

# Contract Law

## Symbolic but sensible – the Contracts (Rights of Third Parties) Act 1999

by Andrew Tettenborn

We all know about the proud mother watching the Sandhurst passing-out parade, who said to her neighbour, 'Can you see our Willie there? He's the only one in step.' Until last year English law was in much the same position in preventing strangers from enforcing contracts concluded for their benefit. The *Contracts (Rights of Third Parties) Act 1999* now briskly aligns us with virtually the whole of the US, New Zealand, and a respectable part of Australia – or will do so when fully in force in May 2000. For this reason, if no other, it deserves at least a passing comment.

### THE 1999 ACT – THE BASIC PROVISION

The kernel of the Act (henceforward, with scant regard for euphony, the CRTPA) is s. 1. This allows strangers to enforce contracts made for their benefit, gives them the use of all the standard contractual remedies to do it with, and emphasises for good measure that they can now validly be exempted from liability pursuant to a contract as well as being given rights to sue for breach of it.

Section 1(1)(a), allowing a third party to enforce a contract where it expressly says he can, is utterly uncontroversial, and is such an obviously sensible provision that it needs no comment whatever. Implied conferral of rights on strangers, a more controversial topic, is covered by s. 1(1)(b). This provides that a contract 'purporting to benefit' a third party is prima facie enforceable by him, unless it is clear from the circumstances that he was not intended to gain any legal rights under it. Other subsections tidy up assorted loose ends. To avoid possible doubt, it is made clear that the stranger, provided he is adequately identified, need not have been in existence at the time of the agreement. But, if he wants to take the benefit of the contract, he must take it warts and all: as the CRTPA puts it, he cannot avail himself of third party contractual rights 'otherwise than subject to and in accordance with any other relevant terms of the contract'.

Presumptively, the stranger will in addition take subject to any contractual defence or set-off which would have been pleadable against the promisee himself, and to any defence or set-off relating to his own position (for example where he has himself induced the promisor to contract by virtue of a misrepresentation).

Lastly, there is the issue of cancellation – which has often worried academic commentators, though its practical implications may well be minor. (One case where it might matter is where A Ltd sells property to B Ltd and B agrees to pay the price in instalments to C Ltd, an associated company of A. Were A to go into liquidation, its liquidator might well wish to persuade B to cancel the obligation to pay C and pay a slightly smaller sum instead to himself.) If promisor and promisee want to take away the third party's rights without his permission after the contract is entered into, s. 2 allows them to do so by mutual agreement, but only for a limited time. The stranger's rights presumptively become irrevocable when he either expressly accepts them, or foreseeably relies on them, or relies on them to the knowledge of the promisor. However, this is only a presumption: the contractors are given an express power to stipulate that the third party's rights remain revocable indefinitely.

### IMPLICATIONS OF THE NEW RIGHTS

Those are the bare bones of the new third party right created by CRTPA, s. 1. What use will actually be made of it is less clear. To find the answer, we shall simply have to wait and see. But a few speculations may be in order.

First, it is suggested that the section may well be more often excluded before the event than invoked after it. Contract draftsmen are ultra-cautious beasts and they have a pathological, if understandable, fear of unexpected liabilities. In drawing up any agreement, their instinct will undoubtedly be to

include a clause ruling out any liability to those other than the original contracting parties.

In some specialised situations, however, the new dispensation will undoubtedly be taken advantage of. Third-party exemption clauses will no doubt proliferate: not only in the shipping context where previous problems have arisen (see, e.g. *Scruttons v Midland Silicones* [1962] AC 446 and *The Eurymedon* [1975] AC 154, the best-known cases on exemption clauses and third parties), but elsewhere too. For example, in construction contracts, head contractors engaging subcontractors may well wish expressly to insulate the site owner from liability for damage to subcontractors' plant and equipment, and the subcontractors from liability for harm to the site owner's premises (see, e.g. *Norwich City Council v Harvey* [1989] 1 WLR 828 and *British Telecommunications plc v James Thomson & Sons (Engineers) Ltd* [1999] 1 WLR 9). Again in the construction context, warranties to potential purchasers contained in the original construction contract may possibly replace the traditional 'duty of care deed'. In property deals, the section may well be used to render enforceable promises by buyers to pay part of the price to some third party, either an associated company or a financier.

#### KERNEL OF THE ACT

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Interestingly, s. 1 may also provide a way for borrowers to create a new kind of non-registrable security over book debts. A company, for example, contracts with its customers that the latter will pay its financier direct, arrangements being to

made for the moneys to be paid into a particular account and (between the company and the financier) for the company to be permitted to draw on them with the financier's consent. The financier's right to sue the customers appears pretty watertight: yet, on the basis that the debts were at all times payable to it and not to the company, it is difficult to see how this could be construed as creating a charge of any sort, let alone a registrable one, over the debts concerned.

#### FEAR

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Most of the serious argument, one suspects, will centre round s. 1(1)(b), dealing with instances when third party contractual rights are to be regarded as arising by implication. Put shortly, this says that a contract term 'purporting to benefit' a third party will prima facie give that third party the right to invoke it, unless the promisor in turn proves a lack of intention to give him enforceable legal rights. What is worth noting about this provision is that, however open-ended it may look at first sight, it is likely to be interpreted rather narrowly. The Law Commission's report – which will, no doubt, inform any judicial approaches on the point – effectively suggests that a contract 'purports to benefit' someone only if performance is to be rendered directly to him or on his property. So while promises to pay a third party money, insure his life or extend his house are in, *White v Jones* ([1995] 2 AC 207) and similar professional negligence scenarios are out, being left exclusively in the province of tort. In promising to draft my will properly, my solicitor is not undertaking to benefit my heirs, but instead to give me facilities to do so, which is (apparently) something quite different. Furthermore, in one vital case where performance does go directly to the third party – where a building subcontractor does work on a site owner's property by arrangement with the head contractor – the Commission suggest that there will still be no direct right in the site owner, this time because of an implicit intention not to give him

one (on the rather lame basis that everybody knows that this is what the parties want, although whether an argument of this sort would necessarily convince a court is open to question).

One further comment on s. 1(1)(b). The subsection may, perhaps surprisingly, be apt to cover a number of situations currently dealt with under equitable doctrine. Notable examples are (a) where A sells land to B against B's undertaking to respect the rights of a third party, such as a sitting tenant C (see, e.g. *Binions v Evans* [1972] Ch. 359); (b) secret trusts; and (c) mutual wills. Although the Act is at pains to preserve rather than supplant existing non-contractual machinery for enforcing third party promises, all these situations arguably sit more comfortably in a contractual than an equitable setting. Their gradual absorption into mainstream contract cannot be ruled out. (Compare dicta in *Staib v Powell* [1979] Qd R 987, suggesting that secret trusts might be enforceable in contract under Queensland anti-privity legislation – which had not, however, been in force at the time of the events concerned.)

#### OTHER ISSUES

A number of other specific issues dealt with by the Act are worth brief mention.

##### *Holding the ring between promisee and third party*

No doubt because of the awkwardnesses of privity, in a number of cases ways have been found to let the promisee himself recover damages so as to provide some measure of de facto protection for deserving third parties. These range from the orthodox (where the promisor's failure to benefit the stranger made the promisee himself liable to him) to the very artificial (as where construction contractors engaged by the promisee bungle works on a stranger's land, but do not thereby trigger any liability of the promisee to the stranger; see also *Alfred McAlpine Construction Ltd v Panatown Ltd* [1998] 58 Con LR 46 and *Jackson v Horizon Holidays Ltd* [1975] 1 WLR 1468, indemnifying a father for his family's displeasure at a ruined holiday – another notorious instance). No doubt some of the latter will gently wither away now the third party can be given a direct right: but potential for double recovery must remain. This problem is covered in s. 4

and 5. Having preserved the promisee's existing rights in s. 4, s. 5 then goes on to say that once the promisee has recovered damages reflecting either the stranger's loss or his own liability to compensate the stranger, credit must be given for this recovery in any subsequent action by the third party. There is an element of rough justice in this – the stranger loses out entirely if the promisee recovers in respect of his loss and then goes bankrupt without having paid over what he got – but it is probably unavoidable. The statute does not say what happens if both promisee and stranger sue at the same time for what is in essence the same loss. (For example, if A agrees with B to pay B's debt of £100 to C, both B and C now have impeccable rights to sue A:B under s. 4, and C under s. 1. The point may become more important since the confirmation in *Total Liban SAL v Vitol Energy SA* [2000] 1 All ER 267 that in such a case B can sue A whether or not he has actually paid C.) Presumably both actions can be consolidated: but if they are, which of the two claimants, both of whom have a good cause of action, gets priority in any award? One can only hope that a bold court will create a practice of preferring the third party in the event of such competition, since it is to him that payment ultimately ought to go.

##### *Exemption from liability*

We have already seen that third parties can now benefit from exemption clauses. The converse issue also arises of how far the third party's rights, conferred by the CRTPA, should be able to be taken away or limited by contrary agreement. On this the CRTPA takes a sensible and robust view: since contracting parties do not have to give strangers any rights in the first place, there can be no objection to giving them curtailed or nugatory ones if they wish to. Section 7(2) makes the necessary dispositions to prevent the *Unfair Contract Terms Act 1977* interfering with the parties' agreement in this respect.

##### *Arbitration*

Arbitration is awkward. The Law Commission reluctantly declined to recommend any provision about it, on the basis that if the matter was dealt with properly a stranger would in certain cases have to be bound by an arbitration clause he had never agreed to, and that such a recommendation would go beyond their

remit. The House of Lords showed no such timidity, and the workmanlike clause which was introduced there and became CRTPA, s. 8 is the result.

Section 8(1) effectively applies the 'warts and all' provision in s. 1(5) to arbitration clauses. Where a term giving a stranger a right under s. 1 contains an arbitration clause,

*'... the third party shall be treated for the purposes of that Act as a party to the arbitration agreement as regards disputes between himself and the promisor relating to the enforcement of the substantive term by the third party.'*

The effect of this is that the stranger can take advantage of the clause (so as to demand that the promisor arbitrate his claim), but is conversely bound to respect it (thus giving the promisor a right to a stay if the stranger sues him in the ordinary courts). But it is worth noting that the section goes a good deal further. It is not limited, as it might have been, to where the stranger seeks to sue on the term, but rather deems him to be a party to the arbitration clause as regards all disputes concerning the substantive term (or, in the case of an exception clause, the right to invoke it in court proceedings), whoever may have raised them. Suppose, for example, that the

promisor seeks a declaration that he is not bound vis-à-vis the stranger by the clause concerned. Although the stranger may never have lifted a finger to enforce the contract, and never *in fact* agreed to submit to any arbitral tribunal whatever, he can it seems be bound willy-nilly to incur the trouble and expense of arbitrating the promisor's claim. (This could have disturbing implications, bearing in mind that all parties to an arbitration, including presumably persons deemed to be parties under CRTPA, s. 8, are jointly bound to contribute to the arbitrator's fee; and, incidentally, that the relevant provision imposing this liability – the *Arbitration Act* 1996, s. 8 – cannot be excluded by contrary agreement.)

The CRTPA, s. 8(2), is more straightforward. It deals with the situation where contracting parties agree that non-contractual claims which either may have against a named stranger shall be arbitrated. In this case the stranger may if sued insist on arbitration, and if he chooses to do so will thereafter be bound by any order the arbitrator makes. (Hence the clause deeming him to have been a party to the arbitration clause 'immediately before the exercise of the right'. If this were not there, the stranger would be able to eat his cake and have it:

he could stay any court proceedings on the basis that he was a third party beneficiary of the arbitration clause and, in addition, decline to honour any arbitrator's award on the basis that he was not bound by it!)

## EXCEPTIONS

Three areas of contract law are expressly left untouched by the CRTPA on the basis that existing specialised regimes should not be upset. They are all fairly predictable: bills of exchange and other negotiable instruments, the 'deemed contract' between members of a company under s. 14 of the *Companies Act* 1985, and international contracts of carriage of goods by sea, rail, air and road, which are already governed by transnational conventions. A fourth exclusion did not appear in the Law Commission draft, but is an unsurprising New Labour addition: contracts of employment are not to give rise to any right of action by third parties against employees personally. 

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