus, when the contract expressly confers a benefit on a third party, there should be a presumption that the parties intended for the third party to have a right to bring an action to enforce this term. This presumption can be rebutted by the contracting parties if they can show that they did not intend for the third party to have a right to enforce this term.

3.04 This approach has a number of advantages. First, the contract must expressly benefit a third party, so third parties would not be able to enforce contracts which impliedly or incidentally benefit them. This will increase certainty for contracting parties, who will not be liable to a third party merely because the contract happens to be of benefit to them. Second, the intention of the parties is paramount. A third party cannot claim a right to enforce the contract if the contracting parties did not intend for the third party to be able to enforce the contract.

3.05 It could be argued that a third party should only be able to bring an action to enforce a contract if the contract expressly says that they can do so. However, this would be excessively narrow, as it is likely that third parties would only have rights of enforcement where the contracting parties had the benefit of legal advice and knew to expressly give a right of enforcement to the third party. Such a requirement could operate to the disadvantage of parties who do not have access to proper legal advice. A presumption that a third party can enforce a contract made for its benefit is more in line with commercial expectations. It is important to remember that the presumption can be rebutted where the contracting parties did not intend for the third party to have a right to enforce the contract.

3.06 One issue which could arise here is the question of what the court is entitled to take into account when ascertaining the intentions of the contracting parties. It is clear that the court should not be restricted to an examination of the term which benefits the third party, but should look at all the contract as a whole. However, it is less clear whether the court should be able to take into account the surrounding circumstances at the time of the formation of the contract. The normal rules on the proper construction of a contract would seem to indicate that when interpreting a contract the courts do take into account the surrounding circumstances at the time of the formation of the contract.<sup>2</sup> However, it is unclear whether this principle

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<sup>2</sup> See *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* [1976] 1 WLR 989 at 995 where Lord Wilberforce stated “No contracts are made in a vacuum; there is always a

should apply when the court is interpreting a contract which is for the benefit of a third party, because the third party may have relied on the plain meaning of the words in the contract and may not have knowledge of the surrounding circumstances.

3.07 The Law Commission for England and Wales favoured an approach which takes into account the overall surrounding circumstances. Thus, for example, where there is a chain of contracts, the overall contractual arrangements entered into by the parties could indicate whether there was an intention to give a third party a right to enforce a contract which benefits them. The Law Commission illustrated this using the example of a situation where an owner enters into a construction contract with a head-contractor, who then in turn enters into sub-contracts with different sub-contractors. The sub-contract may expressly benefit the owner, but the existence of a chain of contracts may indicate that the head-contractor and the sub-contractor (i.e. the parties to the sub-contract) did not intend for the owner to have a direct right to enforce the sub-contract.<sup>3</sup> The Commission stated:

“[E]ven if the sub-contractor has promised to confer a benefit on the expressly designated owner, the parties have deliberately set up a chain of contracts which are well understood in the construction industry as ensuring that a party’s remedies lie against the head contractor who in turn has the right to sue the sub-contractor. In other words, for breach of the promisor’s obligation, the owner’s remedies lie against the head-contractor who in turn has the right to sue the sub-contractor. On the assumption that that deliberately created chain of liability continues to thrive subsequent to our reform, our reform would not cut across it because on a proper construction of the contract – *construed in the light of the surrounding circumstances* (that is, the existence of the connected head-contract and the background practice and understanding of the construction industry) – the contracting parties ... did not intend the third party to have the right of enforceability.”<sup>4</sup>

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setting in which they have to be placed ... In a commercial context it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.”

<sup>3</sup> This would not prevent the third party, that is, the owner, from being able to bring an action on the sub-contract where the sub-contract expressly gives the third party such a right to enforce the contract. See paragraph 3.11 below.

<sup>4</sup> Law Commission for England and Wales *Privity of Contract: Contracts for the Benefit of Third Parties* (Law Com No 242, 1996) at paragraph 7.18, emphasis added.

The English *Contracts (Rights of Third Parties) Act 1999* does not expressly mention the need to take into account the surrounding circumstances. It is unclear whether this is on the basis that the normal rules of contractual interpretation provide for this, or whether in fact the courts are restricted to looking at the language contained in the contract.<sup>5</sup>

3.08 It has been pointed out that the approach of the Law Commission for England and Wales is too subjective, and could be quite unfair where a third party is unaware of the surrounding circumstances.<sup>6</sup> It could be argued that in the interest of fairness the contracting parties should not be able to produce evidence of surrounding circumstances to show that they did not intend the meaning that an ordinary interpretation of the words of the contract would indicate.<sup>7</sup>

3.09 The Commission is of the view that in contract disputes involving third parties, the courts should be free to look at the surrounding circumstances of the formation of the contract, if they would normally do so under the ordinary rules of contractual interpretation. However, to adequately protect the third party, this should be limited to the surrounding circumstances which are “reasonably available” to the third party.<sup>8</sup>

3.10 The test of enforceability proposed here is different in a number of respects to that found in sections 1(1)(b) and 1(2) of the English *Contracts (Rights of Third Parties) Act 1999*. For example, section 1(1)(b) of the 1999 Act provides that a third party may in his own right enforce a term of the contract if “the term purports to confer a benefit on him”, and section 1(2) provides 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 the third party.” The wording of section 1(1)(b) has been criticised, as it is

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<sup>5</sup> See Roe “Contractual Intention under Section 1(1)(b) and 1(2) of the *Contracts (Rights of Third Parties) Act 1999*” (2000) 65 MLR 887 at 888, where the author argues that the 1999 Act restricts the courts to the contract itself when establishing the intention of the contracting parties. English cases where the courts have had to ascertain the intentions of the parties include *Nisshin Shipping Co Ltd v Cleaves & Co Ltd* [2004] 1 All ER (Comm) 481 and *Prudential Assurance Co Ltd v Ayres* [2007] EWHC 775 (Ch).

<sup>6</sup> See Roe “Contractual Intention under Section 1(1)(b) and 1(2) of the *Contracts (Rights of Third Parties) Act 1999*” (2000) 65 MLR 887 at 891. See also the comments of Saville LJ in *National Bank of Sharjah v Dellborg* unreported, English Court of Appeal, July 1997.

<sup>7</sup> See Consultation Paper paragraph 3.29.

<sup>8</sup> The idea that the surrounding circumstances taken into account by the court should be “reasonably available” to the parties can be seen in the speech of Lord Hoffmann in *Investors Compensation Scheme Ltd v West Bromwich BS* [1998] 1 WLR 896 at 912.

difficult to see what exactly is meant by the phrase “purports to”.<sup>9</sup> It could be argued that a term which “purports” to confer a benefit on a third party is somehow different to a term which “confers” a benefit on them. In *Prudential Assurance Co Ltd v Ayres*<sup>10</sup> Lindsay J rejected this, stating “section 1(1)(b) is satisfied if on a true construction of the term in question its sense has the effect of conferring a benefit on the third party in question.”<sup>11</sup> However, the phrase “purports to” seems to have caused unnecessary uncertainty, and the Commission is of the view that it should be omitted from the proposed legislation. A second difference between the proposed legislation and the *Contracts (Rights of Third Parties) Act 1999* is that under the English Act the presumption that the contracting parties intended to give the third party a right of enforcement applies when the contract impliedly benefits the third party, whereas under the proposed legislation this presumption only applies when a contract expressly benefits the third party.

**(2) *When the contract expressly states that the third party has a right to enforce a term of the contract***

3.11 The Commission is of the view that a third party should also be able to enforce a term of a contract when the contract expressly states that the third party has a right of enforcement, whether or not the contract benefits the third party. This means that if the contracting parties intend to give a right of enforcement to a third party, and expressly provide for it in the contract, the courts can give effect to that intention.

3.12 For example, A (a developer) and B (a client) may wish to designate C (a management company) as having the right to sue to enforce a construction contract which benefits D, E and F, who are tenants.<sup>12</sup> Similarly, taking the example above where there is a chain of contracts in the construction industry, the sub-contract may expressly give the employer, a third party to the sub-contract, a right to enforce the sub-contract.<sup>13</sup>

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<sup>9</sup> See for example Stevens “The Contracts (Rights of Third Parties) Act 1999 (2004) 120 LQR 292 at 306.

<sup>10</sup> [2007] EWHC 775 (Ch), [2007] All ER (D) 43.

<sup>11</sup> [2007] EWHC 775, at paragraph 28. Lindsay J further clarified that section 1(1)(b) of the 1999 Act does not require that the benefit to the third party “be the predominant purpose or intent behind the term” and it applies even if a benefit is conferred on someone other than the third party: [2007] EWHC 775, at paragraph 28.

<sup>12</sup> See Law Commission for England and Wales *Privity of Contract: Contracts for the Benefit of Third Parties* (Law Com No 242, 1996) at paragraph 7.14.

<sup>13</sup> See paragraph 3.07 above.

3.13 In England, section 1(1)(a) of the *Contracts (Rights of Third Parties) Act 1999* provides for a similar right of enforcement.<sup>14</sup> It has been used, for example, in contracts for the sale of dogs to give third parties such as the RSPCA<sup>15</sup> contractual rights of enforcement against the buyer if the buyer mistreats the dog. The RSPCA can bring such an action even though it does not benefit from the contract, because the contracting parties (that is, the seller and buyer) expressly provided for such a right of enforcement.

3.14 The ability of the third party to bring an action where the contract gives them an express right to do so may also be important where the contract impliedly benefits the third party. The fact that a contract impliedly benefits a third party will not be enough to raise the presumption that the third party has a right to enforce the contract. However, the third party may still be able to bring an action to enforce the contract if the contract expressly states that he may do. This achieves both protection for the third party and certainty for the contracting parties (who will not be liable to third parties who impliedly benefit from contracts unless the contract expressly states that they are so liable).

**(3) *When the contract excludes or limits the liability of the third party***

3.15 An exemption clause in a contract seeks to exclude or limit the liability of the parties to a contract. This can include liability for breach of contract or liability in tort or under statute. An exemption clause may state that it is to apply to a third party, or a category of third party, such as employees, sub-contractors or agents of the contracting parties.

3.16 The Commission has already discussed a number of difficulties and uncertainties that arise when a third party seeks to rely on an exemption clause, and has identified the need to reform this area of law.<sup>16</sup> The Commission has concluded that a third party should have the right to rely on a term of a contract which excludes or limits the liability of the third party, provided that was the intention of the parties. This is subject to the normal rules on the incorporation and construction of exemption clauses.<sup>17</sup>

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<sup>14</sup> Section 1(1)(a) of the *Contracts (Rights of Third Parties) Act 1999* states that a third party may enforce a term of the contract if “the contract expressly provides that he may”.

<sup>15</sup> Royal Society for the Prevention of Cruelty to Animals.

<sup>16</sup> See paragraphs 2.35 to 2.45 above.

<sup>17</sup> Exclusion clauses are subject to judicial control and scrutiny at common law and under the *Sale of Goods and Supply of Services Act 1980* and the *European Communities (Unfair Terms in Consumer Contracts) Regulations 1995* (SI No. 27 of 1995). See *Clark Contract Law in Ireland* (5<sup>th</sup> ed Thomson Round Hall 2004) Chapter 7.

3.17 *The Commission recommends that a third party should be able to enforce a term of a contract when the term expressly confers a benefit on the third party. However, the third party should not be able to enforce the term if it appears on a proper construction of the contract that the contracting parties did not intend the term to be enforceable by the third party. The contract should be interpreted in accordance with the ordinary rules of contractual interpretation, but surrounding circumstances should only be taken into account if they are reasonably available to the third party.*

3.18 *The Commission recommends that a third party should be able to enforce a contract or a term of a contract when the contract expressly states that they may.*

3.19 *The Commission recommends that a third party should have the right to rely on a term of a contract which excludes or limits the liability of the third party, provided that was the intention of the parties. This is subject to the normal statutory and common law rules on the incorporation and construction of exemption clauses.*

## **C Identification of a third party beneficiary**

3.20 It is important to be able to identify the third party beneficiaries of contracts. One obvious way of identifying a third party is to name them in the contract. However, contracts which benefit third parties are not always that straightforward and a requirement that the third party be named in the contract could be overly restrictive. For example, the contracting parties may want to benefit multiple third parties who are part of a particular group, or class, (for example, all the employees of a company) or third parties who are not yet in existence (for example, all the future employees of a company). In the Consultation Paper the Commission discussed different approaches which could be taken to this issue.<sup>18</sup>

3.21 In the Consultation paper the Commission provisionally recommended that the third party should be identified in the contract either by name or by description, and that such a description should include being a member of a class or group of persons.<sup>19</sup> For example, the third party beneficiaries could be described as “all Sinéad’s employees” or “Mary’s children”. The Commission is still of the view that this is an appropriate way to identify third party beneficiaries, provided that the description is sufficiently precise. A requirement that all third parties be named would be overly restrictive and cumbersome, particularly where the contract is intended to benefit a large number of people. Identification by description is

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<sup>18</sup> Consultation Paper at paragraphs 3.43 – 3.62.

<sup>19</sup> Consultation Paper, paragraph 3.62.

more commercially convenient, and ensures that the contracting parties can still identify the third party with a degree of certainty.

3.22 In the Consultation Paper, the Commission provisionally recommended that there should be an express provision in any reforming legislation that there should be no requirement that the third party be in existence at the time of entering into the contract.<sup>20</sup> For example, the contracting parties may wish to benefit their unborn children, or the future employees of a company, or the future purchasers or tenants of a housing development, or persons that enter into sub-contracts in the future with one contracting party. The Commission is of the view that it should be possible for the contracting parties to do so, and that these third parties should be able to bring an action to enforce the contract provided they can be described with sufficient certainty.

3.23 *The Commission recommends that the third party should be identified in the contract either by name or by description. Such description should include being a member of a class or group of persons.*

3.24 *The Commission recommends that there should be an express provision that there is no requirement that the third party be in existence at the time of the formation of the contract.*

## **D The requirement of consideration**

3.25 As a general rule, a contract is enforceable if the contracting parties have each promised something or done something in return for the promise of the other. It is said that each party must provide “consideration” for the promise of the other. One reason traditionally given to support the privity rule was that the third party should not be able to enforce a contract because they have not provided any consideration under that contract.

3.26 The Commission is of the view that, provided the other requirements are met, a third party should be able to enforce the contract even though they have not provided any consideration. In other words, consideration need not move from the third party beneficiary. However, this would not affect the requirement of consideration in general, and the normal rules as to consideration should apply as between the promisor and promisee.

3.27 *The Commission recommends that a third party should be able to enforce a term of a contract even though they have not provided consideration. The normal rules on consideration should apply to the promisor and promisee.*

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<sup>20</sup> Consultation Paper, paragraph 3.62.

## **E            The right of the contracting parties to vary or cancel the contract**

3.28            Contracting parties are generally free to modify or alter the terms of a contract by mutual agreement. However, if that contract is enforceable by a third party, any such modification of the contract could have an impact on the rights of the third party. If the contracting parties had an unlimited power to vary the contract, the third party's rights would be relatively meaningless, as these rights could be changed by the mutual agreement of the contracting parties at any time. However, if the contracting parties could never agree to vary the terms of the contract it could be commercially inconvenient and restrict the contracting parties' freedom of contract. It is thus important to strike a balance between the interests of the contracting parties to vary the contract and the interest of the third party in securing the promised benefit.

3.29            In many jurisdictions, the contracting parties are free to vary or cancel the terms of the contract until a certain determinable point. After this point, they may not vary or terminate the contract without the consent of the third party. This point, when the third party rights are said to have "crystallised", may occur when the contract is formed; when the third party accepts the contract; when the third party adopts the contract or when the third party relies on or materially alters their position in reliance on the contract. However, different jurisdictions apply different forms of this test.<sup>21</sup> For example, in Scotland<sup>22</sup> the contracting parties cannot revoke or modify the third party's rights once the contract is formed; in Queensland,<sup>23</sup> the Northern Territory,<sup>24</sup> France, Holland and South Africa<sup>25</sup> the contracting parties cannot cancel or modify the contract after it has been accepted by the third party; in Western Australia<sup>26</sup> the contracting parties cannot cancel or modify the third party's rights after the contract has been "adopted" either expressly or by conduct; and in New Zealand<sup>27</sup> and the United States<sup>28</sup> the contracting parties lose the right to vary the contract if the third party has

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<sup>21</sup> See Consultation Paper paragraph 3.66 to 3.85.

<sup>22</sup> See MacQueen "Third Party Rights in Contract: English Reform and Scottish Concerns" (1997) 1 *Edinburgh Law Review* 488 at 489 – 490.

<sup>23</sup> *Property Law Act 1974*, section 55(2).

<sup>24</sup> *Law of Property Act 2000*, section 56(2).

<sup>25</sup> See MacQueen "Third Party Rights in Contract: English Reform and Scottish Concerns" (1997)1 *Edinburgh Law Review* 488 at 490.

<sup>26</sup> *Property Law Act 1969*, section 11(3).

<sup>27</sup> *Contracts (Privity) Act 1982*, section 5(1).

<sup>28</sup> See Section 311 of the American Law Institute's *Restatement (Second) of Contracts*.

“materially altered” their position in reliance on the promise made. In England and Wales the contracting parties lose the right to vary the contract if the third party communicates assent to the term to the promisor or if the promisor is aware that the third party has relied on the term or if the promisor can reasonably be expected to have foreseen that the third party would rely on the term and the third party has in fact relied upon it.<sup>29</sup>

3.30 The Commission considers that a rule, similar to that in Scotland, which would not permit any variation or cancellation of the contract would be too restrictive. A situation could potentially arise where the contracting parties agree to benefit a third party who only becomes aware of the contract many years after. It seems somewhat bizarre that the contracting parties could be held to their agreement until the third party at some point in the future becomes aware of it and consents to its termination or variation. As the Law Commission for England and Wales has pointed out, “where the third party is not even aware of the promise it is hard to see any conceivable injustice to the third party in allowing the contracting parties to vary or cancel the contract.”<sup>30</sup>

3.31 A rule based on the third party’s awareness of their rights under the contract could cause uncertainty for the contracting parties: how are the contracting parties meant to determine the point at which the third party has become aware of their rights under the contract? This test would be too uncertain to be workable and is thus inappropriate.

3.32 A similar point can be made of any test based on the third party’s reliance on the contract, such as the rule that the contracting parties lose the right to vary the contract if the third party has “materially altered” their position in reliance on the contract. How are the contracting parties meant to know whether the third party has relied on the contract?<sup>31</sup> A further

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<sup>29</sup> Section 2(1) of the *Contracts (Rights of Third Parties) Act 1999*.

<sup>30</sup> Law Commission for England and Wales *Privity of Contract: Contracts for the Benefits of Third Parties* (Law Com No 242, 1996) at paragraph 9.10. See also MacQueen “Third Party Rights in Contract: English Reform and Scottish Concerns” (1997)1 *Edinburgh Law Review* 488 at 489 – 490: “Whether the approach of the Scot law ... is either sensible or workable seems very doubtful. ... Twenty years ago the Scottish Law Commission provisionally recommended that a contract which contained a provision in favour of a third party should *ipso facto* be irrevocable. But this may not be in line with what seems increasingly to be the perceived wisdom not only in the Common Law but also in the Civil Law world.”

<sup>31</sup> In England and Wales the *Contracts (Rights of Third Parties) Act 1999* has a test of awareness and foreseeability to deal with this problem, that is, the contracting parties cannot vary the contract if “the promisor is aware that the third party has relied on the term or the promisor can reasonably be expected to have foreseen that the third party would rely on the term and the third party has in fact relied on it.” However, the second part of this test is still vague and both are based on the idea of reliance, which the Commission has rejected as a basis for recovery.

objection that can be made to this test is that it is too restrictive, as it links the third party's ability to enforce the promise with the third party's reliance on that promise. The Commission is of the view that the third party's rights are not based on reliance on the promise but rather are based on the third party's expectation that the promise to it will be kept.<sup>32</sup>

3.33 The Commission has concluded that the contracting parties should not be able to cancel or vary the contract once it has been assented to by the third party and either contracting party is aware of this fact.<sup>33</sup> This assent can be by word or conduct, and such conduct may in a particular case include reliance on the contract. The important point in time here for the crystallisation of the third party's rights would be the point at which the contracting party is aware that the third party has assented to the contract. This approach has the advantage of being certain: the contracting parties know exactly when the third party's rights have crystallised.

3.34 In some jurisdictions where the test is based on assent or acceptance by the third party there is a requirement that it should be communicated by or on behalf of the third party to the contracting party. The difficulty with this approach is that there is a risk that only third parties who know the law may communicate their acceptance. Thus, the Commission favours an approach which is based on the awareness of the contracting parties rather than on any act of communication by the third party. Of course, communication of acceptance by the third party is one way to ensure that the contracting parties are aware that the third party has assented.

3.35 If the contracting parties are aware that the third party has assented to the contract, they need to obtain the consent of the third party to cancel or vary the contract.

3.36 If this consent is not obtained, the variation or termination of the contract will not be taken to affect the rights of the third parties, who may bring an action based on the terms of the contract as they were before the variation.

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<sup>32</sup> See paragraph 2.94 above and paragraph 3.63 to 3.68 below. The Law Commission for England and Wales stressed in its Report *Privity of Contract: Contracts for the Benefits of Third Parties* (Law Com No 242, 1996) that its intention in the draft legislation was to protect the third party's expectation interest, and that the importance of reliance is merely to indicate that certain expectations have been engendered in the third party. Thus there was no requirement that the reliance be "detrimental" or "material" (see paragraphs 9.19 and 9.31 of that Report). However, the reference to reliance could cause confusion and provoke litigation and is best avoided where the third party's rights are not, generally speaking, based on their reliance on the contract.

<sup>33</sup> The term "assent" is preferable to "acceptance", as the latter tends to imply a requirement of communication.

3.37 The Commission considers that the contracting parties should be free to include in their contract an express term providing for variation or termination.<sup>34</sup> This would be in keeping with the principle of freedom of contract and the recommendation below that a third party's right to enforce a provision of a contract is subject to the other terms and conditions in the contract.<sup>35</sup> If the contracting parties expressly agreed to reserve an unlimited right to vary or terminate the contract it would of course reduce the rights of the third party, but this should remain the choice of the contracting parties, who are, of course, free not to contract or to benefit the third party at all. In many cases the rights of the contracting parties to vary the contract will be more limited than this, and will be inserted for commercial convenience. For example, provisions allowing the contracting parties to vary the contract are common in construction contracts, so the specification of the works can be altered as the project progresses.<sup>36</sup> Alternatively, the contracting parties might wish to provide for a right to terminate or vary the contract in the event that there is a fundamental breach of contract or some specific form of default by one contracting party. There is no reason why such express provisions should not have effect where the contract is for the benefit of a third party.

3.38 A situation could arise where the contracting parties are "locked in" to a contract because they cannot obtain the consent of the third party to vary or terminate the contract because the third party cannot reasonably be contacted or because the third party is mentally incapable of consenting to a variation. In New Zealand and England the courts have a discretion to authorise a variation or cancellation of the contract, on such a terms as seems appropriate, in such a situation.<sup>37</sup> The Commission considers that this is an appropriate safeguard for contracting parties which should be adopted as part of the proposed legislative reforms.

3.39 Complications could arise when there is more than one third party. One issue which the Commission referred to in the Consultation Paper was whether a third party should be in existence at the time of the contract is assented to by another third party. For example, could an

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<sup>34</sup> A provision in the contract providing that the contracting parties could not vary or terminate the contract, even before acceptance, would be of no effect as it could itself be varied by mutual agreement.

<sup>35</sup> See paragraph 3.49.

<sup>36</sup> This is formally not a variation to the contract itself but a variation to the work which is contemplated in the terms of the contract. The third party's rights would be subject to such terms and conditions even if the contracting parties could not reserve a right to unilaterally vary the contract.

<sup>37</sup> See the New Zealand *Contracts (Privity) Act 1982*, section 7 and the English *Contracts (Rights of Third Parties) Act 1999*, section 2(4) and 2(5).

agreement entered into by an employer for the benefit of the employees be enforced not only by those employees who have assented to it, but also by those who subsequently join the company? The Commission is of the view that the rights of certain third parties should not, as a general rule, be extinguished simply because other third parties have assented to the contract. It could create an arbitrary distinction between the rights of third parties who are in existence at the time of assent and those who come into existence after this point.<sup>38</sup> If the contracting parties wish to limit the rights of third parties in this manner it should be expressly stated in the contract.<sup>39</sup>

3.40 Another issue which arises when there are multiple third parties who jointly benefit from a contract is whether each third party must individually assent to the contract to crystallise their rights. For example, if a contract benefits a group of employees, must they all individually assent to the contract? It is the view of the Commission that, in general, assent by each third party should be needed to crystallise that third party's rights, but that it should be possible for one third party to assent on behalf of other third parties in an appropriate case. Thus, a third party with the proper authority should be able to consent to a variation in the contract on behalf of the other third parties. Essentially, one party should be able to act as an agent of the other parties in this situation and the normal rules of agency should govern this. It should also be possible to assent to contract terms on behalf of third parties who have not yet come into existence, provided they can be identified with sufficient certainty.

3.41 *The Commission recommends that the contracting parties should not be able to cancel or vary the contract in such a way as to affect the rights of the third party once either contracting party is aware that the third party has assented to the contract, either by word or by conduct. After this point the contracting parties would need to obtain the consent of the third party to cancel or vary the contract. If this consent is not obtained, the variation or termination of the contract will not affect the rights of the third party, who may bring an action based on the terms of the contract which existed before the variation.*

3.42 *The Commission recommends that the contracting parties should remain free to include in the contract an express term providing for variation or termination of the contract.*

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<sup>38</sup> The distinction is arbitrary in part because it is determined by the timing of the actions of existing third parties, and not, for example, by the actions of the contracting parties.

<sup>39</sup> For example, the contract could state that it applies to future employees who accept the contract before a certain date. The third party's right of enforcement is subject to the other terms and conditions of the contract. See paragraph 3.46 below.

3.43 *The Commission recommends that there should be judicial discretion to authorise a cancellation or variation of the contract, on such terms as seem appropriate, when the third party's consent is necessary for such a cancellation or variation, but this cannot be obtained because the third party cannot reasonably be contacted or because they are mentally incapable of giving such consent.*

3.44 *The Commission recommends that there should be an express provision that there is no requirement that a third party be in existence at the time of assent by another third party.*

3.45 *The Commission recommends that where a contract jointly benefits multiple third parties, assent by each third party should be needed to crystallise that third party's rights, but it should be possible for one third party to assent on behalf of other third parties in an appropriate case.*

## **F Third party rights are subject to the terms of the contract**

3.46 The Commission is of the view that it should be possible for the contracting parties to limit the rights of the third party or to impose conditions on the rights of the third party. In other words, the third party's rights should be subject to the terms of the contract. For example, the contracting parties may wish to limit the liability of the promisor to the third party, or may wish to make the benefit to a third party conditional on that third party reaching a certain age.

3.47 However, it is important to remember that these reforms are not intended to impose burdens on third parties.<sup>40</sup> Take the example where a contract is entered into between Marie and Terry, in which Terry agrees to pay a third party, Jennifer, €100, subject to the condition that Jennifer must paint Terry's house. In this situation, provided all the other criteria are fulfilled,<sup>41</sup> Jennifer could sue Terry for the €100, provided she has painted the house. However, Terry could not sue Jennifer to insist that she paint the house, because this would impose a burden on Jennifer. Jennifer's failure to paint the house would simply be a defence to any action brought by Jennifer (or Marie) against Terry for the €100.<sup>42</sup>

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<sup>40</sup> Third parties may be subject to burdens under other exceptions to the privity rule however. See, for example, paragraph 1.61 above.

<sup>41</sup> In particular, for the contract to be binding between Marie and Terry, Marie must have provided some consideration.

<sup>42</sup> This would also mean that if Jennifer began to paint the house but did not complete it, Terry could not bring an action in contract against her to make her complete it, but her failure to complete could act as a defence. Similarly, if Jennifer provided a defective performance, for example by painting the house pink instead of white, it would act as

3.48 In certain circumstances, contracting parties may wish to provide for “step in” rights. The Commission has already discussed how this could arise in the context of construction projects.<sup>43</sup> For example, in England the “Third Party Rights” Schedule in the JCT *Major Project Construction Contract* gives the funder of construction projects the benefit of “step in” rights. This means that in certain situations the funder can give notice in writing to the contractor that the contractor must take instructions from the funder and not the employer. The funder must in turn accept liability for the employer’s contractual obligations, including the payment of any fees owing to the contractor. In this situation the funder’s (third party’s) contractual liability under the proposed legislation would be limited to a claim for set-off by the contractor. However, the contractor may still be able to bring a claim against the funder on the basis that a new contract has come into existence between the funder and the contractor, particularly if the contractor performed at the request of the funder.

3.49 *The Commission recommends that the rights of the third party to enforce the contract or a term of the contract should be subject to the other terms and conditions of the contract.*

## **G Who is the proper defendant?**

3.50 For the sake of clarity, it should be stated that under the proposed reforms, the defendant to any action by the third party will generally be the promisor, i.e. the contracting party who promised to benefit the third party. Thus the third party will not be able to bring an action for breach of contract against a contracting party who has not in fact promised anything to the third party. This will not prejudice any possible action each contracting party may have against each other.<sup>44</sup>

## **H Defences**

3.51 When an action for breach of contract is taken by one contracting party against another contracting party, the defendant can rely on various defences. These include misrepresentation, mistake, duress, undue influence and frustration. The defendant may argue that the plaintiff was in serious breach of contract, or that that plaintiff failed to fulfil a condition which was a prerequisite to the defendant’s liability.

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a defence and not as an independent cause of action in contract. However, this would not prejudice any possible action Terry might have, for example, in tort.

<sup>43</sup> See paragraphs 2.19 to 2.20 above.

<sup>44</sup> See the section on Overlapping Claims, paragraph 3.69 below.

3.52 The Commission is of the view that a third party with a right to enforce a contract, or a term of the contract, should not be placed in a better position than either of the contracting parties. The rights of the third party should be subject to the usual defences which would be available to the promisor if the promisee had taken the action. For example, if the promisee had failed to perform their part of the contract, the promisor may be able to rely on this as a defence to the action by the third party.<sup>45</sup>

3.53 The Commission is aware that the third party may not be aware of all the circumstances surrounding the defences available to the promisor. For example, the promisee may have exercised undue influence over the promisor, and the third party may not be aware of this. However, a requirement that the third party be aware of the potential defence would be unfair to the promisor in this situation. In a situation where two relatively innocent parties are affected by the improper conduct of the promisee, the right of the promisor to avail of the defence should prevail over the right of the third party.

3.54 However, the Commission is of the view that the promisor's right to avail of a defence which would have been available to him if the promisee had taken the action should be limited to any defence which arises out of or in connection with the deed or contract in which the promise is contained.

3.55 In addition to the defences which would have been available to the promisor if the promisee had taken the action, the promisor should be able to rely on any other issues relevant to the conduct of the third party. This means that the rights of the third party should be subject to any defence which would have been available if the third party had been a party to the contract. For example, if the third party exercised undue influence over the promisor and this induced the promisor to enter into the contract, this could be relied upon by the promisor. However, as with the defences which would be available as against the promisee, any such defence must arise out of or in connection with the contract in which the promise is contained.

3.56 Normally in contract cases, the defendant may cross-claim for breach of contract or other wrongs by means of set-off or counterclaim. Set-off is limited to situations that arise out of the same transaction and it cannot exceed the amount of the plaintiff's claim. Counterclaims are not so limited.

3.57 As set-off is limited to the amount of the plaintiff's claim, it can be viewed as a defence which is available to the promisor. Thus it is the Commission's view that this should be available as a defence to the promisor when an action is brought by the third party. For the sake of clarity, it

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<sup>45</sup> As a defence of failure of performance, that is, the idea that the failure to perform is so serious that it gives the other contracting party the right not to perform.

should be pointed out that any set-off should be limited to situations that arise out of the contract in which the promise is contained.

3.58 The promisor should be free to counterclaim against the third party, where the promisor would in any event have had a right of action against the third party. For example, if the promisor could have brought an independent right of action in tort, they should be able to counterclaim for this in the same proceedings. This is not imposing an additional burden on the third party, as any such action could have been taken in any event. However, the promisor should not be able to counterclaim against the third party for matters relating to the promisee. If the promisor could do so, the third party could be subject to liabilities which exceed the benefit promised to them, and the Commission has already emphasised that these reforms should not have the effect of imposing burdens on third parties.

3.59 *The Commission recommends that the rights of the third party should be subject to the usual defences which would be available to the promisor if the promisee had taken the action, provided the defence arises out of or in connection with the contract in which the promise is contained.*

3.60 *The Commission recommends that the rights of the third party should be subject to any defence which would have been available if the third party had been a party to the contract, provided the defence arises out of or in connection with the contract in which the promise is contained.*

3.61 *The Commission recommends that the defences available to the promisor should include the defence of set-off. The promisor should be free to set-off, against the claim of the third party, any claim the promisor has against the promisee. However the promisor's claim cannot exceed the amount claimed by the third party and the promisor's claim must arise out of or in connection with the contract in which the promise to the third party is contained.*

3.62 *The Commission recommends that the promisor should be free to counterclaim against the third party where the promisor would in any event have had a right of action against the third party.*

## **I Remedies**

3.63 In this section the Commission discusses the remedy that should be available to the third party who has a right of action under the proposed reforms.

3.64 It was suggested during the Consultation Period that if damages are available to the third party for breach of contract, these damages should protect the “reliance interest” of the third party only, and not their “expectation interest”. This would mean that a third party who brings an action for breach of contract would be compensated only to the extent to

which they relied on the contract. For example, if Andrea agrees with Eamon that in return for €100 she will give a third party, Mairéad, a bike and in reliance on that contract Mairéad gives away her own bike, which is worth €50, then Mairéad's remedy may be limited to €50, i.e. the cost of Mairéad's reliance on Andrea's promise.<sup>46</sup> In contrast, if the court wished to protect Mairéad's expectation interest it might award her €100, i.e. an amount representing the value of Andrea's promise to her.

3.65 A remedy which protects only the third party's reliance interest could give rise to several problems. First, it is based on a presumption that the basis of these reforms is to protect a third party who has relied on the contract which purports to benefit them. However, the Commission has already stated that it is of the view that these reforms are not contingent on reliance by the third party.<sup>47</sup> Second, it could create a situation where a third party who has a right of enforcement under the proposed legislation only has a limited right to compensation, whereas a third party who has a right of enforcement under an existing exception to the privity rule would not be so limited. Third parties would inevitably seek to rely on the existing exceptions to the rule, rather than on the proposed legislation, and the court could have to decide which rule applied. This could increase the complexity of litigation and cause much uncertainty.<sup>48</sup> Third, the Commission is of the view that third parties should be able to seek an order of specific performance, subject to the normal rules governing such orders. In the example above this would mean that Mairéad could ask the court to order Andrea to give her the bike rather than damages. It would seem logical that if a third party can obtain an order of specific performance, they should be able to obtain damages representing the value of contractual performance.

3.66 It is thus the view of the Commission that the remedies available to the third party should not be different to those which would normally be available in an action for breach of contract. Hence the third party should be able to recover damages to compensate their "expectation interest", if this would normally be appropriate and subject to the normal rules regarding the

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<sup>46</sup> See Clark *Contract Law in Ireland* (5<sup>th</sup> ed Thomson Round Hall 2004) at 547 and 555.

<sup>47</sup> See paragraph 2.94 above.

<sup>48</sup> Third parties to a contract may seek to rely on existing exceptions instead of the proposed legislation where this is more appropriate. This may occur where the "exception" to the privity rule is really a separately recognised area of law, such as agency or trust law. It could also occur where the third party cannot enforce the contract under the proposed legislation because they do not meet all the requirements set forward, but they still come under an existing exception to the rule. See paragraphs 3.80 to 3.88 below. However, a different system of remedies under the proposed legislation would cause a situation where contracting parties who *could* enforce a contract on the basis of the proposed legislation are encouraged to bring an alternative action based on an existing exception.

award of damages. Similarly, in an appropriate case the third party should be able to seek an order of specific performance, subject to the normal rules governing such orders.

3.67 One potential difficulty could arise if a third party is not a beneficiary, either express or implied, of a contract, but nonetheless the contract expressly gives the third party the right to bring an action to enforce the contract.<sup>49</sup> The Commission has already discussed the general rule that it is only possible to recover damages for breach of contract when you can show that you have suffered a loss as a result of the breach.<sup>50</sup> A third party who brings an action, but who is not a beneficiary of the contract, may have difficulty in showing that they have suffered a loss as a result of the breach of contract. However, as the Commission discussed above, the third party may come under an exception to the general rule and may be able to recover damages. Alternatively, the third party could look for an order of specific performance. The Commission is of the view that the difficulties which arise in this situation are the same as those which arise under the current law when a contracting party (promisee) sues to enforce a contract which benefits a third party rather than the promisee. The courts can develop the law in this area as the need arises, and the difficulties involved are not a reason to deny giving effect to the intentions of contracting parties who expressly give a right of enforcement to a third party.

3.68 *The Commission recommends that the third party who brings an action for breach of contract should be entitled to a full range of remedies, including damages and specific performance, subject to the normal rules governing such remedies.*

## **J Overlapping claims**

3.69 In the Consultation Paper, the Commission provisionally recommended that, unless otherwise agreed by the parties, the promisee should retain the right to enforce the contract even if the contract is enforceable by the third party. The Commission is still of the view that this is the correct approach. The promisee should not lose their contractual rights to enforce the promisor's promise, merely because the contract gives a right of enforcement to a third party.

3.70 The rights of the promisee and the third party to enforce the contract are independent of each other, and thus the Commission is of the view that there is no need for any system of priority of action. In other words, the promisee does not have to wait for the third party to refuse the

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<sup>49</sup> See Scottish Law Commission *Constitution and Proof of Voluntary Obligations: Stipulations in favour of Third Parties* (Memorandum No 38, 1977) p.18 – 24.

<sup>50</sup> See paragraph 1.62 - 1.67 above.

opportunity to sue before they can bring an action, and vice versa. However, in an appropriate case it should be possible for the third party to be joined as a party where the promisee sues; and for the promisee to be joined as a party when the third party sues.<sup>51</sup> As a general rule, however, there should be no requirement that the promisee be joined as a party to the litigation when a third party sues to enforce the contract.

3.71 If the promisee sues to enforce the contractual term which benefits the third party, it may not be possible for the promisee to recover damages as they may not be able to show that they have suffered a loss. Under the current law, a promisee who has not suffered a loss may be able to sue under the “legal black hole” exception if the third party who has suffered a loss is unable to sue to recover for that loss. However, under the proposed reforms this exception will be of limited value as the third party would be able to sue for the loss incurred.<sup>52</sup> The Commission has already discussed the issue of the promisee’s remedies, and concluded that this should not be dealt with as part of the current reforms.<sup>53</sup> However, the promisee should not be prevented from suing merely because it may be unclear what kind of remedy is available to them. Furthermore, it is possible to envisage a situation where the promisee may be able to show a loss and recover damages, or a situation where the promisee seeks specific performance of the promisor’s promise to the third party. Take the example given in Chapter 1, where Mary contracts with a builder for the construction of an extension to Mary’s mother’s home.<sup>54</sup> It would be somewhat bizarre if these reforms had the effect of taking away Mary’s right to sue the builder if, for example, the builder refuses to complete the extension.

3.72 It could be argued that a situation could arise where the promisor faces double liability, because both the promisee and the third party have the right to enforce the contract. However, the Commission is of the view that the proposed reforms should not expose the promisor to the risk of double liability. First, as mentioned above, the law on damages is such that it would be difficult for the promisee to recover damages representing the loss incurred by the third party. Second, common sense would seem to dictate that when the promisor has fulfilled their duty to the third party, the promisee should not be able to sue the promisor on the basis that they have failed to perform their promise to the third party. However, to avoid any potential doubt, the Commission recommends that it should be expressly

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<sup>51</sup> See generally, Delany and McGrath *Civil Procedure in the Superior Courts* (2<sup>nd</sup> Edition, Thomson Round Hall, 2005), Chapter 7.

<sup>52</sup> See paragraphs 1.63 to 1.66 and paragraph 2.78 above.

<sup>53</sup> See paragraph 2.78 and 2.79 above.

<sup>54</sup> See paragraph 1.06 above.

stated that once a promisor has fulfilled their duty to the third party, either wholly or partly, the promisor should to that extent be discharged from their duty to the promisee.

3.73 For example, if, in return for valid consideration, Ciara promises Aoife that she will give €100 to a third party, Luke, both Aoife and Luke can bring an action against Ciara if she does not pay Luke the money. However, if Ciara does pay Luke the €100, Ciara's duty to both Aoife and Luke is discharged, and neither Aoife nor Luke can bring an action against Ciara. Of course, if, as part of the same agreement, Ciara also promised to give Aoife €200, then Aoife can still bring an action to recover this sum.

3.74 Taking the example above, a situation could arise where Ciara could be discharged of her contractual obligation to pay the €100 not because she paid the money, but because Luke has agreed to release her from that obligation. In this situation, however, Luke (the third party) could not release Ciara from her obligation to pay the €200 to Aoife. In other words, unless otherwise agreed, the third party cannot release the promisor's obligation to the promisee.

3.75 It is the Commission's view that, given the current rules relating to the award of damages, it is unlikely that a situation will arise where a promisor pays substantial damages to a promisee and then subsequently faces a claim from the third party relating to the same breach. However, if a situation arises in which a promisor is liable to pay substantial damages to a promisee for breach of its promise to benefit the third party, the third party should not be entitled under these reforms to an award which duplicates that sum. This is to protect the promisor from double liability. This situation could appear to be harsh *vis a vis* the third party, but it is the view of the Commission that it is possible for the courts to order, in an appropriate case, that the sum payable to the promisee is held by the promisee for the use and benefit of the third party.<sup>55</sup>

3.76 *The Commission recommends that, unless otherwise agreed by the parties, the promisee should retain the right to enforce the contract even if the contract is enforceable by the third party. There should be no order of priority between the promisee and third party.*

3.77 *The Commission recommends that although there should be no requirement that the promisee be joined as a party to the litigation when a third party sues to enforce a contract, in an appropriate case it should be possible for the third party to be joined as a party where the promisee sues; and for the promisee to be joined as a party when the third party sues.*

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<sup>55</sup> See paragraph 1.66 above.

3.78 *The Commission recommends that once a promisor has fulfilled their duty to the third party, either wholly or partly, the promisor should to that extent be discharged from their duty to the promisee.*

3.79 *The Commission recommends that if the promisee has recovered substantial damages representing the third party's loss or the expense to the promisee of making good to the third party any default of the promisor, then, in any proceedings brought by the third party against the promisor, the court should reduce any award to the third party to such an extent as it thinks appropriate to take account of the sum recovered by the promisee.*

## **K Existing exceptions to the privity rule**

3.80 In Chapter 1, the Commission outlined the numerous exceptions to the privity rule. These include common law exceptions such as agency and trusts, and statutory exceptions such as sections 7 and 8 of the *Married Women's Status Act 1957*. These exceptions can be complex, and the uncertainty caused by them was one of the reasons put forward by the Commission in Chapter 2 in favour of reforming the privity rule.<sup>56</sup>

3.81 The Commission recognises that the proposed reforms will reduce the need to rely on certain exceptions to the privity rule. For example, there will be less need to rely on collateral warranties and assignment as a means of granting rights to third parties. The Commission is also of the view that some exceptions to the rule "have developed through somewhat artificial and forced use of existing concepts"<sup>57</sup>, and the continued use of these concepts in this manner will be unnecessary as a result of these reforms. Exceptions considered to be artificial and overly complex will fall into disuse and eventually become redundant. For example, the law of trusts has been used as a means of avoiding the privity rule, even though it was not always a suitable means of enforcing third party rights. In the future, third parties should be able to rely on the proposed legislation rather than on the trusts exception.

3.82 It could thus be argued that the existing exceptions to the privity rule could be abolished, and that third parties should rely solely on the proposed legislation. However, the Commission is of the view that the existing exceptions to the privity rule should be retained. There are several reasons for this. First, many of the existing exceptions are not used solely as a means of avoiding the privity rule, but have many other important functions. For example, the law of agency is essential in the facilitation of business transactions; and trusts law or the tort of negligence could clearly

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<sup>56</sup> See paragraphs 2.08 to 2.11 above.

<sup>57</sup> Law Commission for England and Wales *Privity of Contract: Contracts for the Benefit of Third Parties* (Law Com No 242, 1996) at paragraph 12.1.

not be replaced by legislation allowing for third party contractual rights. Second, business practice is based on the continued existence of these exceptions. It is not the aim of these reforms to abolish existing ways of doing business, such as the use of assignment or collateral warranties. Rather, it is the aim of these reforms to facilitate new ways of doing business.<sup>58</sup> By keeping the existing exceptions in place, practitioners will have time to adapt practices and advise clients on the best way to utilise the new scheme of third party rights. Third, some of the existing exceptions could give third parties more secure rights than those in the proposed legislation. It is not the intention of the Commission to deprive third parties of existing remedies which are available to them.

3.83 It has been argued that the continued existence of the current exceptions could leave the law in a confused state, as third parties may be able to rely on either the proposed reforms or on an existing exception to the privity rule. For example, a third party who cannot meet the requirements in the proposed legislation (or who is faced with a valid defence under the legislation) could still rely on an existing common law or statutory exception.<sup>59</sup> However, the Commission is of the view that the advantages of retaining the existing exceptions outweigh any difficulties caused by such a scenario. This is subject to certain exceptions which are discussed below.<sup>60</sup>

3.84 In conclusion, the Commission recommends that the existing exceptions to the privity rule should be retained. The Commission also recommends that the existing common law and statutory exceptions to the privity rule should be kept under review.

3.85 In the Consultation Paper, the Commission invited submissions on whether there should be a comprehensive codification of the existing common law and statutory exceptions to the rule.<sup>61</sup> This would involve listing all the common law and statutory exceptions to the privity rule, so that the third party's rights would all be contained in one piece of legislation.<sup>62</sup> However, the Commission has concluded that there should be no statutory codification of the existing exceptions to the privity rule at this

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<sup>58</sup> See paragraph 2.92 above.

<sup>59</sup> See Treitel *The Law of Contract* (11<sup>th</sup> ed Sweet & Maxwell 2003) at 663; Consultation Paper, paragraphs 2.106 to 2.107.

<sup>60</sup> See paragraphs 3.89 to 3.113 below.

<sup>61</sup> See Consultation Paper, paragraph 2.118.

<sup>62</sup> Alternatively, it is possible to state in a general clause that the legislation does not affect any remedy which exists apart from the legislation, and then list *some* of the exceptions to the privity rule. This was done in section 14 of the New Zealand *Contracts (Privity) Act 1982*. However, to expressly retain some exceptions while using a general clause to retain the others could result in confusion, and as it is not exhaustive it will not result in any clarification of the law.

time. The number and complex state of the exceptions would make them difficult to outline clearly in legislation, and the resultant legislation could be overly long and complex. More fundamentally, some of the common law exceptions to the privity rule have not been fully developed, and to preserve them in their current form could reduce the ability of the courts to develop them in the future.<sup>63</sup> This should not however preclude the possibility of any such codification in the future.

3.86 *The Commission recommends that that existing common law and statutory exceptions to the privity rule should be retained and that third parties should not be denied existing remedies available to them.*

3.87 *The Commission recommends that existing common law and statutory exceptions to the privity rule should be kept under review.*

3.88 *The Commission recommends that the proposed legislation should not at this time include a comprehensive codification of the existing common law and statutory exceptions to the privity rule. However, this recommendation should not preclude any such codification in the future.*

## **L Contracts to which the proposed legislation will not apply**

3.89 In the Consultation Paper, the Commission provisionally recommended that certain types of contracts should be excluded from any reforming legislation and invited views on this matter.<sup>64</sup> The Commission has concluded that the following contracts should be excluded, either for policy reasons or because third parties already have enforceable rights and/or obligations under existing rules, and the creation of additional rights could cause uncertainty and undermine the policy behind the existing rules.

### **(1) Contracts of Employment, where the promisor is an employee**

3.90 The proposed legislation should not give any third party a right to enforce any contract of employment against an employee. This exception

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<sup>63</sup> It has been suggested that the judiciary is “unlikely to carve out a doctrine of third party rights which will operate in parallel to the statutory scheme”: Andrews “Strangers to Justice No Longer: The Reversal of the Privity Rule under the *Contracts (Rights of Third Parties) Act 1999*” [2001] CLJ 353 at 379. See also MacMillan “A Birthday Present for Lord Denning: *The Contracts (Rights of Third Parties) Act 1999*” (2000) 63 MLR 721 at 730-731. However, this does not mean that there will be no judicial development of existing exceptions, as many of these “exceptions” are independent doctrines in their own right, which may still be relied upon by third parties. Many of these exceptions have multiple functions other than the conferral of rights on third parties, and there is no reason why these should not be judicially developed.

<sup>64</sup> See Consultation Paper at paragraph 3.147.

will ensure that employees cannot become liable in contract to third parties, for example, in the case of losses caused by strikes or industrial disputes.<sup>65</sup>

3.91 However, employment contracts should not be entirely excluded from the remit of the legislation. The privity rule can have an adverse effect in the employment context, and cases involving third party employees have been highly significant for the development of a third party rule in the Canadian Supreme Court.<sup>66</sup> Hence, the Commission recommends that the legislation should apply to employment contracts, and should only be inapplicable when a third party seeks to enforce a term of a contract of employment against an employee.

3.92 *The Commission recommends that the proposed legislation should not give any third party a right to enforce any contract of employment against an employee.*

## (2) **Company Law**

3.93 The Commission turns to consider the extent to which the proposed legislation should apply in the company law setting. In line with other statutory models, the Commission has concluded that the proposed legislation should not apply to the contract formed between a company and its shareholders, and between individual shareholders, in its articles of association, under section 25 of the *Companies Act 1963*. Thus, for example, a promise in the articles that a solicitor or accountant will be paid a fee is not enforceable by the third party solicitor or accountant.<sup>67</sup> The Commission agrees with the view that a contract between a company and its members should be dealt with by company law, and should not be affected by, or rendered uncertain by, a general reform of contract law.

3.94 The Commission has also considered whether the proposed legislation should apply where the third party is a company which has not yet been incorporated. At common law, a company which is not incorporated at the time that a contract is made on its behalf cannot enforce that contract, despite a purported later ratification of it. Section 37 of the *Companies Act 1963* provides that a contract entered into by a pre-incorporation company may be ratified by the company once it is formed.

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<sup>65</sup> See Merkin “Contracts (Rights of Third Parties) Act 1999” in Merkin (Ed) *Privity of Contract: The Impact of the Contracts (Rights of Third Parties) Act 1999* (LLP 2000) at 134.

<sup>66</sup> *London Drugs v Kuehne & Nagel International Ltd* [1992] 3 SCR 299.

<sup>67</sup> See *Eley v Positive Government Security Life Association Co Ltd* (1876) 1 Ex D 88. See Merkin “Contracts (Rights of Third Parties) Act 1999” in Merkin (Ed) *Privity of Contract: The Impact of the Contracts (Rights of Third Parties) Act 1999* (LLP 2000) at 133.

All rights and obligations arising from the transaction are enforceable by and against the company.

3.95 The proposed reforms could provide another means for the company to enforce a contract made for its benefit before incorporation. In New Zealand, the *Contracts (Privity) Act 1982* has been held to apply to pre-incorporation contracts.<sup>68</sup> This approach found favour with the English Law Commission.<sup>69</sup>

3.96 The advantage of the New Zealand approach is that it avoids a distinction being made between third parties who are incorporated companies when the contract was formed, and third parties that are companies which come into existence at a later date. This approach recognises the different effect of, on the one hand, general legislation which creates a third party right, and, on the other hand, the companies legislative code which renders the company a full party to a contract made for it or on its behalf prior to its incorporation. Nonetheless, the Commission is of the view that there is an important disadvantage to this approach, namely, that it could be seen as creating another exception to the common law rule that a company which is not incorporated at the time that a contract is made on its behalf cannot enforce that contract.

3.97 The Commission has, therefore, concluded that it is preferable that this should be done as part of a general reform of company law and not as part of a reform of contract law. The Commission is also aware that the Company Law Review Group (CLRG) published a comprehensive draft *Companies Consolidation Bill* in 2007, arising from its review of this area, and that this is, at the time of writing (February 2008), under active consideration by the Department of Enterprise, Trade and Employment with a view to the preparation of a Government *Companies Consolidation Bill* based on the extensive work of the CLRG.

3.98 *The Commission recommends that the proposed legislation should not apply to the contract formed between a company and its shareholders, and between individual shareholders, under section 25 of the Companies Act 1963. The Commission also recommends that the proposed legislation should not apply where the third party is a company which has not yet been incorporated.*

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<sup>68</sup> *Palmer v Bellaney* (1983) ANZ ConvR 467, cited in the Law Commission for England and Wales *Privity of Contract: Contracts for the Benefit of Third Parties* (Law Com No 242, 1996) at paragraph 8.13.

<sup>69</sup> Law Commission for England and Wales *Privity of Contract: Contracts for the Benefit of Third Parties* (Law Com No 242, 1996) at paragraphs 8.13 – 8.16.

(3) ***Contracts for the International Carriage of Goods by Air, Rail and Road***

3.99 The international carriage of cargo by air is governed by the Warsaw Convention 1929, as amended by the Hague Convention 1955 and Protocol No 4 of Montreal, 1975, and the Montreal Convention 1999. These Carriage by Air Conventions were given force of law in Ireland by legislation including the *Air Navigation and Transport Act 1936* and the *Air Navigation and Transport (International Conventions) Act 2004*.

3.100 These Conventions give third parties rights to enforce international contracts of carriage in certain situations, but the third party must also take some or all of the burdens under the contracts. Third parties may thus become liable under the contract.<sup>70</sup> This is in contrast to the proposed legislation, which provides that the third party may enforce the contract subject to the terms of the contract, but does not enable burdens to be imposed on the third party.<sup>71</sup> It could cause uncertainty and undermine the policy underlining these conventions if third parties to these contracts could acquire additional rights under the proposed legislation. A third party who wished to benefit from the contract of carriage, but who did not wish to have contractual liabilities imposed on them, could choose to sue under the proposed legislation as a means of avoiding the provisions of the Conventions.

3.101 Similarly, the Conventions outline the extent to which third parties can rely on an exclusion or limitation clause in the contract of carriage.<sup>72</sup> The proposed legislation could confer additional rights on third parties, and could be used as a means of avoiding the provisions of the Conventions.

3.102 The Commission recommends that contracts for the international carriage of goods or cargo by air should be excluded from the general legislative scheme, where such contracts are governed by international transport conventions.

3.103 Similar reasoning applies to contracts for the international carriage of goods by road or rail. The international carriage of goods by road is governed by the Geneva Convention on the Contract for the International Carriage of Goods by Road 1956 (CMR)<sup>73</sup> and the international carriage of goods by rail is governed by the Berne Convention concerning

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<sup>70</sup> Articles 13 and 14 of the Warsaw Convention.

<sup>71</sup> See paragraph 3.46 to 3.49 above.

<sup>72</sup> See Article 25A of the Amended Warsaw Convention.

<sup>73</sup> This Convention, along with a 1978 Protocol, is given statutory force by the *International Carriage of Goods by Road Act 1990*.

International Carriage by Rail 1980 (COTIF).<sup>74</sup> To ensure the existing regime governing such contracts is not undermined, the proposed legislation should not apply to such contracts. Thus, the Commission recommends that the proposed legislation should not apply to contracts for the international carriage of goods by road or rail, where the contract is subject to the rules of an international transport convention.

3.104 *The Commission recommends that the proposed legislation should not apply to a contract for the international carriage of goods by air, rail or road, where the contract is subject to the rules of an international transport convention.*

#### **(4) Contracts for the Carriage of Goods by Sea**

3.105 In Chapter 1, the Commission discussed the exception to the privity rule contained in section 1 of the *Bills of Lading Act 1855*.<sup>75</sup> This section provides that every consignee of goods named in a bill of lading, and every endorsee of it, to whom the property of the goods described in it shall pass upon or by reason of such consignment or endorsement, will have transferred to them all rights of action, and be subject to the same liabilities, in respect of such goods as if the contract contained in the bill of lading had been made with them.

3.106 Despite this provision, there remain a number of situations where third parties may not be able to claim against a carrier. For example, section 1 of the 1855 Act will not apply unless the property in the goods passes “upon or by reason of such consignment or endorsement” of the bill of lading. Hence if the property passes before, or independently of consignment or endorsement, section 1 does not apply.<sup>76</sup> The requirement that “property” passes has been interpreted to mean full property, so a pledgee of goods, who does not acquire full property, will not have any right of action against a carrier.<sup>77</sup> Also, the 1855 Act only applies to bills of lading and will not apply to waybills or delivery orders.

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<sup>74</sup> See the *European Communities (Transport of Dangerous Goods by Rail) Regulations 2003 to 2005* (SI No.701 of 2003 and SI No.347 of 2005), which implemented COTIF in Irish law as well as relevant European Community Directives in this area.

<sup>75</sup> See paragraphs 1.53 to 1.56 above.

<sup>76</sup> See *White Commercial Law* (2002 Thomson Round Hall) at 640. For example, if the cargo remains part of a larger bulk, no property can pass until the goods are ascertained. This will not usually occur until discharge, and so property passes not as a result of the consignment of the bill of lading, but rather because the goods have been separated from the bulk, and so the section will not apply. See also *The Delfini* [1990] 1 Lloyd’s Rep 252; *The Aramis* [1989] 1 Lloyd’s Rep 213.

<sup>77</sup> *Sewell v Burdick* (1884) 10 App Cas 74.

3.107 When the Act does not apply, a contract may be implied between the carrier of the goods and the consignee when the consignee takes delivery of goods from the carrier.<sup>78</sup> However, such an implied contract will not always be implied. For example, if the vessel is lost there can be no implied contract as the goods will not have been delivered to the carrier.<sup>79</sup>

3.108 Hence, there remain a number of situations where consignees of goods cannot sue to enforce the contract of carriage, even they are beneficiaries of it. This has been described as a “long-standing deficiency in the law” and there have been calls for reform in Ireland.<sup>80</sup>

3.109 In the United Kingdom, calls for reform<sup>81</sup> resulted in the enactment of the *Carriage of Goods by Sea Act 1924*. The 1924 Act repealed the 1855 Act, and section 2(1) of the 1924 Act provides that the lawful holder of a bill of lading, or a person entitled to delivery of goods under a sea waybill or a delivery order, will have “transferred to and vested in him all rights of suit under the contract of carriage as if he had been a party to that contract.” There is no longer a requirement that property in the goods pass “upon or by reason of such consignment or endorsement” of the bill of lading, and the Act is not limited to bills of lading but also applies to sea waybills and delivery orders. The *Contracts (Rights of Third Parties) Act 1999* does not apply to contracts for the carriage of goods, on the basis that the rights of third parties under the 1924 Act should not be extended by the 1999 Act.<sup>82</sup> In particular, under the 1924 Act the third party incurs the liabilities of the original contracting party, and so could become liable to the carrier for claims for unpaid freight or for demurrage charges.<sup>83</sup> In contrast, under the 1999 Act the third party cannot have burdens imposed on them. The third party’s claim could be subject to set off with respect to the unpaid freight, but even so the carrier could only use the freight “as a shield and not as a sword”.<sup>84</sup> There were concerns that a third party who wished to benefit from the contract of carriage, but who did not wish to have contractual

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<sup>78</sup> See paragraph 1.55.

<sup>79</sup> See *White Commercial Law* (2002 Thomson Round Hall) at 644.

<sup>80</sup> *White Commercial Law* (2002 Thomson Round Hall) at 645.

<sup>81</sup> See Law Commission *Report on Rights of Suit in Respect of Carriage of Goods by Sea* (Law Com No 196; Scot Law Com No 130, 1991).

<sup>82</sup> See Law Commission for England and Wales *Report on Privity of Contract: Contracts for the Benefit of Third Parties* (Law Com No 242, 1996) at paragraphs 12.7 to 12.11.

<sup>83</sup> Section 3(1).

<sup>84</sup> Law Reform Commission of Hong Kong *Report on Privity of Contract* (2005) at paragraph 4.172. Alternatively it could be argued the third party takes the benefit of the contract subject to the terms and conditions of the contract: section 1(4).

liabilities imposed on them, could choose to sue under the 1999 Act as a means of avoiding the provisions of the 1992 Act.<sup>85</sup>

3.110 It has been suggested that the law in Ireland could be reformed either by a specific reform, as was done in United Kingdom with the *Carriage of Goods by Sea Act 1992*, or as part of a more general reform of the privity rule.<sup>86</sup> The Commission is of the view that this is an area of law in need of reform, but that this should be done by means of a specific review of the law relating to the carriage of goods by sea, and not by way of a general reform of the privity rule. Specific policy concerns exist in relation to the transfer of rights and liabilities in contracts for the carriage of goods by sea, and these should be dealt with in specific legislation, as was done in the United Kingdom, rather than as part of a general reform of the privity rule. However, none of the policy concerns relate to the operation of exclusion or limitation clauses in such contracts. There is no reason why a third party should not be able to rely on an exclusion or limitation clause, merely because it is contained in a contract for the carriage of goods by sea.<sup>87</sup> The Commission is thus of the view that the proposed legislation should not apply to contracts for the carriage of goods by sea, except that a third party should be able to enforce an exclusion or limitation of liability in such a contract if they satisfy the normal test of enforceability.

3.111 *The Commission recommends that the proposed legislation should not apply to a contract for the carriage of goods by sea, except that a third party can enforce an exclusion or limitation of liability in such a contract if he satisfies the test of enforceability.*

#### **(5) Negotiable Instruments**

3.112 The Commission recommends that the proposed legislation should confer no rights on a third party in the case of a contract on a bill of exchange, promissory note or other negotiable instrument. The *Bills of Exchange Act 1882* provides that the rights contained in a negotiable instrument can be transferred to and enforced by certain third parties, referred to as the “holder in due course”.<sup>88</sup> It would cause uncertainty and undermine the policy of the 1882 Act if these rights were extended to other third parties.

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<sup>85</sup> Law Commission for England and Wales *Report on Privity of Contract: Contracts for the Benefit of Third Parties* (Law Com No 242, 1996) at paragraph 12.8.

<sup>86</sup> White *Commercial Law* (2002 Thomson Round Hall) at 644 – 645.

<sup>87</sup> See Law Commission for England and Wales *Report on Privity of Contract: Contracts for the Benefit of Third Parties* (Law Com No 242, 1996) at paragraph 12.10 and Law Reform Commission of Hong Kong *Report on Privity of Contract* (2005) at paragraph 4.172.

<sup>88</sup> See paragraphs 1.51 to 1.52 above.

3.113 *The Commission recommends that the proposed legislation should confer no rights on a third party in the case of a contract on a bill of exchange, promissory note or other negotiable instrument.*

**(6) Letters of credit**

3.114 Sometimes in contracts for the sale of goods, a seller may require a buyer to arrange payment through a letter of credit, or a documentary credit. This means the buyer enters into an arrangement with a bank “whereby the bank gives an undertaking that, provided certain conditions are met, the bank will pay the seller”.<sup>89</sup> The bank’s undertaking to pay is enforceable by the seller, even though arguably the seller has provided no consideration for the bank’s undertaking.<sup>90</sup> Letters of credit are generally regarded as being *sui generis* and are subject to their own regime, which reflects international commercial practice.<sup>91</sup> The Commission is of the view that this regime should not be changed as part of these reforms, and that documentary credits should therefore be excluded from the recommended legislation.<sup>92</sup>

3.115 *The Commission recommends that the proposed legislation should not apply to documentary credits.*

**M Insolvency**

3.116 In liquidation the rights applicable to company contracts vest in the liquidator, and an attempt is made to resolve the rights of debtors, creditors and members of the company collectively:

“The usual object of a winding up by the court is to prevent the creditors from maintaining separate actions against the company and to provide machinery whereby all the creditors are paid so far as the assets of the company permit. Accordingly, the Acts and the Rules prescribe the manner in which [creditors] are to come in and prove their claims and the priority which certain classes of creditors are to enjoy.”<sup>93</sup>

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<sup>89</sup> White *Commercial Law* (2002 Thomson Round Hall) at 648.

<sup>90</sup> See White *Commercial Law* (2002 Thomson Round Hall) at 656; Goode *Commercial Law* (3<sup>rd</sup> ed Penguin 2004) at 970 – 971.

<sup>91</sup> The majority of documentary credits are made expressly subject to the Uniform Customs and Practices relating to Documentary Credits (UCP). See White *Commercial Law* (2002 Thomson Round Hall) at 649.

<sup>92</sup> See Law Reform Commission of Hong Kong *Report on Privity of Contract* (2005) at paragraph 4.174.

<sup>93</sup> Keane *Company Law* (4<sup>th</sup> ed Tottel Publishing 2007) at 567, paragraph 36.127.

Similar rules apply to other types of insolvency proceedings, for example, when an individual becomes bankrupt.

3.117 During the Commission's consultation process, it was suggested that the proposed reforms could cause difficulties during insolvency proceedings. For example, imagine a situation where a client hires a main contractor to do certain construction work. The main contractor then sub-contracts a portion of the work to a sub-contractor. The sub-contract expressly gives a right of enforcement to the client, who is thus a third party beneficiary with a right to enforce the sub-contract under the proposed reforms. The main contractor becomes insolvent and goes into liquidation before the construction work is complete. The liquidator will deal with the assets, rights and obligations of the company in the prescribed fashion. This includes deciding which contracts to enforce to increase the assets available to it during the liquidation. The liquidator may conclude that it is not in its interests to enforce or complete the sub-contract.<sup>94</sup> However, the client may attempt to bypass this system and may bring an action against the sub-contractor to enforce its rights under the sub-contract. It was suggested that this could be inimical to the orderly winding down of the company and serve to undermine the existing regime.

3.118 However, the Commission is of the view that the proposed legislation should apply during insolvency proceedings, and that third party rights should not be extinguished if one of the contracting parties becomes insolvent. If the promisor becomes insolvent, then the third party's right is equivalent (*pari passu*) to that of any other unsecured creditor. If, as in the example above, the promisee becomes insolvent, the promisor runs the risk that they may have to perform that part of the contract which benefits the third party, or pay damages in lieu, even though the promisee has become insolvent and they may never be paid. However, the loss incurred is no different to any other loss caused by the insolvency of a contracting party. Furthermore, the promisor may be able to use any of the defences that are available in the proposed legislation, including set-off and the defence of failure of performance. Alternatively, the contracting parties may wish to state that they are not liable to the third party in the event of the insolvency of either of the contracting parties.

3.119 *The Commission recommends that the third party's right of enforcement should not be extinguished merely because one of the contracting parties has become insolvent. The contracting parties may, if they wish, provide in the contract that they are not liable to the third party in the event of the insolvency of either of the contracting parties.*

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<sup>94</sup> The sub-contractor will be able to claim damages for breach of contract, but it will be an unsecured creditor.

## **N The application of the proposed legislation to deeds**

3.120 The Commission is of the view that the proposed legislation should apply to contracts and to deeds. This was expressly provided for in the *New Zealand Contracts (Privity) Act 1982*.<sup>95</sup> Legislation in other jurisdictions would seem to apply to deeds as well as to contracts, and the issue has not caused much difficulty.<sup>96</sup> However, for the sake of certainty it should be expressly stated that the proposed legislation applies to contracts and deeds.

3.121 *The Commission recommends that the proposed legislation should apply to contracts and deeds.*

## **O Insurance Contracts**

3.122 As a general rule, it is not possible to enforce a contract of insurance unless you have an interest in the subject matter of the insurance. One criticism which was made of the *Contracts (Rights of Third Parties) Act 1999* in England and Wales was that it did not expressly deal with the potential conflict between this requirement and the rights of third parties to enforce the insurance contract.<sup>97</sup>

3.123 The Commission is of the view that this should not cause many problems in practice, as most third parties will have an interest in the insurance policy. However, the proposed legislation should not be viewed as a means of avoiding the necessity for an insurable interest. The proposed reforms should not affect the rule that to enforce an insurance contract you must have a sufficient interest in the subject matter of the insurance policy. However, this should not preclude the possibility of the future reform of this rule.<sup>98</sup>

3.124 *The Commission recommends that the proposed reforms should not affect the rule that to enforce an insurance contract a party must have a*

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<sup>95</sup> See however *Morton-Jones v RB & JR Knight Ltd* [1992] 3 NZLR where it was held that a solicitor's letter purporting to designate a third party as the beneficiary of an existing agreement was not covered by the Act.

<sup>96</sup> See for example the English case of *Prudential Assurance Company Limited v Ayres* [2007] EWHC 775 (Ch), [2007] All ER (D) 43 where the defendants were entitled to rely on the limitation of liability in a deed to which they were not a party. It was not argued that the deed was not a contract for the purposes of the *Contracts (Rights of Third Parties) Act 1999*.

<sup>97</sup> Henley "Insurance" in Merkin (Ed) *Privity of Contract: The Impact of the Contracts (Rights of Third Parties) Act 1999* (LLP 2000) at 226.

<sup>98</sup> The reform of the law of insurance contracts is one of the topics in the Commission's *Third Programme of Law Reform 2008 – 2014*. See Law Reform Commission *Report: Third Programme of Law Reform 2008 – 2014* (LRC 86 – 2007) at 17.

*sufficient interest in the insurance policy. However, this should not preclude the possibility of the future reform of this rule.*

## **P Consumers**

3.125 The reforms proposed by the Commission will have a positive impact on the rights of consumers. To take an example mentioned in Chapter 1, if Mary contracts with a builder for the construction of an extension to Mary's mother's home, the contract expressly benefits Mary's mother and thus there is a presumption that the parties intended for the contract to be enforceable by Mary's mother. Mary's mother is likely to have a right to enforce the contract under the proposed reforms. This is in contrast to the current law, under which Mary's mother does not have a right to enforce the contract. Mary's mother is a consumer in this case, and it is thus clear that the proposed reforms will be of benefit to consumers.

3.126 During the consultation process the Commission considered the possibility that any legislative reform could make a distinction between third parties who are "consumers" and other third parties who are relying on commercial contracts, so as to give extra protection to third party consumers. This issue arose because there are still situations where third party consumers may not be able to make use of the proposed reforms, in particular where it is not the intention of the contracting parties (or, more usually, the contracting party who is not a consumer) to give a third party rights under the contract.

3.127 For example, where a consumer buys a present for a friend, the friend cannot enforce the contract of sale against the retailer because they are not privy to the contract of sale, although they may have a claim for injury caused by the product under the law of tort. It is often the case in Ireland that retailers who operate good customer services will offer some sort of remedy in this situation, but this is discretionary and the third party cannot insist on it.<sup>99</sup>

3.128 The reforms proposed by the Commission would facilitate consumer protection in this situation, but would only do so where the retailer and consumer intended to give the friend rights under the contract. The Law Commission for England and Wales was of the view that in this type of contract, it would be easier than it would be in a commercial contract to show that there was an intention to benefit the third party. For example, if Eilis buys a suite of furniture as a wedding gift for her friend Dearbhla, and makes it clear when purchasing the suite that it is a gift for Dearbhla and the delivery slip makes it clear that the suite is to arrive to Dearbhla's house, then under the under the proposed legislation Dearbhla could most likely

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<sup>99</sup> See paragraph 1.50 above.

bring an action in contract against the shop if, for example, the suite is defective in some way. In contrast, if the shop is entirely unaware that it is a gift for a third party, and delivery is to Dearbhla's home, then Dearbhla could not sue on the contract, as there is no intention to benefit Dearbhla, who was, moreover, not identified as third party beneficiary of the contract of sale.<sup>100</sup> Similarly, Dearbhla will have no right of action if the contract of sale excludes the possibility of any third party having a right to enforce the contract. It is thus clear that the proposed legislation goes some way to solving this problem, in that it facilitates the giving of rights to the third party consumer, but as it is based on the intentions of the contracting parties it does not provide any mandatory statutory protection for third party consumers.

3.129 Second, where a consumer buys a product from a retailer, they cannot bring an action for breach of contract against the manufacturer of the product if, for example, the product is defective. This is subject to a number of exceptions.<sup>101</sup> Here, again, the reforms proposed would facilitate the consumer's ability to bring an action against the manufacturer, but it could only do so where the retailer and manufacturer intended to give the consumer rights against the manufacturer.

3.130 It could thus be argued that the proposed reforms do not offer enough protection to third party consumers in situations such as these, and that there is a need for extra reforms. However, the Commission is of the view that any further reform which offers extra protection to third party consumers, regardless of the intentions of the contracting parties, must take place within a general review of consumer law, and not as part of a review of the rule of privity. The conferring of substantial rights on consumers rests on various policy considerations that cannot be properly analysed as part of general contract law.

3.131 The Commission is particularly conscious that any reform of consumer rights must take account of the work of the European Community. For example, in the European Commission Green Paper on the *Review of the Consumer Acquis*<sup>102</sup> the European Commission sought opinions on various issues which concern privity of contract, including whether producers should be directly liable for non conformity of the goods with the contract, whether

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<sup>100</sup> This example is taken from the Law Commission for England and Wales *Privity of Contract: Contracts for the Benefits of Third Parties* (Law Com No 242, 1996) at paragraphs 7.41 and 7.42. See also paragraphs 7.54 – 7.56.

<sup>101</sup> The consumer may in certain circumstances be able to bring an action in tort against the manufacturer based on legislation such as the *Liability for Defective Products Act 1991*.

<sup>102</sup> Com (2006) 744 final. A summary and analysis of the responses to the consultation is available at [http://ec.europa.eu/consumers/rights/cons\\_acquis\\_en.htm](http://ec.europa.eu/consumers/rights/cons_acquis_en.htm).

there should be default rules for guarantees or warranties given by manufacturers of goods to consumers, and whether such guarantees would be transferable to subsequent purchasers of the goods. In a 2007 Communication the Commission analysed in more detail the case for introducing the direct liability of producers to the final consumers across the European Union, although it refused to draw any conclusions on this matter in the Communication itself.<sup>103</sup>

3.132 The Commission has thus concluded that although the proposed reforms should apply where the third party is a consumer, a more general reform of consumer rights which offers extra mandatory protection to third party consumers, regardless of the intentions of the contracting parties, should not form part of the proposed reform of privity of contract. However, this should not prevent the possibility of any such reforms in the future. The Commission is especially conscious in this respect of the recent establishment of the National Consumer Agency under the *Consumer Protection Act 2007* which has a general remit in this respect.

3.133 Finally, the Commission considered the idea that the proposed legislation should not confer any third party rights *against* consumers. However, the Commission considers that this exclusion could be excessively broad and may go against the intentions of the contracting parties. Consumers can be adequately protected by existing consumer protection measures such as the *Unfair Terms in Consumer Contracts Regulations 1995*.<sup>104</sup> These will be of particular importance when the contract entered into by the consumer includes an exemption clause which limits or excludes the liability of a third party. Such clauses will only be enforceable against consumers if they comply with the standards of the Regulations.

3.134 *The Commission recommends that the proposed reforms should apply where the third party is a consumer.*

3.135 *The Commission recommends that the conferring of additional rights on third party consumers should not form part of the proposed reform of privity of contract.*

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<sup>103</sup> *Communication from the Commission to the Council and the European Parliament on the implementation of Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees including analysis of the case for introducing direct producer's liability* Com (2007) 210 final.

<sup>104</sup> *European Communities (Unfair Terms in Consumer Contracts) Regulations 1995* (SI No.27 of 1995) which implemented Council Directive 93/13/EEC on unfair terms in consumer contracts.

3.136 *The Commission recommends that the legislation should be applicable to give third party rights against consumers, subject to existing consumer protection laws.*

## **Q Unfair contract terms**

3.137 The *Unfair Terms in Consumer Contracts Regulations 1995*<sup>105</sup> protect consumers from unfair contract terms. A contract term will be regarded as unfair if it has not been individually negotiated and if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.<sup>106</sup> An unfair contract term is not binding on the consumer, although the contract itself will, if possible, continue to bind the parties.<sup>107</sup>

3.138 The 1995 Regulations provide important protection to consumers affected by third party rights. For example, a contract entered into by the consumer may include an exemption clause which limits or excludes the liability of a third party. Such clauses will only be enforceable against consumers if they comply with the standards of the 1995 Regulations.<sup>108</sup> It is vital that this protection applies in relation to contracts to which the proposed legislation applies.

3.139 It is unclear whether, beyond this, the 1995 Regulations apply to protect third party consumers. Regulation 6 provides that an unfair term "in a contract concluded with a consumer by a seller or supplier" shall not be binding on the consumer. This seems to imply that it only applies where the consumer is a contracting party, and not where the consumer is a third party. However, in the absence of a judicial decision to this effect, this point remains open.

3.140 The Commission has concluded that nothing in the proposed reforms should be taken to exclude the application of existing statutes affecting contracts, including the *Unfair Terms in Consumer Contracts Regulations 1995* and the *Sale of Goods and Supply of Services Act 1980*.

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<sup>105</sup> *European Communities (Unfair Terms in Consumer Contracts) Regulations 1995* (SI No.27 of 1995) which implemented Council Directive 93/13/EEC on unfair terms in consumer contracts.

<sup>106</sup> Regulation 3(2) of the 1995 Regulations.

<sup>107</sup> Regulation 6 of the 1995 Regulations.

<sup>108</sup> The 1995 Regulations provide that exclusion clauses which exclude or limit the liability of a seller or supplier in the event of an injury to the consumer are void. Exclusion clauses are also subject to judicial control and scrutiny under the *Sale of Goods and Supply of Services Act 1980* and at common law. See *Carroll v An Post National Lottery Co* [1996] 1 IR 443. See generally Clark *Contract Law in Ireland* (5<sup>th</sup> ed Thomson Round Hall 2004) at Chapter 7.

3.141 *The Commission recommends that nothing in the proposed reforms should be taken to exclude the application of existing legislation affecting contracts, including the Unfair Terms in Consumer Contracts Regulations 1995 and the Sale of Goods and Supply of Services Act 1980.*

## **R Arbitration Agreements and Jurisdiction Agreements**

3.142 A contract may contain an arbitration clause obliging the contracting parties to refer any disputes arising from the contract to arbitration. An exclusive jurisdiction clause specifies the jurisdiction for any action in relation to the contract. It is possible to envisage a situation where a contract which benefits a third party may make the third party's right subject to an arbitration clause or jurisdiction clause.<sup>109</sup> In this section the Commission discusses whether these clauses should be binding on third parties.

3.143 In England and Wales, section 8 of the *Contracts (Rights of Third Parties) Act 1999* provides that if the term benefiting the third party is subject to an arbitration agreement, a third party who wants to enforce their substantive right under the Act is not only entitled to arbitration, but is also bound to enforce their right by arbitration.<sup>110</sup> Thus "if the parties' intention is that the third party should enforce the right conferred on him by arbitration, the third party, in choosing to enforce the right, must do so by means of arbitration".<sup>111</sup>

3.144 One difficulty which has arisen in England concerns the situation where the contracting parties provide for disputes to be resolved by arbitration, but fail to expressly mention disputes involving the third party in the arbitration clause. In *Nisshin Shipping Co Ltd v Cleaves & Co Ltd*<sup>112</sup> a number of contracts contract between the owner of a ship and the charterer of a ship provided for the payment of commission to a third party (a broker), and the third party claimed this commission against the owner. Each contract contained an arbitration clause which referred to disputes between "the parties to the charterparty". The wording was wide enough to cover a claim by the charterers against the owners for failure by the owners to perform their promise to pay commission to the brokers but there was no reference to

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<sup>109</sup> The third party takes the right in the contract subject to the terms of the contract. See paragraphs 3.46 to 3.49 above.

<sup>110</sup> A stay of proceedings can be ordered against them under section 9 of the *Arbitration Act 1996*.

<sup>111</sup> Law Reform Commission of Hong Kong *Report on Privity of Contract* (2005) at paragraph 4.152, quoting Diamond "The Third Man: The 1999 Act Sets Back Separability?" (2001) 17 AR 211 at 213.

<sup>112</sup> [2003] EWHC 2602.

disputes between the brokers and the promisor. The brokers referred the issue of their commission to arbitration, and it was held that they were entitled to do so. The court was influenced by the fact that the third party had become a statutory assignee of the charterer's right of action against the owner. It was pointed out that an assignee stands in the shoes of the promisee as regards enforcement of the contract, and this meant that the assignee would be both entitled and obliged to refer to arbitration, in the same way the promisee would have been. However, the decision of the court appears to take a broad view of such arbitration clauses, and implies that third parties will be bound by them, even if not expressly mentioned in them. Colman J stated:

“The third party never was expressed to be a party to the arbitration agreement but, in view of the fact that he has in effect become a statutory assignee of the promisee's right of action against the promisor and because, by reason of the underlying policy of the 1999 Act expressed in s 1(4),<sup>113</sup> he is confined to the means of enforcement provided by the contract to the promisee, namely arbitration, he is to be treated as standing in the shoes of that promisee for the purpose only of the enforcement of the substantive term. Thus although the wording of sub-s 8(1)(a) - 'is subject to a term' - is capable of having a range of possible meanings, one of those meanings is that which I have described and, having regard to the further words of the subsection, entirely reflects the assignment analogy referred to . . .”<sup>114</sup>

3.145 This broad approach means that the third party could still be bound by the arbitration clause even if the contracting parties forget to expressly provide for it in the contract. This approach has been criticised, and it has been suggested that a third party should not be obliged to enforce his rights by arbitration unless the contracting parties expressly state this in the contract.<sup>115</sup>

3.146 The Commission is of the view that the broad approach is not a suitable one in the context of these reforms. The proposed reforms are concerned with *express* benefits, and not with implied benefits. A third party who wishes to refer a dispute to arbitration should only be able to do so

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<sup>113</sup> Section 1(4) of the 1999 Act provides that the third party's right to enforce a term of a contract is “subject to and in accordance with any other relevant terms of the contract”.

<sup>114</sup> [2003] EWHC 2602 at paragraph 42.

<sup>115</sup> See Law Reform Commission of Hong Kong *Report on Privity of Contract* (2005) at paragraph 4.155, quoting Diamond “The Third Man: The 1999 Act Sets Back Separability?” (2001) 17 AR 211. In the final analysis, the Law Reform Commission of Hong recommended following the English approach.

if the contract expressly provides that they can. Similarly, a third party should only be required to submit to arbitration when the contract expressly provides that they must.

3.147 The Commission recommends that if a third party wishes to enforce a term of the contract under the proposed legislation, and there is an express term of the contract providing that the third party is to enforce the term by arbitration, the third party should be bound by that express term. and should be considered a party to the arbitration agreement as regards disputes between the third party and the promisor.

3.148 Similarly, if the contracting parties want the third party to enforce their rights under the Act in a particular jurisdiction, the parties should be free to impose this condition. Any such exclusive jurisdiction clause should be expressly stated and should expressly refer to the third party.

3.149 The Commission recommends that if a third party wishes to enforce a term of the contract under the proposed legislation, and there is an express term of the contract providing that the third party is to enforce the term in a particular jurisdiction, the third party should be bound by that express term. This is subject to the normal rules relating to jurisdiction clauses.

3.150 *The Commission recommends that if a third party wishes to enforce a term of the contract under the proposed legislation, and there is an express term of the contract providing that the third party is to enforce the term by arbitration, the third party should be bound by that express term and should be considered a party to the arbitration agreement as regards disputes between the third party and the promisor.*

3.151 *The Commission recommends that if a third party wishes to enforce a term of the contract under the proposed legislation, and there is an express term of the contract providing that the third party is to enforce the term in a particular jurisdiction, the third party should be bound by that express term. This is subject to the normal rules relating to jurisdiction clauses.*

## **S Contracting out**

3.152 The proposed legislation is designed to give effect to the intentions of contracting parties who wish to confer contractual rights on third parties. It is intended to be facilitative, rather than mandatory, in nature. Thus, contracting parties who do not wish the proposed legislation to apply should be able to exclude the proposed legislation, or “contract out” of it. It should be remembered that even if contracting parties fail to exclude the proposed legislation, there is no guarantee that a third party will have a right to enforce the contract. Third parties must satisfy the test of

enforceability before they can have a right to enforce the contract under the proposed legislation.

3.153 *The Commission recommends that contracting parties should be able to expressly exclude or “contract out” of the proposed legislation.*



## CHAPTER 4 SUMMARY OF RECOMMENDATIONS

4.01 The recommendations of the Commission may be summarised as follows:

4.02 The Commission recommends that the privity of contract rule should be reformed to allow third parties to enforce rights under contracts made for their benefit. [Paragraph 2.66]

4.03 The Commission recommends that legislative reform of the rule of privity is more appropriate than judicial reform. The Commission also recommends that legislative reform of the privity rule should not constrain judicial development of third party rights. [Paragraph 2.73]

4.04 The Commission recommends that legislative reform of the promisee's remedies should not form part of the proposals to reform the rule of privity. The Commission acknowledges that reform of the rule of privity should not prevent judicial development of the principles relating to the award of damages or specific performance. [Paragraph 2.79]

4.05 The Commission recommends that reform of the privity rule should not be by the creation of further exceptions to the privity rule in specific instances. [Paragraph 2.83]

4.06 The Commission recommends that the privity of contract rule should be reformed by means of detailed legislation. [Paragraph 2.88]

4.07 The Commission recommends that a third party should be able to enforce a term of a contract when the term expressly confers a benefit on the third party. However, the third party should not be able to enforce the term if it appears on a proper construction of the contract that the contracting parties did not intend the term to be enforceable by the third party. The contract should be interpreted in accordance with the ordinary rules of contractual interpretation, but surrounding circumstances should only be taken into account if they are reasonably available to the third party. [Paragraph 3.17]

4.08 The Commission recommends that a third party should be able to enforce a contract or a term of a contract when the contract expressly states that they may. [Paragraph 3.18]

4.09 The Commission recommends that a third party should have the right to rely on a term of a contract which excludes or limits the liability of the third party, provided that was the intention of the parties. This is subject to the normal statutory and common law rules on the incorporation and construction of exemption clauses. [Paragraph 3.19]

4.10 The Commission recommends that the third party should be identified in the contract either by name or by description. Such description should include being a member of a class or group of persons. [Paragraph 3.23]

4.11 The Commission recommends that there should be an express provision that there is no requirement that the third party be in existence at the time of the formation of the contract. [Paragraph 3.24]

4.12 The Commission recommends that a third party should be able to enforce a term of a contract even though they have not provided consideration. The normal rules on consideration should apply to the promisor and promisee. [Paragraph 3.27]

4.13 The Commission recommends that the contracting parties should not be able to cancel or vary the contract in such a way as to affect the rights of the third party once either contracting party is aware that the third party has assented to the contract, either by word or by conduct. After this point the contracting parties would need to obtain the consent of the third party to cancel or vary the contract. If this consent is not obtained, the variation or termination of the contract will not affect the rights of the third party, who may bring an action based on the terms of the contract which existed before the variation. [Paragraph 3.41]

4.14 The Commission recommends that the contracting parties should remain free to include in the contract an express term providing for variation or termination of the contract. [Paragraph 3.42]

4.15 The Commission recommends that there should be judicial discretion to authorise a cancellation or variation of the contract, on such terms as seem appropriate, when the third party's consent is necessary for such a cancellation or variation, but this cannot be obtained because the third party cannot reasonably be contacted or because they are mentally incapable of giving such consent. [Paragraph 3.43]

4.16 The Commission recommends that there should be an express provision that there is no requirement that a third party be in existence at the time of assent by another third party. [Paragraph 3.44]

4.17 The Commission recommends that where a contract jointly benefits multiple third parties, assent by each third party should be needed to crystallise that third party's rights, but it should be possible for one third

party to assent on behalf of other third parties in an appropriate case. [Paragraph 3.45]

4.18 The Commission recommends that the rights of the third party to enforce the contract or a term of the contract should be subject to the other terms and conditions of the contract. [Paragraph 3.49]

4.19 The Commission recommends that the rights of the third party should be subject to the usual defences which would be available to the promisor if the promisee had taken the action, provided the defence arises out of or in connection with the contract in which the promise is contained. [Paragraph 3.59]

4.20 The Commission recommends that the rights of the third party should be subject to any defence which would have been available if the third party had been a party to the contract, provided the defence arises out of or in connection with the contract in which the promise is contained. [Paragraph 3.60]

4.21 The Commission recommends that the defences available to the promisor should include the defence of set-off. The promisor should be free to set-off, against the claim of the third party, any claim the promisor has against the promisee. However the promisor's claim cannot exceed the amount claimed by the third party and the promisor's claim must arise out of or in connection with the contract in which the promise to the third party is contained. [Paragraph 3.61]

4.22 The Commission recommends that the promisor should be free to counterclaim against the third party where the promisor would in any event have had a right of action against the third party. [Paragraph 3.62]

4.23 The Commission recommends that the third party who brings an action for breach of contract should be entitled to a full range of remedies, including damages and specific performance, subject to the normal rules governing such remedies. [Paragraph 3.68]

4.24 The Commission recommends that, unless otherwise agreed by the parties, the promisee should retain the right to enforce the contract even if the contract is enforceable by the third party. There should be no order of priority between the promisee and third party. [Paragraph 3.76]

4.25 The Commission recommends that although there should be no requirement that the promisee be joined as a party to the litigation when a third party sues to enforce a contract, in an appropriate case it should be possible for the third party to be joined as a party where the promisee sues, and for the promisee to be joined as a party when the third party sues. [Paragraph 3.77]

4.26 The Commission recommends that once a promisor has fulfilled their duty to the third party, either wholly or partly, the promisor should to that extent be discharged from their duty to the promisee. [Paragraph 3.78]

4.27 The Commission recommends that if the promisee has recovered substantial damages representing the third party's loss or the expense to the promisee of making good to the third party any default of the promisor, then, in any proceedings brought by the third party against the promisor, the court should reduce any award to the third party to such an extent as it thinks appropriate to take account of the sum recovered by the promisee. [Paragraph 3.79]

4.28 The Commission recommends that that existing common law and statutory exceptions to the privity rule should be retained and that third parties should not be denied existing remedies available to them. [Paragraph 3.86]

4.29 The Commission recommends that existing common law and statutory exceptions to the privity rule should be kept under review. [Paragraph 3.87]

4.30 The Commission recommends that the proposed legislation should not at this time include a comprehensive codification of the existing common law and statutory exceptions to the privity rule. However, this recommendation should not preclude any such codification in the future. [Paragraph 3.88]

4.31 The Commission recommends that the proposed legislation should not give any third party a right to enforce any contract of employment against an employee. [Paragraph 3.92]

4.32 The Commission recommends that the proposed legislation should not apply to the contract formed between a company and its shareholders, and between individual shareholders, under section 25 of the Companies Act 1963. The Commission also recommends that the proposed legislation should not apply where the third party is a company which has not yet been incorporated. [Paragraph 3.98]

4.33 The Commission recommends that the proposed legislation should not apply to a contract for the international carriage of goods by air, rail or road, where the contract is subject to the rules of an international transport convention. [Paragraph 3.104]

4.34 The Commission recommends that the proposed legislation should not apply to a contract for the carriage of goods by sea, except that a third party can enforce an exclusion or limitation of liability in such a contract if they satisfy the test of enforceability. [Paragraph 3.111]

4.35 The Commission recommends that the proposed legislation should confer no rights on a third party in the case of a contract on a bill of exchange, promissory note or other negotiable instrument. [Paragraph 3.113]

4.36 The Commission recommends that the proposed legislation should not apply to documentary credits. [Paragraph 3.115]

4.37 The Commission recommends that the third party's right of enforcement should not be extinguished merely because one of the contracting parties has become insolvent. The contracting parties may, if they wish, provide in the contract that they are not liable to the third party in the event of the insolvency of either of the contracting parties. [Paragraph 3.119]

4.38 The Commission recommends that the proposed legislation should apply to contracts and deeds. [Paragraph 3.121]

4.39 The Commission recommends that the proposed reforms should not affect the rule that to enforce an insurance contract a party must have a sufficient interest in the insurance policy. However, this should not preclude the possibility of the future reform of this rule. [Paragraph 3.124]

4.40 The Commission recommends that the proposed reforms should apply where the third party is a consumer. [Paragraph 3.134]

4.41 The Commission recommends that the conferring of additional rights on third party consumers should not form part of the proposed reform of privity of contract. [Paragraph 3.135]

4.42 The Commission recommends that the legislation should be applicable to give third party rights against consumers, subject to existing consumer protection laws. [Paragraph 3.136]

4.43 The Commission recommends that nothing in the proposed reforms should be taken to exclude the application of existing legislation affecting contracts, including the Unfair Terms in Consumer Contracts Regulations 1995 and the Sale of Goods and Supply of Services Act 1980. [Paragraph 3.141]

4.44 The Commission recommends that if a third party wishes to enforce a term of the contract under the proposed legislation, and there is an express term of the contract providing that the third party is to enforce the term by arbitration, the third party should be bound by that express term and should be considered a party to the arbitration agreement as regards disputes between the third party and the promisor. [Paragraph 3.150]

4.45 The Commission recommends that if a third party wishes to enforce a term of the contract under the proposed legislation, and there is an express term of the contract providing that the third party is to enforce the term in a particular jurisdiction, the third party should be bound by that

express term. This is subject to the normal rules relating to jurisdiction clauses. [Paragraph 3.151]

4.46 The Commission recommends that contracting parties should be able to expressly exclude or “contract out” of the proposed legislation. [Paragraph 3.153]

**APPENDIX A      DRAFT CONTRACT LAW (PRIVITY OF  
CONTRACT AND THIRD PARTY RIGHTS) BILL  
2008**

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DRAFT CONTRACT LAW (PRIVITY OF CONTRACT AND  
THIRD PARTY RIGHTS) BILL 2008

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ARRANGEMENT OF SECTIONS

Section

1. Short title and commencement
2. Definitions
3. Right of third party to enforce contractual term
4. Variation and termination of contract
5. Defences and remedies available to promisor
6. Enforcement of contract by promisee
7. Protection of promisor from double liability
8. Specific contracts
9. Exceptions and related matters

ACTS REFERRED TO

Companies Act 1963

1963, No.33

European Communities Act 1972

1972, No.27

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DRAFT CONTRACT LAW (PRIVITY OF CONTRACT AND THIRD  
PARTY RIGHTS) BILL 2008

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**BILL**

*Entitled*

AN ACT TO REFORM THE LAW OF PRIVITY OF CONTRACT AND  
TO PROVIDE FOR THE ENFORCEMENT OF CONTRACT TERMS  
MADE FOR THE BENEFIT OF THIRD PARTIES AND TO PROVIDE  
FOR RELATED MATTERS

BE IT ENACTED BY THE OIREACHTAS AS FOLLOWS:

**Short title and commencement**

**1.**— (1) This Act may be cited as the Contract Law (Privity of Contract and Third Party Rights) Act 2008.

(2) This Act comes into force on such day or days as the Minister may appoint by Order or Orders.

**Definitions**

**2.** — In this Act, unless the context otherwise requires —

“court” means, subject to their jurisdictional limits, the Circuit Court or the High Court;

“Minister” means the Minister for Justice, Equality and Law Reform;

“promisee” means the party to a contract by whom the term is enforceable against the promisor;

“promisor” means the party to a contract against whom the term is enforceable by the third party;

“third party” means a person who is not a party to a contract.

### **Right of third party to enforce contractual term**

**3.** — (1) Subject to the provisions of this Act, a third party may enforce a term of a contract in his or her own right if—

- (a) the contract expressly provides that he or she may, or
- (b) subject to *subsection (2)*, the term expressly confers a benefit on him or her.

(2) *Subsection (1)(b)* does not apply if it appears that, on a proper construction of the contract, interpreted in light of the surrounding circumstances which are reasonably available to the third party, the parties did not intend the term to be enforceable by the third party.

(3) Where a term of a contract excludes or limits liability in relation to any matter, references in this Act to the third party enforcing the term shall be construed as references to the third party availing of the exclusion or limitation.

(4) The third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description.

(5) Nothing in this Act shall be interpreted as requiring that the third party be in existence either at the time the contract was entered into or at the time of assent of the contract by another third party.

(6) Without prejudice to the requirements for consideration between the promisor and promisee, a third party may enforce a term of a contract in accordance with *subsection (1)* even though he or she has not provided any consideration for the contract.

(7) 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.

(8) For the purpose of exercising his or her right to enforce a term of the contract, there shall be available to the third party any remedy that would have been available to him or her in an action for breach of contract if he or she had been a party to the contract (and the rules relating to damages, injunctions, specific performance and other relief shall apply accordingly).

#### ***Explanatory note***

Section 3 implements the recommendations in paragraphs 3.17, 3.18, 3.19, 3.23, 3.24, 3.27, 3.44, 3.49 and 3.68.

## Variation and termination of contract

4.— (1) Subject to the provisions of this section, where a third party has a right under *section 3* 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 or her entitlement under that right, without his or her consent if the third party has assented to the contract and either contracting party is aware of this.

(2) The assent referred to in *subsection (1)*

(a) may be by words or conduct, and

(b) if sent to the promisor by post or other means, shall not be regarded as communicated to the promisor until received by him or her.

(3) *Subsection (1)* is subject to any express term of the contract under which—

(a) the parties to the contract may by agreement rescind or vary the contract without the consent of the third party, or

(b) the consent of the third party is required in circumstances specified in the contract instead of those set out in *subsection (1)*.

(4) Where the consent of a third party is required under *subsection (1)* or (3), the court may, on the application of the parties to the contract, dispense with his or her consent if satisfied—

(a) that his or her consent cannot be obtained because his or her whereabouts cannot reasonably be ascertained, or

(b) that he or she lacks the mental capacity to give his or her consent.

(5) The court may, on the application of the parties to a contract, dispense with any consent that may be required under *subsection (1)(c)* if satisfied that it cannot reasonably be ascertained whether or not the third party has in fact assented to the term.

(6) If the court dispenses with a third party's consent, it may impose such conditions as it thinks fit, including a condition requiring the payment of compensation to the third party.

(7) Where a contract jointly benefits more than one third party, assent by each third party is required to crystallise that third party's rights; but where it is deemed appropriate by the Court one such third party may assent on behalf of another such third party or other such third parties;

***Explanatory note***

Section 4 implements the recommendations in paragraphs 3.41, 3.42, 3.43 and 3.45.

**Defences and remedies available to promisor**

**5.**— (1) *Subsections (2) to (4)* apply where, in reliance on *section 3*, proceedings for the enforcement of a term of a contract are brought by a third party.

(2) The promisor shall have available to him or her by way of defence or set-off any matter that—

(a) arises from or in connection with the contract and is relevant to the term, and

(b) would have been available to him or her by way of defence or set-off if the proceedings had been brought by the promisee.

(3) The promisor shall also have available to him or her—

(a) by way of defence or set-off any matter, and

(b) by way of counterclaim any matter not arising from the contract,

that would have been available to him or her by way of defence or set-off or, as the case may be, by way of counterclaim against the third party if the third party had been a party to the contract.

(4) *Subsections (2) and (3)* are subject to any express term of the contract.

(5) Where in any proceedings brought against him or her a third party seeks in reliance on *section 3* to enforce a term of a contract (including, in particular, a term purporting to exclude or limit liability), he or she may not do so if he or she could not have done so (whether by reason of any particular circumstances relating to him or her or otherwise) had he or she been a party to the contract.

***Explanatory note***

Section 5 implements the recommendations in paragraphs 3.59, 3.60, 3.61 and 3.62.

### **Enforcement of contract by promisee**

**6.** — *Section 3* does not affect any right of the promisee to enforce any term of the contract.

#### ***Explanatory note***

Section 6 implements the recommendations in paragraph 3.76.

### **Protection of promisor from double liability**

**7.**—(1) Where a promisor has fulfilled his or her duty to the third party, either wholly or partly, the promisor shall to that extent be discharged from his or her duty to the promisee.

(2) Where under *section 3* a term of a contract is enforceable by a third party, and the promisee has recovered from the promisor a sum in respect of—

(a) the third party's loss in respect of the term, or

(b) the expense to the promisee of making good to the third party the default of the promisor,

then, in any proceedings brought in reliance on that section by the third party, the court shall reduce any award to the third party to such extent as it thinks appropriate to take account of the sum recovered by the promisee.

#### ***Explanatory note***

Section 7 implements the recommendations in paragraphs 3.78 and 3.79.

### **Specific contracts**

**8.**— (1) For the avoidance of doubt, this Act shall apply to deeds.

(2) For the avoidance of doubt, this Act shall not affect the rule that to enforce an insurance contract a party must have a sufficient interest in the insurance policy.

(3) For the avoidance of doubt, this Act shall apply to consumers, without prejudice to any greater protection available to consumers under any Act or under Regulations made in accordance with the European Communities Act 1972.

#### ***Explanatory note***

Section 8 implements the recommendations in paragraphs 3.121, 3.124, 3.134 and 3.136.

## **Exceptions and related matters**

**9.**— (1) *Section 3* confers no rights on a third party—

- (a) in the case of a contract on a bill of exchange, promissory note or other negotiable instrument, or
- (b) in the case of a documentary credit.

(2) *Section 3* confers no rights on a third party in the case of any contract coming within section 25 of the Companies Act 1963, nor shall it confer any rights where the third party is a company which has not yet been incorporated.

(3) *Section 3* confers no right on a third party to enforce—

- (a) any term of a contract of employment against an employee,
- (b) any term of a worker's contract against a worker (including a home worker), or
- (c) any term of a contract against an agency worker.

(4) (a) *Section 3* confers no rights on a third party in the case of a contract for the carriage of goods by sea except that a third party may in reliance on that section avail himself or herself of an exclusion or limitation of liability in such a contract;

(b) *Section 3* confers no rights on a third party in the case of a contract for the carriage of goods by rail or road, or for the carriage of cargo by air, which is subject to the rules of the appropriate international transport convention.

(5) *Section 3* does not affect any right or remedy of a third party that exists or is available apart from this Act, including rights which are available to a third party under common law or which are available to a third party as a consumer under any Act or under Regulations made in accordance with the European Communities Act 1972.

(6) Where there is an express term of the contract providing that the third party is to enforce the term by arbitration, the third party shall be bound by that express term and shall be considered a party to the arbitration agreement as regards disputes between the third party and the promisor.

(7) Where there is an express term of the contract providing that the third party is to enforce the term in a particular jurisdiction, the third party shall be bound by that express term, subject to any rule of law relating to jurisdiction clauses.

(8) Nothing in this Act shall be interpreted as preventing contracting parties from expressly excluding the application of the terms of this Act from their contract.

***Explanatory note***

Section 9 implements the recommendations in paragraphs 3.86, 3.92, 3.98, 3.104, 3.111, 3.113, 3.115, 3.141, 3.150, 3.151 and 3.153.