



Concentrate Questions and Answers Contract Law: Law Q&A Revision and Study Guide (3rd edn)

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p. 209 13. Privity of Contract

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Abstract

The *Concentrate Questions and Answers* series offers the best preparation for tackling exam questions. Each book includes typical questions, answer plans and suggested answers, author commentary, and other features. This chapter explores the privity of contract. Traditionally the doctrine of privity of contract regards contract as based upon agreement and consequently only the parties to that agreement can enforce it. This chapter discusses common law limitations to the doctrine of privity; common law attempts to evade privity; and statutory developments. It covers the Contracts (Rights of Third Parties) Act 1999, including the freedom given to the contracting parties to exclude the provisions of the Act, or to set out procedures for post-contractual variation of arrangements that avoid the need to obtain the third party's consent.

Keywords: common law, contract law, contractual responsibility, privity, limitations

Are you ready?

In order to attempt the questions in this chapter you must have covered the following areas in your revision:

- The doctrine of privity of contract which provides that, generally, only parties to a contract can have rights and liabilities under that contract;
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The interrelationship of the doctrine of privity of contract with the doctrine of consideration.

Although entwined, two separate policy issues can also be identified: privity of contract relates to those who can enforce a contract; consideration concerns the types of promise that can be enforced;

- Common law and equitable mechanisms to evade the doctrine of privity of contract, including: trusts, restrictive covenants, and collateral contracts;
- The concept of agency as an exception to the doctrine of privity of contract: an agent may contract on behalf of his/her principal with a third party and form a binding contract between principal and third party;
- Statutory developments: the **Contracts (Rights of Third Parties) Act 1999**;
- That the Act gives freedom to the contracting parties to exclude the provisions of the Act or to set out procedures for post-contractual variation of arrangements that avoid the need to obtain the third party's consent.

Question 1

It was clearly desirable to amend, by the **Contracts (Rights of Third Parties) Act 1999**, the rule that a third party may not sue on a contract, which is made for his/her benefit.

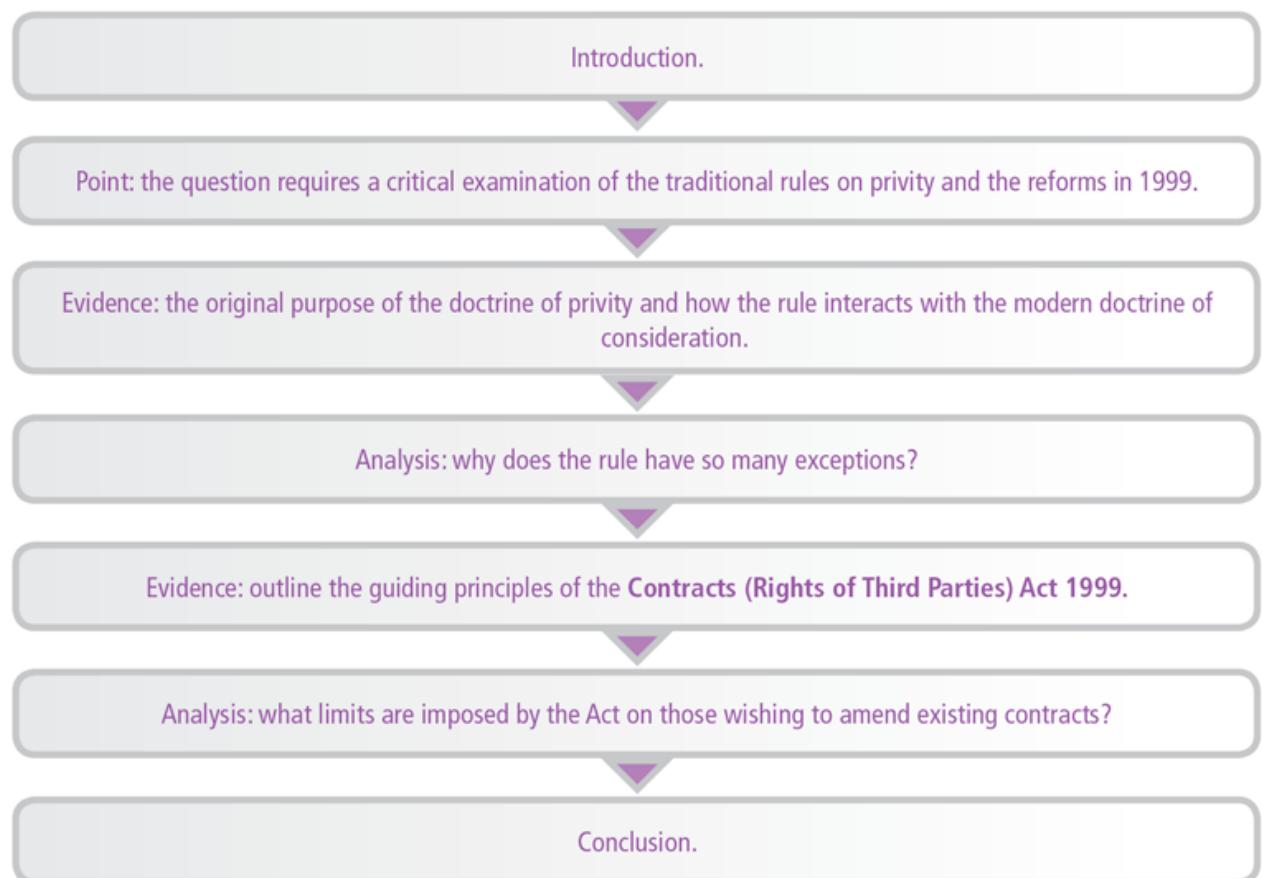
Discuss.

p. 210

Caution!

- Questions centring entirely on the doctrine of privity often require a good knowledge of pre-1999 common law case law.
- This essay requires an understanding and evaluation of the traditional doctrine of privity of contract in the context of contracts which are made for the benefit of third parties.
- You would also be expected to critically examine whether the law needed reform in 1999; this will require knowledge of the Law Commission's recommendations regarding contracts made for the benefit of third parties (Report No. 242, 1996) and the **Contracts (Rights of Third Parties) Act 1999**.

Diagram answer plan



Suggested answer

This question concerns the doctrine of privity of contract, which provides that, generally, only parties to a contract can have rights and liabilities under that contract. Before the passing of the **Contracts (Rights of Third Parties) Act 1999** (the ‘Act’) it was clear that a third party generally could not sue on a contract to which he/she was not privy, even if the sole purpose of the contract was to benefit that third party. The privity rule was criticized as being unfair, yet common law attempts to circumvent it were also often criticized as artificial and often questionable. However, whilst the Act arguably gives effect to the intentions of the contracting parties and the legitimate expectations of named third parties, it also raises complex legal issues.¹

¹ These are the points that you will develop in your answer.

The rule that a third party could not sue on a contract to which he/she was not privy became entrenched in the nineteenth century (see, for example, *Tweddle v Atkinson* (1861) 1 B & S 393), although since then it has been subject to much criticism.² The arguable injustice of the doctrine of privity was reinforced by the rules relating to damages.³ In *Jackson v Horizon Holidays Ltd* [1975] 1 WLR 1468, the defendants contracted with the plaintiff to provide holiday accommodation for the plaintiff, his wife, and their two children. The accommodation was inadequate. The plaintiff recovered damages including £500 for ‘mental distress’. Lord Denning MR considered £500 to be excessive for the plaintiff’s own distress but adequate where the plaintiff contracted for the benefit of himself and his family; and Lord Denning MR allowed the plaintiff to recover in respect of the loss suffered by his family. Some of Lord Denning’s wider comments in this case were strongly disapproved by the House of Lords in *Woodar Investment Development Ltd v Wimpey Construction UK Ltd* [1980] 1 WLR 277 although the promisee’s general inability to recover damages in respect of loss suffered by the third party was described as ‘most unsatisfactory’ and in need of re-evaluation.⁴ The perceived injustice of the doctrine led to common law attempts to evade privity, for example via trusts (*Affréteurs (Les) Réunis SA v Leopold Walford (London) Ltd* [1919] AC 801), but the rule remained.⁵ Indeed, such attempts were on an ad hoc basis and were often both artificial and overcomplicated (eg *New Zealand Shipping Co. Ltd v AM Satterthwaite & Co. Ltd (The Eurymedon)* [1975] AC 154).

² The historical context is necessary here to explain the rule.

³ Here you explain how the law could be regarded as ‘unfair’.

⁴ Demonstrates the uncertainties in the law.

⁵ You do not need detailed analysis of these cases; the point is made concisely here.

Several justifications have been advanced in support of the general denial of rights to third parties under the traditional privity rule.⁶ First, contractual rights and duties are essentially the personal domain of those who create them; thus, as the third party has played no part in the technical formation of the contract, some would argue that the third party should not obtain contractual rights. On the other hand, the Law Commission emphasized that requiring consent in contracts protected personal autonomy but that allowing third parties to obtain *benefits* under a contract would not necessarily undermine such autonomy. Secondly, the third party’s failure to provide any

consideration is often thought to prohibit his/her having any rights under the contract. Again, the Law Commission noted that consideration was provided by the promisee meaning that the promisor's promise had been paid for, albeit not by the third party. Thirdly, it may be unjust to treat someone as a party to a contract for the purpose of suing on it when he/she could not be sued. However, the promisor's interests are protected by his/her having a claim against the promisee whereas the third party has no such security under the traditional rule of privity.

6 Explain and analyse each in turn.

Fourthly, it is sometimes argued that giving a third party the right to enforce the contract could subject the promisor to two actions (from both the promisee and the third party). The Law Commission suggested that this could be dealt with by making it clear that there was only *one* promise giving rise to *one* cause of action; once the promise is enforced it is extinguished, the promisor then ceasing to be liable. Fifthly, whilst privity does not permit the creation of contractual rights in third parties, appropriate drafting can achieve the same result in practice. However, the Law Commission noted that laymen often fail to draft around the rule and that problems arise even where the parties have taken legal advice (eg *Beswick v Beswick* [1968] AC 58). Finally, the ability of third parties to sue on the contract made for their benefit may detract from the rights of the contracting parties to rescind or vary their contract and would expose the promisor to a potentially wide range of possible third-party claimants. The Law Commission acknowledged that any reform had to safeguard the rights of the parties and to define 'third parties' so as to prevent a flood of litigation.

One might, therefore, question how far the doctrine of privity was ever justifiable. The Law Commission considered that a 'detailed legislative scheme' was needed to guarantee the rights of third parties. It is not clear, however, whether the Act was the most appropriate way forward.⁷

7 Introduce your analysis of the statutory provisions.

On the central issue of the test of an enforceable benefit, s. 1 provides that a third party will be entitled to enforce a contractual term in his/her own right if either the contract 'expressly' so provides (s. 1(1)(a)), or the term 'purports to confer a benefit' on the third party (s. 1(1)(b)). As regards the latter possibility, the Act, in effect, sets up a rebuttable presumption that if the parties confer a benefit on a third party, they intend that the third party is empowered to enforce the term that creates the benefit (see s. 1(2)). The word 'purports' may be contentious:⁸ for example, the mere fact that a third party will be better off if a contract is performed does not mean that the contract had the purpose of conferring a benefit on that party (see *Prudential Assurance Co Ltd v Ayres* [2007] EWHC 775 (reversed on other grounds [2008] EWCA Civ 52)). Case law suggests that courts are prepared to find the

requisite intent via a process of implication or *default reasoning*: for example, in *Nissin Shipping Co. Ltd v Cleaves & Co. Ltd* [2003] EWHC 2602 (Comm), [2004] 1 Lloyd's Rep 38, or *Laemthong International Lines Co. Ltd v Artis* [2005] EWCA Civ 519, [2005] 1 Lloyd's Rep 688.

8 Analyse possible shortcomings in the law.

p. 213

← Nevertheless, the possible unintended consequences of interpreting s. 1(1) too widely are partly mitigated by s. 1(3), which requires any third party to be expressly identified in the contract by name, or as a member of a class, or as answering a particular description (s. 1(3) although compare *Starlight Shipping Co v Allianz Marine and Aviation Versicherungs AG* [2014] EWHC 3068 (Comm), at [88], for a broad approach to this provision). So, on the facts of *Jackson v Horizon Holidays*, as the family members were all referred to in the contract (ie satisfying s. 1(3)), they travelled together on a 'family trip', and the cost clearly encompassed all the family, a court would likely conclude that the contract had purported to confer the benefit of the contract terms on all the claimant's family. Moreover in *Chudley & Others v Clydesdale Bank Plc (Trading as Yorkshire Bank)* [2019] EWCA Civ 344, Flaux LJ stated at [80] that it is not a requirement of the Act that the third party was aware of the relevant contract at the time it was made.

However, problems arise where the contract does not specify the names of third parties but refers to categories or classes of people.⁹ *Avraamides v Colwill* [2006] EWCA Civ 1533 suggests that the word 'expressly' did not permit a 'process of implication or construction'; a clause directed towards a wide range of unidentified persons would not make individuals 'expressly' identified for the purposes of s. 1(3).

9 Indicate any remaining difficulties with the law.

Section 2 concerns the difficult issue of variation and rescission. In general, it recognizes that where a third party has a right under s. 1 to enforce a term of the contract, the contracting parties cannot, by agreement, rescind the contract, or vary it in such a way as to alter that right without prior permission from the third party. This restriction presupposes that the third party has communicated to the promisor his assent to the term, or the promisor is aware that the third party has relied upon the term, or the promisor could reasonably foresee reliance by the third party on the term and such reliance has in fact occurred. In this, the Act seems to uphold the right to vary the subject only to express intervention by the third party. In practice, as it will often be reasonably foreseeable that the third party might rely on the term in question, the contracting parties should contact the third party before any variation to check whether such reliance had indeed taken place.

Finally, the Act makes no mention of consideration.¹⁰ The Law Commission seemingly reinterpreted *Tweddle* by distinguishing promises that are supported by consideration (albeit enforced by a third party) and promises that are wholly gratuitous. This interpretation of the Act will therefore focus on the right to enforce a promise supported by consideration, even though the third party conferred no benefit.

¹⁰ The doctrine of consideration was seen by some as one of the impediments to reform.

p. 214

→ In conclusion, the Act means that the artificial and often questionable exemptions that the common law created to circumvent the unfairness of the privity rule are less relevant today.¹¹ However, while the Act gives effect to the intentions of the contracting parties and the legitimate expectations of named third parties, it raises further complex legal issues.

¹¹ A general conclusion pulls together the arguments, completing the analysis of the question.

Looking for extra marks?

- For the House of Lords' criticism of the privity rule after *Tweddle*, compare *Dunlop Pneumatic Tyre Co. Ltd v Selfridge & Co. Ltd* [1915] AC 847 and *Midland Silicones Ltd v Scrutons Ltd* [1962] AC 446, with *Beswick* and *Woodar Investment*.
- You might also refer to Dillon J's description of the position before the Act as 'a blot on our law and most unjust' (see *Forster v Silvermere Golf and Equestrian Centre* (1981) 125 SJ 397).
- Remember: the Act allows contracting parties to exclude the provisions of the Act or to set out procedures for post-contractual variation of arrangements that avoid the need to obtain the third party's consent.

Taking things further

- Adams, J., Beyleveld, D., and Brownsword, R., 'Privity of Contract—The Benefits and the Burdens of Law Reform' (1997) 60 MLR 238.

13. Privity of Contract

Considers the Law Commission Report, Privity of Contract: Contracts for the Benefit of Third Parties (Law Com. No. 242, Cm 3329, 1996).

- Andrews, N., 'Strangers to Justice No Longer—The Reversal of the Privity Rule under the Contracts (Rights of Third Parties) Act 1999' (2001) 60 CLJ 353.

In favour of the privity reform.

- MacMillan, C., 'A Birthday Present for Lord Denning: The Contracts (Rights of Third Parties) Act 1999' (2000) 63 MLR 721.

In favour of the privity reform.

- Smith, S., 'Contracts for the Benefit of Third Parties: In Defence of the Third Party Rule' (1997) 7 OJLS 643.

Critical of the privity reform.

- Stevens, R., 'The Contracts (Rights of Third Parties) Act 1999' (2004) 120 LQR 292.

Critical of the privity reform.

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