

*These notes refer to the Contracts (Rights of Third Parties) Act 1999 (c.31) which received Royal Assent on 11 November 1999*

# CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

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## EXPLANATORY NOTES

### INTRODUCTION

1. These explanatory notes relate to the Contracts (Rights of Third Parties) Act 1999 which received Royal Assent on 11 November 1999. They have been prepared by the Lord Chancellor's Department in order to assist the reader in understanding the Act. They do not form part of the Act and have not been endorsed by Parliament.
2. The notes need to be read in conjunction with the Act. They are not, and are not meant to be, a comprehensive description of the Act. So where a section or part of a section does not seem to require any explanation or comment, none is given.

### SUMMARY

3. The Act reforms the rule of "privity of contract" under which a person can only enforce a contract if he is a party to it. The rule means that, even if a contract is made with the purpose of conferring a benefit on someone who is not a party to it, that person (a "third party") has no right to sue for breach of contract.
4. The Act sets out the circumstances in which a third party is to have a right to enforce a term of the contract (section 1), the situations in which such a term may be varied or rescinded (section 2) and the defences available to the promisor when the third party seeks to enforce the term (section 3). It makes it clear that section 1 does not affect the promisee's rights, or any rights that the third party may have which are independent of the Act (sections 4 and 7(1)). The Act does not apply to certain contracts (whether wholly or partially) (section 6).

### BACKGROUND

5. The Act implements, with some amendments, the recommendations of the Law Commission in its Report on *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com No 242 (1996).

### COMMENTARY

#### ***Section 1: Right of third party to enforce contractual term***

6. *Section 1* gives effect to the central purpose of the Act. It sets out the circumstances in which a third party would have the right to enforce a term of the contract.
7. *Subsection (1)* sets out a two-limbed test for the circumstances in which a third party may enforce a term of a contract. The first limb is where the contract itself expressly so provides. The second limb is where the term purports to confer a benefit on the third party unless it appears on a true construction of the contract that the contracting parties did not intend him to have the right to enforce it (*subsection (2)*).

8. *Subsection (3)* requires that, for subsection (1) to apply, the third party must be expressly identified in the contract by name, class or description, but establishes that the third party need not be in existence when the contract is made. This allows contracting parties to confer enforceable rights on, for example, an unborn child or a future spouse or a company that has not yet been incorporated.
9. *Subsection (4)* clarifies subsection (1). The third party's right of enforcement is subject to the contract's terms and conditions. It is open to the parties to limit or place conditions on the third party's right; for example, if he wishes to enforce the right he is to do so by way of arbitration and not litigation.
10. *Subsection (5)* makes it clear that the courts may award all the remedies which are available to a person bringing a claim for breach of contract to a third party seeking to enforce his rights under subsection (1). The normal rules of law applicable to those remedies, including the rules relating to causation, remoteness and the duty to mitigate one's loss, apply to the third party's claim.
11. *Subsection (6)* makes it clear that the Act is to apply so as to enable a third party to take advantage of an exclusion or limitation clause in the contract, as well as to enforce "positive" rights. The Act, for example, allows a term of a contract which excludes or limits the promisee's liability to the promisor for the tort of negligence and expressly states that the exclusion or limitation is for the benefit of the promisee's "agents or servants or subcontractors" to be enforceable by these groups.

### ***Section 2: Variation and rescission of contract***

12. *Subsection (1)* provides that, where a third party has a right under section 1, the contracting parties may not, by agreement, rescind or vary the contract in a way which affects the third party's right without his consent. This section uses the term variation in its legal sense to mean a variation of the terms of an agreement by further agreement between the parties to the original agreement. It does not, for example, affect the terms of a construction contract which allow one of the parties to that contract unilaterally to alter, or "vary", the details of the work; such a variation is not to the contract but only to the work.
13. *Subsection (3)* provides that subsection (1) is subject to an express term of the contract, that the contract can by agreement be rescinded or varied without the third party's consent or that the third party's consent is to be required in specified circumstances different to those which are set out in subsection (1).
14. *Subsections (4) and (5)* give the court or arbitral tribunal the power to dispense with the requirement for the third party's consent where it cannot be obtained because his whereabouts are unknown or he is mentally incapable of giving his consent or where it cannot reasonably be ascertained whether he has in fact relied on the contractual term.

### ***Section 3: Defences etc. available to promisor***

15. *Section 3* enables the promisor, in a claim by the third party, to rely on any defence or set-off arising out of the contract and relevant to the term being enforced, which would have been available to him had the claim been by the promisee. He may also rely on any defence or set-off, or make any counterclaim, where this would have been possible had the third party been a party to the contract.
16. *Subsection (2)* can be illustrated as follows-
  - (1) a third party can no more enforce a void, discharged or unenforceable contract than a promisee could;
  - (2) P1 (the promisor) and P2 (the promisee) contract that P2 will sell goods to P1, who will pay the contract price to P3 (the third party). In breach of contract, P2 delivers goods that are not of the standard contracted for. In an action for the price

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by P3 (just as in an action for the price by P2) P1 is entitled to reduce or extinguish the price by reason of the damages for breach of contract.

17. *Subsection (3)* can be illustrated as follows-

P1 and P2 contract that P1 will pay P3 if P2 transfers his car to P1. P2 owes P1 money under a wholly unrelated contract. P1 and P2 agree to an express term in the contract which provides that P1 can raise against a claim by P3 any matter which would have given P1 a defence or set-off to a claim by P2.

18. *Subsection (4)* makes it clear that the promisor also has available any defence or set-off, and any counterclaim not arising from the contract, which is specific to the third party. It can be illustrated as follows.

(1) P1 contracts with P2 to pay P3 £1000. P3 already owes P1 £600. P1 has a set-off to P3's claim so that P1 is only bound to pay P3 £400.

(2) P3 induced P1 to enter into the contract with P2 by misrepresentation, but P2 has no actual or constructive notice of that misrepresentation. P1 may have a defence (or a counterclaim for damages) against P3 which would not have been available had the action been brought by P2.

19. *Subsection (5)* makes subsections (2) and (4) subject to any express term of the contract which narrows the defences or set-offs available under section 3(2) or narrows the defences, set-offs or counterclaims available under section 3(4). For example-

(1) in relation to subsection (2), P2 agrees with P1 to purchase a painting, the painting to be delivered to P3, who is expressly given a right to enforce the delivery obligation. P2 owes P1 considerable sums for other art works purchased. P2 wishes to ensure that P3's right is not affected. P1 and P2 expressly agree that P1 may not raise against P3 defences and set-offs that would have been available to P1 in an action by P2.

(2) in relation to subsection (4), P1 agrees with P2 to pay £5000 to P3 if P2 will transfer a number of cases of wine to P1. P3 is in dispute with P1 over a prior contract and P1 alleges that P3 owes P1 money. P2 is concerned that P1 may seek to withhold part of the £5000 payable to P3 by raising a set-off or counterclaim against P3 in relation to the prior contract. Consequently P1 and P2 include an express term that P1 may raise no defences, set-offs or counterclaims of any nature whatever against a claim by P3 to enforce P1's obligation to pay the £5000.

20. *Subsection (6)* ensures that an analogous approach to that set out in subsections (2) to (5) applies where the proceedings are brought against the third party and he seeks to avail himself of, for example, an exclusion section.

#### ***Section 4: Enforcement of Contract by Promisee***

21. *Section 4* provides that the right conferred by section 1 is additional to any right the promisee has in relation to the enforcement of a contract term which benefits a third party.

#### ***Section 5: Protection of Promisor from Double Liability***

22. *Section 5* provides that where the promisee has recovered damages (or an agreed sum) from the promisor in respect of either the third party's loss or the promisee's expense in making good that loss, the court or arbitral tribunal shall reduce any award to the third party enforcing a term under section 1 to take account of the sum already recovered.

#### ***Section 6: Exceptions***

23. *Subsection (1)* ensures that the Act does not undermine the existing law on who can enforce negotiable instruments.

24. *Subsection (2)* excepts the contract under section 14(1) of the Companies Act 1985 which states-

"Subject to the provisions of this Act, the memorandum and articles, when registered, bind the company and its members to the same extent as if they respectively had been signed and sealed by each member, and contained covenants on the part of each member to observe all the provisions of the memorandum and of the articles".

25. *Subsection (3)*, which prevents a third party (for example, a customer of an employer) acquiring a right under the Act to enforce a term of a contract of employment, or similar contract, against an employee or worker uses various expressions which are defined in the National Minimum Wage Act 1998 or are defined by reference to that Act. The definitions, which are referred to in *subsection (4)*, are as follows.

- (1) By section 54-

"*contract of employment*" means a contract of service or apprenticeship, whether express or implied, and (if it is express) whether oral or in writing;

"*employee*" means an individual who has entered into or works under (or, where the employment has ceased, worked under) a contract of employment;

"*worker*" (except in the phrase "*agency worker*" or "*home worker*") means an individual who has entered into or works under (or, where the employment has ceased, worked under)-

- (a) a *contract of employment*, or

- (b) any other contract, whether express or implied and (if it is express) whether oral or in writing, whereby the individual undertakes to do or perform personally any work or services for another party to the contract whose status is not by virtue of the contract that of a client or customer of any profession or business undertaking carried on by the individual;

"*worker's contract*" is to be read in accordance with the definition of a worker.

- (2) By section 35(2)-

an individual is a "*home worker*" if he contracts with a person for the purpose of that person's business, for the execution of work to be done in a place not under the control or management of that person.

- (3) By section 34(1)-

an individual is an "*agency worker*" if he-

- (a) is supplied by a person ("the agent") to do work for another ("the principal") under a contract or other arrangements made between the agent and the principal; but

- (b) is not, as respects that work, a worker, because of the absence of a worker's contract between the person and the agent or the principal; and

- (c) is not a party to a contract under which he undertakes to do the work for another party to the contract whose status is, by virtue of the contract, that of a client or customer of any profession or business undertaking carried on by the individual.

- ((IV) As to the definition of "*relevant contract*", the reference to the case where section 34 applies is to the circumstances in which, under subsection (1) of that section, an individual is an agency worker. The work falling within paragraph (a)

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of that subsection is the work which the agency worker is supplied to do for the principal.

26. *Subsection (5)*, which excludes certain contracts relating to the carriage of goods, nevertheless does not prevent a third party from taking advantage of a term excluding or limiting liability. In particular, this enables clauses which seek to extend an exclusion or limitation of liability of a carrier of goods by sea to servants, agents and independent contractors engaged in the loading and unloading process, to be enforced by those servants, agents or independent contractors (so called "Himalaya" clauses).

27. *Subsections (6) and (7)* set out the definition of a "contract for the carriage of goods by sea". The purpose of this definition is to exclude from this Act not only those contracts already covered by the Carriage of Goods by Sea Act 1992 but also those to which the 1992 Act could be applied under section 1(5) of that Act (e.g. a contract for the carriage of goods by sea evidenced by an electronic Act of lading). Section 1(5) of the 1992 Act states-

"The Secretary of State may by regulations make provision for the application of this Act to cases where a telecommunication system or any other information technology is used for effecting transactions corresponding to -

- (a) the issue of a document to which this Act applies;
- (b) the indorsement, delivery or other transfer of such a document; or
- (c) the doing of anything else in relation to such a document."

No such regulations have yet been made.

### ***Section 7: Supplementary provisions relating to third party***

28. *Subsection (1)* ensures that the Act does not affect any existing right or remedy of the third party and allows for the judicial development of a third party's rights.

29. *Subsection (2)* prevents a third party from invoking section 2(2) of the Unfair Contract Terms Act 1977 to contest the validity of a term excluding or limiting the promisor's liability under the Act to the third party for negligently caused loss or damage (other than personal injury or death). Section 2(2) of the 1977 Act (in which "other loss or damage" means loss or damage other than death or personal injury), states-

"In the case of other loss or damage, a person cannot so exclude or restrict his liability for negligence except in so far as the term or notice satisfies the requirement of reasonableness".

30. *Subsection (3)*, which applies the standard limitation periods for actions for breach of contract to actions by third parties under the Act, refers to sections 5 and 8(1) of the Limitation Act 1980. Section 5 states-

"An action founded on simple contract shall not be brought after the expiration of six years from the date on which the cause of action accrued".

*Section 8(1)* states-

"An action upon a specialty shall not be brought after the expiration of twelve years from the date on which the cause of action accrued".

31. *Subsection (4)* ensures that those references in the Act to the position "if the third party had been a party to the contract" are not to be interpreted as meaning that the third party should be treated as a party to the contract for the purposes of any other enactment. One example is section 3 of the Unfair Contract Terms Act 1977 which applies "as between contracting parties where one of them deals as a consumer or on the other's written standard terms of business". This subsection makes it clear that nothing in sections 1(5)

or 3(4) or 3(6) means that “contracting parties” in section 3 of the 1977 Act includes a third party with a right under section 1 of this Act.

32. Nothing in subsection (4), nor anything in paragraphs 13.1-13.8 of the Law Commission’s Report (*Privity of Contract: Contracts for the Benefits of Third Parties*, Law Com. Report No. 242), is intended to have any bearing on the interpretation of Article 17 of the Brussels Convention (on jurisdiction agreements). This is given effect to in the United Kingdom by the Civil Jurisdiction and Judgments Act 1982. The question of whether a third party given a procedural right to enforce a jurisdiction agreement under section 1 of this Act falls within Article 17, or whether a third party with a substantive right under section 1, subject to a jurisdiction clause, is “bound” by that clause under Article 17 (applying a conditional benefit analysis) is a matter for the European Court of Justice. Relevant decisions of the ECJ include *Gerling v il Tesoro* [1983] ECR 2503 and *Tilly Russ* [1984] ECR 2417.

### **Section 8: Arbitration provisions**

33. *Section 8* ensures that, where appropriate, the provisions of the Arbitration Act 1996 apply in relation to third party rights under this Act. Without this section, the main provisions of the Arbitration Act 1996 would not apply because a third party is not a party to the arbitration agreement between the promisor and the promisee.
34. *Subsection (1)* deals with what is likely to be the most common situation. The third party’s substantive right (for example, to payment by the promisor) is conferred subject to disputes being referred to arbitration (see section 1(4)). This section is based on a “conditional benefit” approach. It ensures that a third party who wishes to take action to enforce his substantive right is not only able to enforce effectively his right to arbitrate, but is also “bound” to enforce his right by arbitration (so that, for example, a stay of proceedings can be ordered against him under section 9 of the Arbitration Act 1996). This approach is analogous to that applied to assignees who may be prevented from unconscionably taking a substantive benefit free of its procedural burden (see, for example, *DVA v Voest Alpine, The Jaybola* [1997] 2 Lloyd’s Rep 279). “Disputes . . . relating to the enforcement of the substantive term by the third party” is intended to have a wide ambit and to include disputes between the third party (who wishes to enforce the term) and the promisor as to the validity, interpretation, existence or performance of the term; the third party’s entitlement to enforce the term; the jurisdiction of the arbitral tribunal; or the recognition and enforcement of an arbitration award. But to avoid imposing a “pure” burden on the third party, it does not cover, for example, a separate dispute in relation to a tort claim by the promisor against the third party for damages.
35. *Subsection (2)* is likely to be of rarer application. It deals with situations where the third party is given a right to arbitrate under section 1 but the “conditional benefit” approach underpinning subsection (1) is inapplicable. For example, where the contracting parties give the third party a unilateral right to arbitrate or a right to arbitrate a dispute other than one concerning a right conferred on the third party under section (1). To avoid imposing a pure burden on the third party (in a situation where, for example, the contracting parties give the third party a right to arbitrate a tort claim made by the promisor against the third party) the subsection requires the third party to have chosen to exercise the right. The timing point at the end of the subsection is designed to ensure that a third party who chooses to exercise his right to go to arbitration by, for example, applying for a stay of proceedings under section 9 of the Arbitration Act 1996, can do so. Under section 9 of the Arbitration Act 1996, the right to apply for a stay of proceedings can only be exercised by someone who is already a party to the arbitration agreement.

### **Section 9: Northern Ireland**

36. *Section 9* modifies the Act in its application to Northern Ireland and makes consequential repeals in existing Northern Ireland legislation.

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37. *Subsection (2)* modifies section 6(2) so that, in Northern Ireland, it has effect with a reference to the Northern Ireland equivalent of section 14 of the Companies Act 1985. This is Article 25(1) of the Companies (Northern Ireland) Order 1986, which states-  
““Subject to the provisions of this Order, the memorandum and articles, when registered, bind the company and its members to the same extent as if they respectively had been signed and sealed by each member, and contained covenants on the part of each member to observe all the provisions of the memorandum and of the articles.”
38. *Subsection (3)* modifies section 7 so that, in Northern Ireland, subsection (3) refers in appropriate terms to the Northern Ireland equivalents of sections 5 and 8 of the Limitation Act 1980. These are Articles 4(a) and 15 of the Limitation (Northern Ireland) Order 1989. Article 4(a) provides that an action founded on simple contract may not be brought after the expiration of six years from the date on which the cause of action accrued. Article 15 provides that an action upon an instrument under seal may not be brought after the expiration of 12 years from the date on which the cause of action accrued.
39. *Subsection (4)* repeals section 5 of the Law Reform (Husband and Wife) (Northern Ireland) Act 1964. This section modifies the rule of privity of contract in respect of contracts which are expressed to be for the benefit of, or expressly purport to confer a right on, the spouse or child of one of the contracting parties. As this Act makes comprehensive provision for third party beneficiaries under a contract, there is no longer any need for this provision. Subsection (4) also makes repeals in section 6 of the Law Reform (Husband and Wife) (Northern Ireland) Act 1964 Act which are consequential on the repeal of section 5 of that Act.

#### **APPLICATION TO THE CROWN**

40. This Act does not impose any obligation or restraint on the Crown. It is simply an enabling measure which allows the parties to a contract, including the Crown, to confer enforceable rights on third parties. The Crown Proceedings Act 1947 enables proceedings in contract to be brought against the Crown, whether they are brought by the promisee or a third party.

#### **COMMENCEMENT**

41. The Act is to come into force on Royal Assent (section 10). It will only apply to contracts which are entered into during the six month period after Royal Assent if the contract expressly provides for it to do so. Where there is no such express provision it will not apply to contracts entered into before the end of that six month period.

#### **HANSARD REFERENCES**

42. The following table sets out the dates and Hansard references for each stage of this Act's passage through Parliament.

<i>Stage</i>	<i>Date</i>	<i>Hansard Reference</i>
<b>House of Lords</b>		
Introduction	3 December 1998	Vol. 595 Col. 605
Second Reading	11 January 1999	Vol. 596 Cols. 20-33
Committee	2 February 1999	Vol. 596 Cols. 1423-35
Report	27 May 1999	Vol. 601 Cols. 1046-1061
Third Reading	14 June 1999	Vol. 602 Cols. 11-14
<b>House of Commons</b>		

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<b>Stage</b>	<b>Date</b>	<b>Hansard Reference</b>
Introduction	14 June 1999	–
Second Reading Committee	29 June 1999	Second Reading Committee Hansard
Second Reading (formal)	5 July 1999	Vol. 334 Col. 791
Committee (SCF)	15 July 1999	Standing Committee D Hansard
Report/Third Reading	1 November 1999	Vol. 337 Cols. 23-30
<b>House of Lords</b>		
Consideration of Commons Amendments	10 November 1999	Vol. 606 Cols. 1361-1366
<b>Royal Assent – 11 November 1999</b>	House of Lords	Hansard Vol. 606 Col 1469
	House of Commons	Hansard Vol. 337 Col 1306