

# Contract Law

## The Law Commission's proposals on privity

by Stephen A Smith

In The Third Party Rule of Contract: Contracts for the Benefit of Third Parties No. 242 (1996), the Law Commission proposes that the third party rule – the rule that only parties to a contract can enforce the contract – be reformed so that third parties have the right to enforce a contract where either:

- (1) the contract expressly confers such a right; or
- (2) the contract purports to confer a benefit on the third party and does not indicate an intention that such a right not be enjoyed by third parties.

It seems to be widely accepted by academics, judges and the Law Commission that the case for reforming privity is self-evident, the only real issue being how reform should be achieved. Thus most critical comments on the

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report and on the earlier consultation document (No. 121, 1991) focus on the details of reform.

The 'how' and 'why' of reform are connected, however; and it is suggested that the difficulties encountered by the Commission in getting the details of reform correct (discussed below) can be traced to a failure to appreciate fully the central role played by the third party rule in contract law. The rule is no mere historical blip. This can be seen if we address squarely the critical question that must be asked any time the law contemplates extending a cause of action to a new category of plaintiff-defendant: what right of the plaintiff has the defendant infringed? The answer in this case is that while in certain circumstances defaulting promisors arguably have infringed third parties' rights, the rights infringed are not rights to enforce

agreements to which third parties are strangers.

### THE LAW'S PROTECTION

One right protected by private law is the right to have unjust enrichments reversed. A third party has no possible action in this regard since, while a promisor might be unjustly enriched by breaking a promise to benefit that party, the enrichment is at the expense of the person who paid for the promise, not the third party. Admittedly, the rules regarding, *inter alia*, total failure of consideration may arbitrarily limit protection of the promisee's restitutionary interest but such limitations cannot be blamed on the third party rule.

A second right protected by the law is the right not to have your person or property harmed in certain ways, typically through another's intentional or careless actions. A third party could be harmed by reasonably relying on a promise made by A to B. Under current English law, a third party cannot recover for losses so incurred. The reason, however, is not the third party rule, as that rule bars only actions in contract. A third party who seeks compensation for loss incurred in reliance on a promisor's statement of intention is not seeking to enforce a promise *qua* promise, but to enforce a duty which, if it exists, is imposed by law. In this instance, reform efforts should be directed at the rules governing the use of estoppel as a cause of action.

A third right protected by private law is the right to have voluntary obligations (e.g. promises) made to you performed. It is this, the contractual right, that the Law Commission proposes granting to third parties. Even leaving consideration aside, however, the duty to perform a promise is not owed to the world but only to the promisee. Promissory obligations are obligations undertaken to particular people: the word 'promisee' exists precisely so that we can distinguish persons to whom promissory duties are owed from all others.

Indeed if promissory obligations were not personal, then in theory anyone should be able to enforce a contract. And third parties, by definition, are not promisees of the relevant promise. They are intended beneficiaries but that is a different thing. If I tell a colleague that I intend to give her £100, she cannot sue me if I fail to do so, even if consideration is abolished. A mere intent to benefit, even where the benefit is a legal right, is not a promise and therefore does not, and should not, give rise to contractual

### THE MOST IMPORTANT FEATURE

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obligations. Thus, while the defendant in a privity case may have breached a promissory duty, that duty is owed to the promisee, not the third party.

### RIGHTS AND DUTIES

The bifurcation of right and duty is fatal. It is basic to private law that a successful plaintiff must show that the defendant breached his duty and that this breach infringed the plaintiff's rights. Duties are correlative to rights: that is why we have plaintiffs suing defendants, not plaintiffs suing the state and the state suing defendants. Granting third parties contractual rights would sever the most important feature of private law: the link between plaintiff and defendant.

It may be that the rules governing hard-to-quantify losses inadequately compensate promisees for the breach of promises to benefit others. That, however, is not the fault of the third party rule. It may also be that in some cases a third party, though not privy to the agreement between A and B, is privy (*i.e.* the promisee) to a separate but identical promise by A, which promise the third party cannot enforce. But again, the third party rule is not the culprit: the culprit is consideration.

Might third party rights be *sui generis*; and thus comparison with unjust enrichment, tort and contract unhelpful? It is not clear what interest such rights could protect, nor why such rights ought to allow third parties to obtain the benefit of a contract between strangers, but even if such rights did exist the third party rule is not a barrier to their protection. The third party rule, to repeat, bars only actions in contract.

### INEVITABLE DIFFICULTIES

Seen in this light, it is to be expected that the Law Commission's project would encounter problems in deciding the 'how' issues of reform. The details do not fall neatly into place because the proposal is inconsistent with the structure of private law. Consider the question of whether contracting parties should be able to vary their contracts. The Law Commission proposes that a third party's rights crystallise once he or she either relies on or assents to the contract (cl. 2(1), (2)). Reliance is relevant if the third party's action is for induced detrimental reliance but the

action is in contract where reliance is not relevant. Assent, which appears similar to the contractual requirement of acceptance, seems a better candidate at first blush. But to what is the third party assenting? You cannot assent to an agreement to which you are not party. An agreement is an agreement whether or not a third party assents to it.

Of course some benefits cannot in practice be conferred without the beneficiary's consent: I cannot leave goods on your property without your permission. Many benefits, however, can be conferred without permission: if A and B agree that A will send C £100 in the post there is nothing to which C can assent. C can have knowledge of the agreement but it is hard to see why mere knowledge is relevant to C's rights.

A second 'how' question is whether the promisor should be able to raise defences or set-offs against the third party that could have been raised against the promisee. The proposal that this be allowed (cl. 3) seems to envision the third party as either a joint promisee or

as the promisee's undisclosed principle or assignee. Yet the contracting parties' ability to vary their agreement is inconsistent with these possibilities. What defences or set-offs should then be allowed? Unfortunately, there is no right answer to this question, just as there is no right answer to the question of when a third party's rights should crystallise. There is no right answer because there is no coherent principle underlying the proposals from which a right answer could be derived. Ad hoc solutions are all that can be expected.

### CONCLUSION

The third party rule is a fundamental feature of contract law. Any attempts to reform the law's treatment of privity cases – which, as I have hinted, may well be required – should be directed elsewhere. 

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