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# THE PRIVITY RULE UNDER THE ENGLISH LAW AND THE CONTRACT ACT 1872

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The word "privity" means the "connection or relationship between two parties, each having a legally recognized interest in the same subject matter (such as a transaction, proceeding, or piece of property)".[1] The doctrine of privity of contract is based on the general principle that no one but the parties to a contract can be entitled to benefit under it, or bound by it. Party to the contract means, there is one party to whom a promise is made (who is called promisee) and in return the person to whom such promise is made is giving or passing some consideration. A promisee who is expecting some benefit and if in return is not passing any consideration (either pecuniary or otherwise), can not enforce the promise. Similarly, a beneficiary who is not the promisee and provides no consideration can not bring any action on that promise to be enforced. Thus, a contract cannot bestow rights or entail obligations arising under it on any person except the parties to it. No one but the parties to a contract can be entitled to have any benefit under it, or bound by it. This principle is known as that of privity of contract or privity rule. The doctrine of privity may involve any (or more) of the four questions:[2]

(i) Can a person who is not a party to the contract enforce it?

(ii) Can a person set up a defense based on the terms of a contract to which he is not a party in order to answer a claim brought by a person who is a party to the relevant contract?

(iii) Can a contracting party set up a defense based on the terms of his own contract in order to answer a claim brought by a person who is not a party to the relevant contract?

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1. Black's Law Dictionary, Seventh Edition p. 1217.
2. Adams & Bronsword (1993) 56 MLR 722

(iv) Can a contracting party enforce his own contract against a person who is not a party to the relevant contract?

**1. The Doctrine under the English Law**

This principle of privity, essentially based on common law, had its roots in the legal principles of the 16th century and had developed onwards, not coherently or gradually but as necessity of time and custom demanded. The basic rule of the English common law was that a person who is not a party to a contract can neither sue on nor rely on defenses based on that contract. The rule was a relative late comer to the English law and was not clearly established until the middle of the nineteenth century. The development of the rule of privity of contract was linked with that of the doctrine of consideration and early cases used both aspects of reasoning. There were some situations however where the traditional rule that a person who is not a party to a contract can not bring any action to that contract, did not apply, e. g. collateral contracts, joint promisee, multi-parties agreements, companies etc. Furthermore there were several solutions where the rule preventing a third party from suing did not apply particularly those based on statute where the third party rule was simply overridden. In others the third party claimant did not need to rely on the contract but was able to have recourse to other areas of the law and to rely on a property right, a possessory right, or was able to sue in tort. Alternatively, the third party may be able to establish a collateral contract with the promisor. Other exceptions to and circumvention of the rule may be seen in assignment, agency, transfer on death, bankruptcy, trust, covenants, tortuous duty of care to third party, remedies for promisee under the law of property Act 1925, commercial practice etc.

The early period of privity is divided into three periods: (i) "The formative period" (1500-1680), (ii) The Chancery Phase (1680-1800), (iii) The Modern Times (1861-1999). The formative period only deals with common law courts, which were more flexible about permitting a beneficiary action than at any subsequent time. During the chancery phase, beneficiaries could get relief easily because the modern components of the "party only" principle and the rule "the consideration must move from the promisee" were

not in existence or non-operative. The modern third art rule was conclusively established in 1861 in Tweddle v *Atkinson* [3] where Wightman J said that no stranger to the consideration can take advantage of a contract though made for his benefit. This principle was acknowledged in *Dunlop Pneumatic Tyre Co. Ltd v Selfridge & Co. Ltd.*[4] House of Lords here accepted this principle as fundamental principle of English Law that only a party to the contract who provides consideration can bring an action for breach. The basic rule of the English common law is that a person who is not a party to a contract can neither sue on nor rely on defenses based on the contract.[5]

The formative period exclusively deals with the common law and covers actions brought in assumpsit. Assumpsit was then in its infancy, and the common law courts were more flexible about permitting a beneficiary action then than at any subsequent time. There were basically four individual paths to privity for the beneficiary, and each of these will need to be treated in separate sections. The conditions under which relief could be granted were determined by the notions of interest, benefit, agency and consideration. The following are the different theoretical bases for the nature of decisions in the formative period.

**i) Interest Theory :** The interest theory was typically expressed in the statement, "he that hath interest in the promise shall have the action." In Ha*dves v Levit*[6] the bride's father promised the groom's father that he would pay £ 200 to the son after the marriage had taken place. On the basis of this promise the groom's father agreed to that marriage. After the marriage the bride's father failed to pay the money. As a result of the breach of promise the groom's father brought an action. But the claim was rejected by the court of Common Pleas. Richardson J stated that the action should have been "more properly" brought by the son, for he was the person "in

3. (1861) 1 B & S 393
4. (1915) AC 847 HL
5. *Scruttons v Midland Silicones* [1962] A.C. 446
6. 1632 Het. 176

whom the interest is".[7] It is interesting to note here that no question was raised about the groom not being a party. A more exact precedent for the court's view may be found in *Levelt v Hewes*[8] where a father brought assumpsit upon a promise made directly to him that marriage money would be paid to his son. The Court was of opinion that the action ought to have been brought by the son, "for the promise is made to the son's use and the ordinary covenants of marriage are with the father to stand seised to the son's use; and the use shall be changed and transferred to the son, as if it were a covenant with himself," and the damage of non-permitting the beneficiary's action was that non-performance of the promise caused an injury to his interest, and he should receive compensation. Under this theory, assumpsit functioned somewhat as a tort remedy for the beneficiary's damages. Vindication of this interest in the performance of the promise was additionally conceptualized as the enforcement of a "use" created by the promise.

**ii) The Benefit Theory :** The benefit theory asserted that, "the party to whom the benefit of a promise accrues may bring an action". Clearly the attitude of this period toward promises of gifts contracts with modern law which views contracts basically in terms of commercial exchange. In formative period there was little conflict between the doctrine of consideration and the idea of enforcing promises of gifts. The 16th and 17th century cases show that gifts, marriage contracts, family agreements etc. were enforceable in assempsit, even though these agreements would not be viewed by modern standards as part of the world of commerce.

**iii) The "Agency" Theory :** The word "agency" as a term of art, was to remain unknown to law as late as Blackstone. The essential characteristic of modern agency- the legal power to alter the principal's legal relations with third parties had been recognized long before, and therefore, the legal idea also played a role in the

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7. 1 Vent 6; The History of Privity-Vernon V Palmer
8. 1599 Cro. Eliz. 652

Formative Period. It is true that the early basis were extremely narrow. Agency was the exception, not the rule of contractual intercourse. When originally introduced, agency was simply a branch of master and servant, whereas today, master and servant is a branch of agency.[9]

**iv) The Consideration Theory :** The importance of consideration does not clearly emerge until one nears the end of this period and even then it emerges only within a specific line of cases. To illustrate in *Bourne V Mason* (1669),[10] the debtor A owed £ 100 to the creditor, and at the same time B owed debtor A £ 100. Instead of wasting motion, the two debtors then and there exchanged promises that their mutual debt will be discharged and satisfied upon debtor B 's payment of £ 100 directly to the creditor. The creditor sued to enforce B's promise to A. The creditor was refused because he had furnished no consideration.

During the 16th & 17th century, the beneficiary suing in assumpsit succeeded as in no other period. However, this period ended with the formation of a solid privity limitation based upon the consideration doctrine.

## 2. Development of the Third Party Rule

The modem third party rule was conclusively established in 1861 in Tweddle *v Atkinson.*[11] William Tweddle married the daughter of William Guy. Prior to the wedding William Guy entered into a verbal agreement with John Tweddle, William Tweddle's father, under which both promised to give their children marriage portions. After the wedding had taked place, they entered into a written agreement which was intended to give effect to the verbal promises under which William Guy agreed to pay Pound Sterling 200 to William Tweddle and John Tweddle agreed to pay him Pound Sterling 100. The agreement contained the following sentence –"it is hereby further agreed by the aforesaid William

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9. Floyd R Mechem, A Treatise on the Law of Agency (Callaghan and Co., Chicago, 1914), 2d ed., v. I, pp. 1210, 1211
10. 1 Vent 6; The History of Privity – Vernon V Palmer
11. Ibid 2

Guy and the said John Tweddle that the said William Tweddle has full power to sue the said parties in any court of law or equity for the aforesaid sums hereby promised and specified". William Guy failed to pay the promised amount and so William Tweddle brought an action against the executor of William Guy's estate for the sum of Pound Sterling 200. His claim failed either because he didn't pay any consideration to William Guy, or alternatively he was not party to the contract. Therefore he could not enforce any benefit under a contract to which he was a 'stranger'. In this decision the focus was more on the rule of consideration although both the points were discussed.

In Drive *Yourself Hire Co. (London) Ltd. v Strvtt*[12] Denning LJ stated that a fundamental principle of our law is that only a person who is a party to a contract can sue on it. I wish to assert, as distinctly as I can, that the common law in its original setting knew no such principle. Indeed it said the quite contrary. For the 2000 years before 1861 it was settled law that, if a promise in a simple contract was made expressly for the benefit of a third person in such circumstances that it was intended to be enforceable by him, then the common law would enforce the promise at his instance, although he was not party to the contract." and Lord Denning cited several cases to support this view. In *Dutton v Poole*[13] a son promised his father that he will pay £ 1000 to his sister, if he did not sell the wood. Father kept his promise but son did not pay. The court held that sister could sue because the right has extended to her on the ground of the tie of blood between them.

In Dunlop *Tyre Co. Ltd v Selfridge & Co. Ltd.*[14] in 1911, Messrs Dew, motor accessory agents, agreed to buy a quantity of tyres and other goods from Dunlop (the appellants) who carried on business as motor tyre manufacturers. Dunlop agreed to give Dew certain discounts off their list price and Dew in return agreed not to sell Dunlop's goods to any person at less than the list prices. However,

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12. (1954) IQ8 250 at 274, (1953) All E R 1475 at 1483
13. (1678) 2 Lev 210; 83 ER 523
14. Ibid 3

it was also agreed that Dew could give genuine trade customers a limited discount off Dunlop's list prices if, as agents of Dunlop, Dew obtained from the trader a similar written undertaking that it would observe the list prices. On 2nd January 1912, the respondents, Selfridge, large store keepers who sold tyres by retail to the public, ordered Dunlop Tyres from Dew. Dew agreed to give Selfridge certain discount off Dunlop's list prices and selfridge agreed not to sell any Dunlop Tyres to private customers at less than the list prices. Dunlop sued Selfridge for breach of this undertaking when Selfridge sold Dunlop Tyres to privat customers for less than the list prices. The trial judge gave judgment for Dunlop. The Court of Appeal reversed this decision on the ground that the agreement of 2nd January 1912 was not a contract between Dunlop and Selfridge but between Dew and Selfridge. The House of Lords dismissed Dunlop's appeal.

In *Scruttons v Midland Silicones*[15] the plaintiffs bought a drum of chemicals, which was shipped to consignors in New York on a vessel owned by the United States Line. The bill of lading contained a clause limiting the liability of the ship owners. The defendants were stevedores who had contracted with the U.S Line to act for them in London. Under the contract between the defendants and the U.S. Lines, the defendants were to have the benefit of the clause in the bill of lading (the Defandant's were not parties to the bill of lading). The Plaintiffs were not aware of the existence of the contract between the Dfendant's and the U. S. Lines. As a result of the Defendant's negligence they were sued and the Defendant's pleaded the clause limiting liability in the bill of lading. It was held that the defendants were not protected by the clause since they were not parties to the contract in which it was contained. If stevedore would be able to show that he is a party to the contract and paid some consideration then he might be able to rely on the clause in the bill of lading, which limits the liability of the carrier- which principle brought about the insertion of a series

15. (1962) A.C. 446, (1962) 1 All ER 1

of "Himalaya" clauses[16] in later contracts to expressly protect such people.

## 3. Privity and consideration

The debate between the doctrine of consideration and privity may be a non-ending one. There are many questions which is related to the nature of privity and what relation it has to consideration. Is privity a different doctrine from the requirement of consideration or does the consideration doctrine contain the essence of the privity limitation? On this point Furmston's view[17] is that "There is no difference between the doctrine of privity of contract and the rule that consideration must move from the promisee". He is able to state categorically that. "The two rules are identical". Chitty on contracts furnishes an example: 'A man might promise his daughter to pay £1,000 to any man who married her. A person who married the daughter with knowledge of and in reliance on such a promise might provide consideration for it, but could not sue on it as it was

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16. A Himalaya clause is a clause in the principal contractor's conditions (such as the bill of lading) that gives subcontractors certain contractual benefits – particularly in relation to the exclusion or limitation of liability – which they would not otherwise enjoy. This clause was first considered in the case of *Adler v Dickson (The Himalaya)* (1955), hence the name.

    Himalaya clauses are now upheld in most major jurisdictions. However, to be effective, they must satisfy the four conditions laid down in the English House of Lords decision in *Midland Silicones Ltd v Scrutton (ibid)*:

    (1) the bill of lading must make it clear that the stevedore or terminal operator is intended to have the protection of the exclusion or limitation provisions contained in the bill;

    (2) the bill must make it clear that, in addition to contracting on its own behalf, the carrier is contracting as agent for the stevedore or terminal operator when ensuring that the exclusion or limitation provisions also apply to the stevedore or terminal operator;

    (3) the carrier must have authority from the stevedore or terminal operator to act on their behalf in this way; and

    (4) any difficulties about the stevedore or terminal operator providing legal consideration for such protection need to be overcome.

17. M. P. Furmston, Return to Dunlop V Selfridge, 23 MOD, L. REV, 373, 382-83 (1960)

not addressed to him." That is to say, he (the groom) was not a party to the contract. A person can be party to an agreement, but not provide consideration. If at the request of A, B promises C that he (B) will pay A £ 50 if C will dig his garden, A can be said in one sense to be 'party' to the agreement, but he does not provide consideration. A will not be able to enforce the contract. However, in White *V Jones* [18] and *London Drugs Ltd. v Kuchene & Najel International Ltd.*[19] Supreme Court of Canada clearly distinguished the two doctrines and the balance of authority supports the existence of two distinct rules of consideration and privity. The two rules reflect two logically separate issues of polices. The first, primarily associated with the privity doctrine, relates to who can enforce a contract. The second, primarily associated with consideration, concerns the types of promises that can be enforced. There are two position in the relation of privity and consideration: (1) monist position, (2) dualist position. According to the monist position the two rules are basically equivalent, but this requires the monist to read the consideration rule as if it said "consideration must move from the promisee and plaintiff must be the promisee". To illustrate, in a typical life insurance contract, the parties only rule would conclusively block the third party beneficiaries action on the policy simply because he was a non-party. The consideration rule, however, would not have the effect by its literal terms because consideration (a promise or a premium payment) would have been provided by the promisee (the insured party) to the insurance company. The beneficiary is barred only if the rule is enlarged to say and plaintiff must be the promisee. The dualist position, on the other hand, recognizes that the consideration rule does not literally bar the beneficiary's action if the promisee has given consideration, and that the promisee will have done this in the usual case. Thus Pollock wrote, "It is laid down in the books that consideration must move from the promisee, and it is sometimes supposed that infringement of this rule is the basis of the objection to allowing an action upon a promise made for his benefit. This

18. [1995] 2 AC 207 at p 262-3
19. [1992] 3 SCR 299 at p 417

is not the case. In case of such promises the beneficiary who seeks to maintain an action on the promise is not the "promisee".[20] It is perhaps due to the tacit acceptance, generally, of the "dualist approach" that special situations had been singled out by the courts where privity would be circumvented and alleged not even to be in issue, and exceptions identified where privity rules apply but were overridden by other policy considerations either in common law or by statute. Such varied policy consideration explain the lack of organized and coherent development of the law on privity.

## 4. Developed special situations

There are some situations which used to fall outside the privity rule. There were certain situations where the traditional approach of privity to the right and liabilities which are subject to a contract to assert that they can vest only in a party to the contract, would not apply. These circumstances did not properly fall in the 'exceptions' to the rule because the question of privity was thought to be not in issue if the situation existed some of these are discussed below:

### *4.1 Collateral contracts*

The word 'collateral' means something that stands side by side with the main contract springing out of it and fortifying it. In Shanklin *Pier V Detel Products*[21] the plaintiffs nominated contractors to paint a pier, subject to that the contractors will buy the paint made by defendants. The Defendant's gave a guarantee that the paint would last for seven years; but it only lasted for three months. The court held that the plaintiff could sue the defendants on the basis of a collateral contract because they provided a consideration by instructing the contractors to buy the paints from the defendants. Hence the presence of consideration created a collateral contract so the rule on privity was circumvented. But

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20. Sir Freaderick Pollock. Principles of Contract at law and in Equity, 3rd Amer, ed. By Williston (106)

21. [1951] 2 KB 854

Ch*arnok v Liverpool Corp*[22] raises some doubt as to the presence of consideration. Here the plaintiff's car was damaged. The insurance company had a contract with a garage (the defendant) for repairing the plaintiff's car. The court held that there was no existence of collateral contract between the plaintiff and the defendant to do the repair job within a reasonable time but the court found that the consideration was the leaving of the car at the garage. This was not, of course, a detriment to the plaintiff but it was a benefit to the garage. To look from a different view a collateral contract is that which arises between the seller of goods and a bank when buyer opens an irrevocable letter of credit in favor of the seller. When the buyer 'opens' the letter of credit, it means that a contract has been formed between the buyer of the goods and the bank where in the bank undertakes to pay the seller. Once the bank informs the seller, it seems that there is a collateral contract. But where is the consideration? It can be described in two ways. First, when the bank made a unilateral offer to seller, and the seller and buyer has accepted the offer by performance of the contract. Secondly the seller provided consideration by forbearing to sue the buyer of the price.

### *4.2 Joint Promises*

If a joint promise is made by A and B but the consideration was only provided by A, can it be said that the consideration has been given by both the parties? We can discuss the issue in the light of a Culls v *Bagots Executor and Trustee Co. Ltd*[23] where the husband granted the quarrying to his land to his company in return to pay royalties to himself and his wife and to the sole survivor when one of them died. The written agreement was signed by the company and by the husband and wife. After the husband's death the question arose whether the wife was entitled to the payment? The court was divided upon the construction of the agreement. Three judges held that the clause authorizing the company to pay his wife was merely a revocable mandate which had been revoked

22. [1968] 1WLR 1498
23. 1967 ALR 385

by his death. But judges interpreted that the wife was a party to agreement and therefore, even though she didn't pay any consideration personally, she was able to receive the payment. This is another example of the tacit acceptance of the dualist approach.

The question raised in this case is: what should be the precise rights of enforcement of the joint promisee, who has not provided consideration? Should such a joint promisee be regarded as a third party to a contract? Firstly: it is arguable that a joint promisee should have a more secure entitlement to sue than (other) third parties on the basis that the promise was directly addressed, or given to him; Secondly: the promisee is a joint promisee and is therefore closely connected with the other joint promisee vis-a-vis the promise.

### *4.3 Multi-parties agreements*

Clubs and incorporated associations where a person joins a club or other incorporated associations, he may contract with all the other members, even though he may not know any of them.

### *4.4 Companies*

The position is similar where a person becomes a member of an incorporated body. The Company Act 1985 Sec. 14 provides that, the Memorandum and Articles of a company bind the company and its members as though signed and sealed by each member, and amount to a covenant between each member and every other member. It therefore appears that were consideration was provided, the very notion of the rule of privity was avoided by creation of the doctrine of collateral contracts and where consideration was missing, but a person was a party to a contract, naturally no question of privity was raised. It remains to be seen, however, how exceptions to the rule, then, could be created.

## 5. Exceptions and circumventions

Now we will discuss certain situations where third party rule was thought not to apply at all. Usually third party did not need to rely on contract but was able to have resource to other areas of law and to rely on a property right, a possessory right, or was based on the

law of tort. Other exceptions could be seen in assignment, agency, transfer on death, and bankruptcy.

### *5.1 Agency*

The concept of agency is an exception to the doctrine of privity in that an agent may contract on behalf of his principal with a third party and form a binding contract between the principal and third party. For example, a third party may be able to take the benefit of an exclusion clause by proving that the party imposing the clause was acting as the agent of the third party, thereby bringing the third party into a direct contractual relationship with the plaintiff. In Scruttons L*td v Midland Silicones Ltd.*, [24] a bill of lading limited the liability of a shipping company to $500 per package. The defendant stevedores had contracted with the shipping company to unload the plaintiff's goods on the basis that they were to be covered by the exclusion clause in the bill of lading. The plaintiffs were ignorant of the contract between the shipping company and the stevedores. Owing to the stevedores negligence, the cargo was damaged and, when sued, they pleaded the limitation clause in the bill of lading. The House of Lords held that the stevedores could not rely on the clause as there was no privity of contract between the plaintiffs and defendants. Lord Reid suggested that the stevedores could be brought into a contractual relationship with the owner of the goods through the agency of the carrier provided certain conditions were met: (1) that the bill of lading makes it clear that the stevedore is intended to be protected by the exclusion clauses therein. (2) that the bill of lading makes it clear that the carrier is contracting as agent for the stevedore. (3) the carrier must have authority from the stevedore to act as agent, or perhaps, later ratification by the stevedore would suffice. (4) consideration must move from the stevedore. All of the above conditions were satisfied in *New Zealand Shipping v AM Satterthwaite (The Eurymedon).*[25]

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24. [1962] AC 446
25. [1975] AC 154

### 5.2 *Trusts*

Equity developed a general exception to the doctrine of privity by use of the concept of trust. A trust is an equitable obligation to hold property on behalf of another. Where A makes a promise to B for the benefit of C, the promise can be enforced by C against A if B has constituted himself trustee of A's promise for C. This equitable principle was first laid down by Lord Hardwicke in the eighteenth century in *Tomlinson v Gill.*[26] The device was approved by the House of Lords in *Les Affreteurs Reunis v Leopold Walford,*[27] where a broker (C) negotiated a charterparty by which the shipowner (A) promised the charterer (B) to pay the broker a commission. It was held that B was trustee of this promise for C, who could thus enforce it against A. However, the trust device has fallen into disuse because of the strict requirements of constituting a trust and most particularly that there should be a specific intention on the part of the person declaring the trust that it should be a trust.

### 5.3 *Restrictive Covenants*

Restrictive covenants may, if certain conditions are satisfied, run with the land and bind purchasers of it to observe the covenants for the benefit of adjoining owners. For example, in *Tulk v Moxhay,*[28] the plaintiff who owned several houses in Leicester Square sold the garden in the centre to Elms, who covenanted that he would keep the gardens and railings in their present condition and continue to allow individuals to use the gardens. The land was sold to the defendants who knew of the restriction contained in the contract between the plaintiff and Elms. The defendant announced that he was going to build on the land, and the plaintiff, who still owned several adjacent houses, sought an injunction to restrain him from doing so. It was held that the covenant would be enforced in equity against all subsequent purchasers with notice.

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26. (1756) Amb 330
27. [1919] AC 801
28. (1848) 2 Ph 774

This device was carried over into the law of contract by the Privy Council in *Lord Strathcona SS Co v Dominion Coal Co,*[29] but Diplock J refused to follow the decision in *Port Line Ltd v Ben Line Steamers.*[30] Recently, in *Law Debenture Trust Corp v Ural Caspian Oil Corp,*[31] it was emphasized that the principle permitted no more than the grant of a negative injunction to restrain the person acquiring the property from doing acts which would be inconsistent with the performance of the contract by his predecessor and had never been used to impose upon a purchaser a positive duty to perform the covenants of his predecessor.

### *5.4 Statutes*

Certain exceptions to the doctrine of privity have been created by statute, including price maintenance agreements; and certain contracts of insurance enforceable in favor of third parties. For example, under section 148(4) of the Road Traffic Act 1972, an injured party may recover compensation from an insurance company once he has obtained judgment against the insured person.

### *5.5 Remedies of the contracting party*

The question of the extent to which a contracting party may recover for loss sustained by a third party who is intended to benefit from the contract was raised in *Jackson v Horizon Holidays.*[32] In this case Julien Jackson booked a holiday for himself, his wife and his three year old sons at the Pegasus Reef Hotel, Sri Lanka, through Horizon Holidays Ltd., a travel company. Before making the booking Jackson set out his precise reqirements regarding accommodation, food, amenities and facilities in a letter to Horizon and was assured by Horizon that they would be met. The price payable was Pound Sterling 1432. Son afterwards Horizon informed Jackson that the Oegasus Reef Hotel would not

29. [1926] AC 108
30. [1958] 2 QB 146
31. [1993] 2 All ER 355
32. [1975] 1 WLR 1468

be ready in time and offered him accommodation at the Brown's Beach Hotel for Pound Sterling 1200. Jackson agreed after an assurance from Horizon that the Hotel would be upto his expectation. The accommodation, food, amenities and facilities at the Brown's Beach Hotel were unsatisfactory and the whole family suffered distress and inconvenience. Jackson brought an action against Horizon claiming damages for misrepresentation and breach of contract. Jackson recovered damages and the defendants appealed against the amount. Lord Denning MR thought the amount awarded was excessive compensation for the plaintiff himself, but he upheld the award on the ground that the plaintiff had made a contract for the benefit of himself and his family, and that he could recover for their loss as well as for his own.

However, in Woo*dar Investment Development v Wimpey Construction,*[33] the House of Lords rejected the basis on which Lord Denning had arrived at his decision, and reaffirmed the view that a contracting party cannot recover damages for the loss sustained by the third party. Their Lordships did not dissent from the actual decision in Jackson, which they felt could be supported either because the damages were awarded for the plaintiff's own loss; or because booking family holidays or ordering meals in restaurants calls for special treatment.

### *5.6 Assignment*

The idea of assignment of contractual rights represents an important limit on the doctrine of privity. A contractual party can transfer his rights to the third party in some situations, E.g. X (creditor) may assign his rights against Y (debtor) to Z (third party). In this case Z has got every right from X against Y. The consent from Y is not required here but a notice will be given to him. 1991, Law Commission Paper stated that, the practical importance of assignment is considerable; the whole industry of debt collection and credit factoring depends upon it. The identity of creditor is not matter to debtor. But court always takes care about the debtor in

33. [1980] 1 WLR 277

that the transaction must not lead the debtor to a disadvantageous position, and it must not be contrary to the public interest. E.g. right arising out of personal is not interest assignable. Suppose, A employs B to perform certain service, here it is unfair to permit A to assign his contractual rights to C. So an employer is entitled to transfer the benefit of his employers services to a third party. Considering those factors, it seems that the doctrine of privity is still retained, the willingness of law to allow the assignment of existing contractual rights to third party. The law appears very illogical sometimes when a party to a contract is not able to create rights for a third party at the time of contracting.

### *5.7 Tortious duty of care to third party*

Certain obligations between the contracting parties, lead to a tortious duty of care by one party towards a third party, for example an occupiers liability towards third party visitors imposed by Occupier's Liability Act 1957, section 3; Defective Premises Act 1972, sections 1 (1) (b) and 4. In case of professionals like surveyors and solicitors, Hedley Byrne *& Co, Ltd. v Heller & P Ltd.*[34] it was held that the professional persons will be liable in tort to third parties who have suffered loss by reason of the misrepresentation or defective performance of the contract.

### *5.8 Remedies of the promisee*

If the promisor fails to perform his promise, the remedies are available for promisee is subject to his or her willingness to enforce the contract for the benefit of third party. In Beswick *V Beswick*[35]- it was held that the widow would not be able to obtain her annuity if her husband appointed his nephew the executor of his estate instead of his widow. But the existence of the right of claim does not assure that the third party will be able to obtain the right, promised in the contract.

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34. [1964] A.C. 465
35. (1968) AC 58

In W*ooder Investment Development Ltd. v Wimpy Construction UK Ltd* [36], Defendant purchased land from Plaintiff for Pound Sterling 850,000. Defendant agreed to pay to third party Pound Sterling 150,000 on completion, but failed. Plaintiff claimed damages for breach and repudiation of the contract. House of Lords held that, there was no repudiation by the Defendant. But even if the Defendant, had repudiated the contract Plaintiff must have to show that he himself suffered loss or was agent or trustee for the third party to recover the damages for non-payment of the £150,000.

In *Jackson v Horizon Holidays Ltd.* [37] Lord Denning stated that if a contract was made for the benefit f third party and the promisor failed to perform the promise which caused sufferings to the third party then promise can recover the damages and give it to the third party. In this case Plaintiff booked a tour with Defendant (tour comp) for his wife and children. The standard of accommodation provided was below what they had stated, for which the family suffered discomfort, vexation, inconvenience, and distress. It was held that Plaintiff was able t recover £100 damages including £500 for P's mental distress.

### *5.9 Law of Property Act (LPA) 1925*

Section 56 LPA 1925 provides that 'A person may take an interest in land or other property or the benefits concerning land or other property although he may not be named a party to the conveyance or other instrument'. This statute put Lord Denning MR to believe that there is no existence of the doctrine of privity in law and that the only reason it was recognized was due to constant erroneous interpretations over the years. Lord Denning's interpretation was later rejected on the ground that section 56 of the LPA should be interpreted in its context.

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36. (1980) 1 WLR 277
37. (1975) 3 All E R 92

## *5.10 Commercial Practice*

### 5.10.1. Letters of Credit

Letter of credit is an exception to privity of contract. If the seller and buyers are in different countries, then letter of credit to finance the contract of sale of goods, particularly if any delay occurs in transaction are widely used and relied upon. The traditional doctrine of privity of contract would pose serious barrier to the smooth performance of such trade practices. Irrevocable latter of credit doesn't fit in common law. If the transaction is a simple contract between the buyer and banker, the seller becomes a third party to the contract and unable to sue if the banker revokes the letter of credit or paid ,to make payment for any reason. In Donald ***H Scott Ltd. v Barclays Bank Ltd.***[38] established that, the banker is under an absolute obligation to pay, despite of any dispute between the seller and the buyer. It has also been argued that the irrevocable letter of credit forms an exception to the doctrine of privity of contract; but it seems better to regard the promise of payment given by the banker to the seller as an autonomous undertaking, independent of any other contract. Thus the irrevocable letter of credit is not an exception to privity of contract but to the doctrine of consideration. It is either an irrevocable offer by the banker to the seller or a unilateral contract between the banker and the seller to pay on tender of the shipping documents.

### 5.10.2 Bill of exchange

Bill of exchange is a negotiable instrument which is transferable by delivery and gives to the transferee for value, who acts in good faith, ownership of or a security interest in, the instrument free from equities. Under the Bill of Exchange Act 1982, section 38 (i), the holder of a bill of exchange may sue on the bill of in his own name. If a bill of exchange is dishonored, the drawer, acceptor and endorsers are all liable to compensate the holder in due course.

### 5.10.3 Contract for carriage of goods by sea

In such a case a consignor may recover substantial damages even

38. [1923] 2 KB 1

where he has sold the goods and they are not at his risk provided it is not contemplated that the carrier would also be put into a direct contractual relationship with whomsoever might become the owner of the goods as is also the case with Bills for lading and Bills of Exchange which are both negotiable prima facie. Section 83 The Fire Prevention Act 1774, provides that if an insured property is destroyed by fire, the insured may be required upon the request of any person or persons interested to layout the insurance money for the reiteration of the building. This means, a tenant can claim under its landlord's insurance, and a landlord under its tenant's insurance.

With all such exceptions to the privity rule under the English law, it is not surprising that reform in the area became a necessity to avoid circumvention of the rule because the rule almost became a textbook issue only.

## 6. Privity under the Contract Act 1872

Under the Contract Act 1872 (hereinafter referred to as the Contract Act or the Act), similarly as in English law the third party cannot sue on the contract although the consideration for a contract may proceed from a third party. Under the Contract Act, the definition of consideration is wider than in English law which provides that "when at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise".[39] However, the common law principle is generally applicable in Bangladesh with the effect that only a party to the contract is entitled to enforce the same.[40] In Krishna *Lal Sadhu v Promila Bala Dasi* Rankin CJ stated that "Clause (d) of section 2 of the Contract Act widens the definition of 'consideration' so as to enable a party to a contract to enforce the

39. Section 2(d) of the Contract Act 1872.

40. Narayani Devi v Tagore Comnrercial Corporation Ltd. AIR 1973 Cal 401 at 405

same in India in certain cases in which the English law would regard the party as the recipient of a purely voluntary promise and would refuse to him a right of action on the ground of *nudum pactum*. Not only, however, is there nothing in s 2 to encourage the idea that contracts can be enforced by a person who is not a party to the contract but this notion is rigidly excluded by the definition of 'promisor' and 'promisee'."[41]

In *Deb Narain Dutt v Ram Sadhan Mandal* [42] the Calcutta High Court has held that the administration of justice was not to be hampered by *Tweddle v Atkinson*, and that "in India, we are free from these trammels and are guided in matters of procedure by the rules of justice, equity and 'good conscience'". The decision was later approved and followed in N *Devaraje Urs v M Ramakrishniah.*[43]

## 7. Relationship of the doctrine of privity and consideration

The English rule that a party wishing to enforce the contract must furnish or have furnished consideration is to be distinguished from the doctrine of privity. The rules of privity and consideration may not always coincide. The two rules reflect separate issues of policy. The rule of privity relates to who can enforce the contract, and the consideration issue is about the types of promises which can be enforced.[44]

Under the Contract Act, consideration may move from the promisee or any other person. In *Kepong Prospecting Ltd v Schimdt,*[45] the Privy Council considered the provisions of section 2(d) of the Malaya Contracts Ordinance (the same as in this Act) and held that the provision gave a wider interpretation to the definition of "consideration" than that which applied in England. Particularly in that it enabled consideration to move from another person than

41. AIR 1928 Cal 518, 32 CWN 634,114 IC 658
42. (1914) 41 Cal 137 per Jenkins CJ at 145.20 IC 630. AIR 1914 Call29
43. AIR 1952 Mys 109
44. Anson's Law of Contract. 27th edition p 409
45. [1968] AC 810, [1968] 2 WLR 55

the promisee, yet that did not affect the law relating to enforcement of contracts by third parties. On the contrary, paragraphs (a), (b), (c) and (e) of section 2 of the Contract Act supported the English conception of a contract as an agreement on which only the parties to it could sue.

The doctrine of privity has two aspects. The first aspect is that no one out the parties to the contract is entitled under it. Contracting parties may confer rights or benefits upon a third parry in the form of promise to pay, or to perform a service, or a promise not to sue (at all or in circumstances covered by an exclusion or limitation clause). But the third party on whom such right or benefit is conferred by contract can neither sue under it nor can rely on defenses based on the contract.

The second aspect of the doctrine is that parties to a contract cannot impose liabilities on a third party. A person cannot be subject to the burden of a contract of which he is not a party. It is the counterpart of rule proposition that a Third party cannot acquire rights under a conrract.[46] This rule, for example, also bars a person from being bound by an exemption clause contained in a contract to which it is not a party, so that a contract between A and B cannot impose a liability upon C. For example it was held that owner of a building not privity to contract between the tenant and the Electricity Board.[47]

## 8. Application of the doctrine of privity

As stated earlier the general rule is that only the persons entitled to the benefits or bound by the obligations of a contract are entitled to sue or be sued upon it. Except in the case of a beneficiary under a trust created by a contract or in the case of a family arrangement, no right may be enforced by a person who is not a party to the contract. This is so even where it is clear from the contract that some provision in it was included to benefit such third party. Therefore, if A for good consideration agrees with B that he will

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46. Shiv Dayal v Union of India (1963)2 Punj 463, AIR 1963 Punj 538

47. Fatehchand Murlidhar v Maharashtra State Electricity Board AIR 1985 Born 71 at 74

not sue C for C's negligence, the latter will not be able to use the promise of A to B as defense. There is no difference in principle between A promising B to pay C and A promising B that he will not claim that which C ought to pay A.

In MC *Chacko v State bank of Travancore*[48] the appellant was the Managing Director of the Highland Bank. K the father of the appellant, had guaranteed amounts due by the Highland Bank to the Kottayam Bank for an overdraft arrangement between the two banks. K had executed a deed making the appellant and other members of the family as universal donees of his properties. This deed contained a clause stating that "I have no debts whatsoever. If in pursuance of the letter given by me to the Kottayam Bank at the request of my eldest son, Chacko, for the purpose of Highland Bank Ltd., Kottayam, of which he is the Managing Director, any amount is due and payable to the Kottayam Bank, that amount is to be paid to from the Highland Bank by my son, Chacko. If the same is not so done and any amount becomes payable (by me) as per my letter, for that my eldest son Chacko and the properties in Schedule A will be answerable for that amount." K's guarantee was barred by limitation. The Kottayam Bank sued the Highland Bank and the appellant and other family members. The claim against the appellant rested upon the fact that he was one of the donees under the deed, which, it was claimed, created a charge on the properties mentioned. The Supreme Court of India held that the deed was an arrangement binding between the members of the family for satisfaction of the debt, if any, under the guarantee. The covenant that K would either personally or out of the properties given to him satisfy the debt, was intended to confer an indemnity upon the appellant and others. It did not create a charge in favor of the bank. According to the principle that a stranger could not sue under a contract, the Kottayam Bank could not recover under the deed.

Where a person transfers property to another and requires for the payment by the purchaser to a third person, a suit by such person

48. AIR 1970 SC 504

to enforce the stipulation will not lie. Similarly third party creditor of mortgagor cannot enforce an agreement under which the mongagee agreed with the mortgagor to pay part of amount to such creditor.[49] A stranger providing legal advise to the arbitrator, and hence indirectly to the parties to an arbitration agreement, could not sue for the benefit conferred upon him by the award,[50] nor could a company sue upon a contract entered into by the managing director of the company on his own behalf and on behalf of his friends, relatives and other directors. It was held that the zamindar, not being a party to the lease, was not entitled to sue the lessee under the terms of the lease where a lease contained a stipulation that the lessee would pay to the zamindar those zamindari dues which were payable by the lessor to the zamindar.[51] By a resolution, the owners of certain villages were given full rights over the forests in those villages under their *vahivat*. Some of these villagers executed contracts in favor of the plaintiffs. The government after merger of the states cancelled the resolutions. In an action for injunctions against the government, it was held that the plaintiffs could not enforce the agreement as they were not parties thereto.[52]

A contract between A and the government authorized the latter to take possession of all tools, plants, machinery, stores and materials in or upon the works in certain eventualities of breach of contract. It could not, it was held, jeopardize the property of B who had entered into a partnership with A with the knowledge of government and did not impose a liability on him. In *State of Bihar v Charanjit Lal* an agreement between the government and forest officers appointed for the forests of a *raj* was not enforceable against the *raj* "after the government gives up its administration of the forests, because there is no privity of contract.[53] A issued an advertisement

49. A R Iswaran Pillai v Sonnivevaru V Tharagran (1913) 38 Mad 753, AIR 1914 Mad 701
50. Tarachand Khimandas v Syed Abdul Razak Shah AIR 1939 Sind 125
51. Mangal Sen v Muahammad Hussain (1915) 37 All 115
52. State of Gujarat , Vora Fiddali AIR 1964 SC 1043 at 1076
53. AIR 1960 Pat 139

for a circus run by B, the proposal for which was approved by C, B's financier. A's suit against C for recovery of the dues for services rendered was dismissed for want or privity.[54] In *Gujarat Bottling Co Ltd v Coca Cola Co*[55] it was held that a clause in a franchisee agreement between the two companies by which company G agreed not to sell, assign, transfer, pledge, mortgage, lease or license or in any other way encumber or dispose off in whole or part, the agreement or any interest therein, either directly or indirectly, nor to pass by operation of law or in any other manner without the consent of company C. It was held that interim injunction could not be issued restraining the shareholders of G from transferring their shares as they were not parties to the contract between G and C.

## 9. Exceptions to Application of the Principle

In similitude with the exceptions to the doctrine of privity, circumventions and alternative ideas have also been invented under the contract Act with heads like; Benefit of Exclusion Clauses; Collateral Contracts; Assignment; Contracts requiring duty of care to third parties under the law of tort; Contract for Benefit of a Third Person, Insurance, creation of charge, Trust, Family arrangements and marriage settlements, statutes etc. Since these have been discussed while addressing the English rule of privity, it is not reiterated here. However, the three exceptions are addressed below which are distinct from the aforesaid examples.

### *9.1 Trust*

The equitable exception of trust to circumvent the rule of privity was applied under the Contract Act by the Privy Council in Khwaja *Muhammad Khan v Hussaini Begam*[56] Where it was held that if an obligation in equity amounting to a trust arising out of the contract exists, the beneficiary has a right to enforce his

54. Aries Advertising Bureau v CT Devaraj AIR 1995 SC 2251, (1995) 3 SCC 250

55. AIR 1995 SC 2372, (1995) 5 SCC 545

56. (1910) 32 All 410

beneficial interest. In this case, the father of the bridegroom had contracted with the father of the bride to make for the daughter an allowance for expenses of her *pan* if she married the son. Alter the marriage, the daughter sued her father-in-law to recover arrears of the allowance. The Privy Council held that though she was not a party to the contract she was clearly entitled to proceed in equity to enforce her claim.

Under the Contract Act in order to establish that a trust of the promise has been created, it is necessary firstly to establish an intention of the promisee to enter into the contract as a trustee. A trust does not arise simply because a party to a contract undertakes to confer a benefit on a stranger.[57] Use of express words like 'trust' or 'trustee' establishes the intention, In the absence of express words, no satisfactory test can be laid down to determine whether the requisite intention exists. Nearness of relationship is a circumstance which may be indicative of a trust but does not on its own enable a third party to sue. Mere direction in a document to which the plaintiff is not a party, to pay a certain sum to the plaintiff, is not enough to create a trust in his favor.[58] Sometimes, it has been found difficult to decide whether in a contract, the intention is to create a right arising by way of contract or by way of property under a trust.

### *9.1.1 Four principles of Trust*

The Indian Supreme Court laid down four considerations to ascertain the issue of Trust in a contract:[59]

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57. Ibid 10

58. Gurdit Singh v Chuni Lal AIR 1932 Lah 66

59. Inuganti Kasturamma v Chelikani Venkatasurayya Garu, (1915) 29 Mad U 538. AIR 1916 Mad 65. In this case A contracted with B to pay a sum of money to C, it was held that the latter could not sue A merely on the basis of the contract. In order to enable C to sue, the contract must be intended to secure a benefit to him so that he may be entitled to any that he has a beneficial interest as cestui que trust. It was not possible to lay down categorically and exhaustively the circumstances which have to be considered in order to determine whether or not a contract is intended to secure such a benefit. The plaintiff, in the instant case, could recover payment as the document was held to have created a trust in his favor.

(i) "whether the defendant was made a trustee for the plaintiff by the document, or whether the defendant's position was merely such that she might become a trustee if certain events were to take place as contemplated in the document;

(ii) If she was made or had become a trustee, had she any personal and substantial interest in the property which she had a right to protect, or did the contract override any interest of her own in the property; in other words

(iii) was any specific property charged with the payment to the plaintiff in which the defendant was to have no interest whatsoever;

(iv) was the deed communicated to the plaintiff and did he accept in lieu of any rights that he had prior to the deed."

### *9.2 Acknowledgement and estoppel*

If one of the parties to the contract agrees with stranger to pay him or acknowledges any payment in respect of a transaction arising out of a contract he is made to pay or is stopped from denying the liability to so pay. A promisor is able to create privity between himself and the third party by conduct, by acknowledgement or otherwise constituting himself the agent f the third party, entitling the third party to sue.

In De*b Narain Dutt v Ram Sadhan Mandal* [60] "A advanced Rs 300 to B on the security of *Pattah* related to immovable property and deposited with him by B. B then transferred by a registered Kabala all his property movable or immovable, to C for a sum of Rs 2000. The entire amount of Rs 2000 was not paid, as there was a provision and declaration in the *kabala* that out of this consideration money of Rs 2000, the sum of Rs 300 due to A should be paid by C. A sued C for Rs 300, basing his claim upon the *Kabala*. It was found that there was no agreement between A and C for payment of Rs 300 by C to A. But on the very day on which the *Kabala* was executed, C acknowledged the obligation to pay Rs 300 to A, the acknowledgement was communicated and

60. AIR 1914 Cal 129

accepted by A, and that as a result of this, the *pattah*, which was erroneously believed by the parties as constituting a charge, was handed over by A to C. Upon these facts it was held that A was entitled to recover the amount claimed from C."[61] The same principal was followed in another was where it was held that no communication to A is necessary for the principle of acknowledgement and estoppel to work.

### *9.3 Covenants running with Land*

In Bangladesh the enforcement of covenants running with the land is provided under section 40 of the Transfer of Property Act 1882, in respect of:

(i) a right to restrain enjoyment in a particular manner of property imposed for the more beneficial enjoyment of the property; and

(ii) benefit of an obligation arising out of contract and annexed to the ownership of property.

These can be enforced against the transferee with notice or a gratuitous transferee, but not against transferee for consideration and without notice of the right or obligation. The privity of contract doctrine has been relaxed to allow certain positive or restrictive covenants to run with the land so as to benefit or burden persons not party to the contract imposing such covenants for commercial reasons. Third parries can acquire rights in this manner under a covenant to which they were not a party. These are rather properly classified as belonging to the law of property.

### *9.4 Salient Statutes conferring rights or imposing liabilities on third parties in Bangladesh*

(i) Where a person (principal employer) employs a contractor for execution of any work involved in his business or trade, such principal employer is liable to pay compensation under section 12 of the Workmen's Compensation Act arising out of accidents to the workmen employed by the contractor in

61. Mulla, Indian Contract and Specific Relief Acts, Twelfth Edition

doing such work (subject to being indemnified by the contractor).

(ii) Section 8 of the Negotiable Instruments Act 1881 allows a holder of a promissory note, bill of exchange or cheque to recover the amount due thereon.

(iii) Section 1 of the Bills of Lading Act provides for every consignee of goods under a bill of lading and every endorsee of a bill of lading the right of suit and is subject to the same liabilities as if he were a party to the bill of lading.

(iv) Right of assignees to sue under section 37 of the Contract Act 1872.

**10. Reform of the privity rule**

When one considers the number of ways and means devised and discovered to circumvent the rule of privity, as discussed above, both under the English rule and under the Contract Act, a question is raised in one's mind as to whether there does exist any necessity for reform because one can only reform an existing rule and it would appear that for all practical purposes, the rule of privity only exists in textbooks. However, there has been attempts to reform and here we deal with the various proposals and actions taken in England and India.

The rule that no one except a party to the contract will be liable under it is just and sensible. But the rule that no one except a party to a contract can enforce it may cause inconvenience, because it prevents a person from suing, who has interest in that contract. There are many exceptions which made the practice tolerable but sometimes it provoked a question whether it could not be better to modify the doctrine, or to abolish it altogether. The autonomy of the will is to give the parties proper respect. The law of contract should give effect to the reasonable expectations of contracting parties. Because often the parties and specially third parties organize there affairs on the faith of contract. Where a party is relying on a contract, it is unfair to deny their rights. In this situation Steyn L. J. said, "I will not struggle with that point since nobody seriously asserts the contrary." The rule was continuously criticized by the courts. E.g. in Wooder Investment *Development*

*Ltd. v Wimpy Construction UK Ltd.*[62], Lord Scarman said that, House of Lords would in future, "reconsider *Tweddle v Atkison* and other cases which stand guard over this unjust rule." Despite so many criticisms the judiciary was reluctant to challenge the basic rule and only progress was made by gradual extension of the various exceptions.

## 11. Arguments for reform

### *11.1 The intentions of the original contracting parties*

The first argument in favor of the reform is that the third party rule prevents effect being given to the intentions of the parties to the contract. P Kincaid in "the UK Law Commission's Privity Proposals and Contract Theory"[63] argued that the promise theory underpinning contract dictated that only the promisee could enforce the promise: "in our view, this is to take an unnecessarily narrow view of the morality of promise-keeping where a promise is intended to benefit a third party".

### *11.2 The injustice to the third party*

It was argued that the privity rule was an injustice to the third party where a valid contract between the other two parties gave an expectation of legal rights to enforce the contract to the third party, and the third party had relied on such expectation in order to regulate his affairs. His situation was usually based on the above agreement that is the intention of the contracting parties. he intention of the contracting parties and the reasonable expectation of the third party are consistent with each other. But the problem arose if the contracting parties discharged the contract. That issue could be presented as raising the conflict between these two fundamental arguments for reform. In other words, should the injustice to the third party override the intentions of the parties where those intentions change? As will become clear, it was believed that where the injustice to the third party is sufficiently "strong' it should override the changed intentions of the contracting

62. [1980] 1 WLR 277

63. (1994) 8JCL 51

parties. That is the original parties right to change their minds and vary the contract should be overridden once the third party has relied on, or accepted, the contractual promise.

### *11.3 The person who has suffered the loss cannot sue, while the person who has suffered no loss can sue*

This point as an argument for reform can be discussed in the light of the case Beswick v *Beswick.*[64] In this case House of Lords held that the widow could not bring an action in her personal capacity as when the contract was made, she was not privy to that. But as the administratrix of her husband's estate, she could sue on the promise. Since the nephew's breach couldn't make any harm to the uncle and his estate so the widow will be only able to recover nominal damages. So, here we can see that the widow, who was the intended beneficiary to the contract, in her personal capacity was not be able to sue. But where the widow, as an administratrix suffered no loss but was able to sue. In this case their Lordships made the decision for specific performance (e.g. where the contract is not one supported by valuable consideration or where the contract is one for personal service), but in some situations where specific performance is not available51 there the result is perverse and unjust.

### *11.4 Even if the promisee can obtain a satisfactory remedy for the third party, the promisee may not be able to, or wish to, sue*

If a contract was made for the benefit of third party, and the contracting party was ill or outside the jurisdiction, or it may be that the contracting party had died and his estate was reluctant to do any act which was for the benefit of third party, in those situations the beneficiary had no right to enforce the contract. In Be*swick* the promisee, as represented by the widow as - admmistratix, clearly wanted to sue to enforce the contract made for her personal benefit.

### *11.5 The development of non-comprehensive exceptions*

The third party rule had got some exceptions in Statute and in

64. (1966) Ch 538.

Common law. That meant the party right had been recognized by some case law and created by statute. By this recognition until recently the beneficiary had got advantages and they did not have to face difficulties to establish their rights. But in other words this recognition was a strong jurisdiction for reform. There were two reasons for that first, the existence of common law and statute as an exception of third party rule shows that the third party rule was not giving the necessary justice. Second, the fact that these exceptions continued to evolve and to be the subject of extensive litigation demonstrated that the existing exceptions had not resolved all the problems.

### *11.6 Complexity, artificiality and uncertainty*

The recognition of the exception of third party rule and existance of the rule of third party made the situation complex. Reform would enable to remove some of the artificiality and some of the complexity could be avoided. The other problem was the rule in every separate case lead to uncertainty. That means, defendant could raise the argument that a technical requirement had not been fulfilled by the plaintiff. Such uncertainty was commercially not convenient.

### *11.7 The third parties rule causes difficulties in commercial life*

The statute and common law exceptions of third party rule made way for an erroneous thought that there was no problem with the third party rule now a days. The demand of reform was purely the rhetoric rather than practical. But this type of thinking was not true. There were pointed out two types of contract by which it could be proved that, still there are some difficulties caused by the rule. Two types of contracts are- construction contracts and insurance contracts.

#### 11.7.1 Construction Contracts

There are two types of construction contracts, (a) simple construction contract; (b) complex construction contract. The first one involves an employer and a builder. The second one involves several main contractors. Subcontractor and design professionals are usually affected by the third party rule.

**(a) Simple construction contracts**

One party made a contract with another party, to pay for work to be done by him, which will benefit the third party to the contract. Eg. A contracted with B to build a house for C. B is a builder, he worked for C but the house was defective. In this situation, though B worked for C, C would not be able to bring an action against B. It was only A who could sue B for his failure to deliver the promised performance. According to the decisions in *Linder Garden Trustv Lenesta Sludge Dispossals Ltd.*[65] and *Darlington BC v Wiltshier Northern Ltd.*[66] the client can only recover a nominal damage, since he will have suffered no direct financial loss as a result of the builders failure to perform. Here C could not sue B for the breach of contract, and according to *Murphy v Brentwood DC* [67] this is a pure economic loss which is not recoverable in tort of negligence. Therefore C will not be able to recover the cost of repair in tort of negligence.

**(b) Complex construction contracts**

In complex construction contracts, there are several agreements between the parties in the project, such as; the client, the main contractor, specialist sub-contractors. All the responsibilities and liabilities are allocated to them. The third party rule only allows the parties to the contract to sue. In a big project there are several people who have their own duty of care such as, consultants (architects, engineers and surveyors) duty is duty of care and skill, constructor's duty is to build as he is instructed. If they do not perform their duty properly it might cause loss to the purchases or tenants. But the purchaser or the tenants do not have any right to claim damages for loss from them, if the third party rule exist there. Similar problems apply when the third parties seeking rights of suit are tenants with full repairing leases, and who are therefore under a contractual obligation to the landlord of the building to maintain its fabric. Same fate is due to the subsequent purchasers of properties as well.

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65. (1994) AC 85
66. (1995) 1 WLR 68
67. (1991) 1 AC 398

Thus an architect, engineer or contractor who made any collateral warranty will not be included in any consequential claims of economics loss caused to a third party or subsequent purchaser. No reason has been given why the architect's engineer's and contractor's liability to the third party could not be limited, as because it is under collateral warranty agreements, so it excludes consequential loss and is limited to a specified share of the third party's loss. In contract, collateral warranties, limitation clause will not be subject to S. 2 (2) or 3 of the Unfair Contract Terms Act 1977 in England. There are some provisions providing the finance house purchaser or tenant a license to copy and use for specified purposes any designs or documents that are the party of the contractor or architect or engineer, and a clause undertaking that the contractor, architect or engineer will maintain professional indemnity insurance in a specified sum for a specified period. The warranty will normally permit assignment by the finance house, purchaser or tenant without any consent of the warrantor being required. Another point is, whether the sub-financiers can take the benefit of the warranty down the line. This means whether the assignee can recover the full damages or Lin*der Garden Trustv Lenesta Sludge Dispossals Ltd.*[68] and *Darlington BC v Wiltshier Northern Ltd.*[69] were exceptions to the general rule on quantification of damages under the common law. Collateral warranties could be excluded from the main contract if the party had the right in the main contract. In spite of that contracting parties could meet the stipulated terms in the collateral warranties if the reform proposal would be accepted. It was thought that if the privity rule was reformed the parties; (client and main contractor) would get the benefit by using the exclusion clauses to limit their liability for defective performance. The contractors make agreement themselves and for sub-contractors in order to exclude liability under tort for negligence.

Another problem used to arise in relation to the method of payment. E.g. if the main contractor did not pay the sub-contractor after the work, was performed, the sub-contractors had no right to

68. (1994) AC 85

69. (1995) 1 WLR 68

sue the client, even if the client was getting the benefit of the subcontractor's work. JCT 80 and from NSC (Employer Nominated Subcontractor's Agreement) 2a, clause 6 (1), provides a duty on the part of the client to pay nominated subcontractors direct. But the third party rule prevented those rights to be enforced or executed, unless the subcontractor and the client had a contractual relationship.

Employers sometimes make agreements with contractor for the benefit of the neighbors, such as noise, access and working hours. Though neighbors are protected under the tort of nuisance but the reform of third party rule can give the better and straight forward protection than tort to the neighbors.

### 11.7.2 Insurance Contracts

Insurance contract is a different situation where one party is taking an insurance policy for the benefit of other party. The third party rule would prevent the third party to enforce the insurance contract against the insurer. To overcome this situation England had a number of statutory inroads. E.g. section 11 Married Women's Peoperty Act 1982, Life insurance policy, section 148 (7); Road Traffic Act 1988, fire insurance etc. In those circumstances third party can bring action against the insurance company even though their names are not expressly mentioned in the contract. But there are some situations where statute does not allow the party to enforce the contract against the insurer e.g. a life insurance policy taken out for the benefit of dependents other than spouses and children, a parent or a stepchild, falls outside the Married Women's Property Act 1882 and appears, therefore not to be enforceable by those dependents. If an employer takes health insurance policy for his employee, the employee not had no right to enforce the insurance contract.[70]

## 12. Reform in England

Proposals for legislative reform were made by the Law Revision Committee as long ago as 1937 (Cmnd. 5449) and further proposals were put forward for discussion by the Law Commission in 1991 (Paper No 121, 1991). In July 1996, the Law Commission published

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70. *Cf Green v Russell* [1954]62

proposals in "Privity of Contract; Contracts for the Benefit of Third Parties" (Cmnd. 3329; Law Com No 242), which recommended that the law expressly provide for third parties to be able to enforce contracts (including taking advantage of exclusion/ limitation clauses) in certain circumstances. These proposals for reform were acted upon. The Contracts (Rights of Third Parties) Act 1999 received Royal Assent on 11 November 1999. It reforms the common law rule of privity of contract. Section 1 provides that a third party may in his own right enforce a term of a contract if:

> (a) the contract expressly provides that he may, or (b) the term purports to confer a benefit on him (except where on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party).

There shall be available to the third party any remedy that would have been available to him in an action for breach of contract if he had been a party to the contract: s1(5).

Hence a future third party, e.g. an unborn child, a future spouse or a company still being promoted may be thus protected. Furthermore the courts may award all the remedies to the third party as would be available to a party to the "contract" claiming breach of contract. There is an inherent protection against flood gates in the section in that a third party will not be able to bring a claim if on true construction of the contract it appears that the parties had not intended to confer a right of claim on the third party.

Section 2 of the Act deals with the rights of the parties to the contract to vary or rescind the contract in so far that the consent of the third party is required unless, of course, there is an express term in the contract that dispenses with such a requirement. Again, the courts are the final arbiters of whether such consent is required or not in any given situation.

The promisor is further protected by section 3 of the Act in that all the defenses including of set-offs and counterclaims, are available to him in a claim by the third party, as would have been available to him in a claim brought by the promisee. The promisor is also protected from double liability by section 5 which provides that if the promisee has already brought an action and has been awarded damages for loss caused to himself and/or the third party, the courts will have to take into consideration in a claim brought by

the concerned third party.

Meanwhile section 4 reserves the right of the Promisee to enforce the contract which benefits the third party.

The Act of 1999 also ensures that a third party may be prevented from unconscionably taking substantive benefit free of its procedural burden in that section 8 of the Act provides that where appropriate the provisions of the Arbitration Act 1996 will apply in relation to third party also.

This is the briefest possible overview of the contract (Rights of Third Parties) Act of 1999 and the law as it stands currently. It remains to be seen what legal implications it may have other than the obviously contemplated ones.

**13. Reform proposed in India**

The Law Commission of India recognized that a rigid adherence to the doctrine of privity caused hardship, and recommended incorporation of a separate section into the Contract Act. The amendment proposed purported to make a contract enforceable by the third party in his own name, if the contract expressly conferred a benefit on him, but subject to any defenses available to the contracting parties. It also proposed that the parties to the contract should be unable to vary or rescind or alter the contract, once the third party had adopted the contract. The text of the proposed amendment is as follows:

Law Commission of India, 87th Report 1958 paragraph 16, recommended adding s 37A to the Act as follows:

37 A. Benefits conferred on third parties:

1. where a contract expressly confers a benefit directly on a third party, then, unless the contract otherwise provides, it shall be enforceable by the third party in his own name, subject to any defenses that would have been valid between the contracting parties.
2. Where a contract expressly conferring a benefit directly upon a third party has been adopted, expressly or impliedly, by a third party, the parties to the contract cannot substitute a new contract for it or rescind or alter it so as to effect the rights of the third party.

## 14. Abrogation of the privity rule in other Common Law jurisdictions

### *14.1 Western Australia*

Western Australia Property Law Act 1969, S. 11 (2) (W Austl Act 1969, No. 32) provides that, " where a contract expressly in its terms 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....". If the third party becomes a party to the contract he can have the same defense which is available for the promisor as well.

The Western Australian legislation has been criticised by the New Zealand Contracts and Commercial Law Reform Committee, Privity of Contract (1981). They said that if third party is not in existence within the temporal and contemplated purviews of the contract he should not be permitted to enforce his right under that contract. If third party has a right of enforcement then his name should be expressly mentioned in the contract.

### *14.2 Queensland*

Section 55 of the Queensland Property Law Act 1974 provides that: A promisor who, for a valuable consideration moving from a promisee, promises to do or to refrain from doing an act or acts for the benefit of a beneficiary shall, upon acceptance by the beneficiary, be subject to a duty enforceable by the beneficiary to perform that promise."

S. 55 of the Queensland Properly Law Act 1974 further provides that before the contract has been concluded the promisor and promisee can change the terms of the promise. In this case they don't need any consent from the beneficiary. But once the contract has been concluded the promisor is bound to perform his duty in favour of the beneficiary provides in Sec 55 (3) (a) and (d) of the Queensland Properly Law Act 1974. S. 55 (3) (b) of the Queensland properly Law Act 1974 provides that, on acceptance, the beneficiary is bound to perform any acts that may be required of him by the terms of the promise.

Queensland legislation does not intend to confer benefit on the third party. Although the promise must appear to be intended to confer a legal right enforceable by the third party.

Queens land legislation can also be criticised like Western Australia because it also differs in that the beneficiary need not be named or be in existence or be identified at the time of making the contract.

### *14.3 New Zealand*

The New Zealand Contract Act 1982, section 4 provides that, "Where a promise contained in a deed or contract confers, or purports to confer, a benefit on a person, designated by description or reference to a class, who is not a party to the deed or contract ...the promiser shall be under an obligation, enforceable at the suit of that person, to perform that promise."

The Act provides that promises benefiting third parties may not be varied without the consent of the third party if he has either (i) materially altered his position in reliance on the promise; (ii) obtained judgment on the promise; or (iii) obtained an arbitration award on the promise.. However there is an express provision permitting variation in other circumstances, which is known to the third party, such variation is permitted.

### *14.4 United States*

The third party right in United States is a very vast topic. From Lawerance V Fox (1859)[71] it appears that a third party is able to enforce a contractual obligation made for his benefit. However, the problem of defining what is meant by a third party beneficiary has never adequately been solved. Third party beneficiary is not "donee" e.g. in private construction context, subcontractors were neither donee nor creditor beneficiaries.[72] Some courts do not apply this rule and they allow beneficiaries to recover who were neither creditors nor donee.

This uncertainty of beneficiaries who can enforce contracts, as contrasted with incidental beneficiaries, who can not, has been solved under second Restatement of Contracts 1981 section 302. Section 133 of the First Restatement of contracts published in 1932 distinguished donee beneficiaries, creditor beneficiaries and incidental beneficiaries only donee and creditor beneficiaries could enforce contracts made for their benefit. A person was a

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71. 20 NY 268

72. Summers, 'Third Party Beneficiaries and the Restatement (Second) of Contracts (1982) 67 Cornell L Rev 880, 884

"doneee beneficiary" if the purpose of the promisee was to make a gift to him. A person was a "creditor beneficiary" if performance of the promise would satisfy an actual duty of the promise to him. A person was an "incidental beneficiary" if the benefits to him were merely incidental to the performance of the promise.

**15. Conclusion and case for reform in Bangladesh**

It is noteworthy that in Bangladesh the legal literature on privity is absent. As and when required the courts may apply methods and precedents innovated to circumvent the rule of privity. But as we are all perfectly aware the courts have their limitations and can only ignore precedent to a degree unless there is clear statutory verdict. Hence, with all good intentions and all methods and precedents innovated to circumvent the rule of privity, it would be difficult for a potential beneficiary of a contract to agree very much if a court decided to follow traditional precedent and granted him no relief. Further, there are situations whereby even the law of tort or other ancillary provisions are not helping much in the way of giving priority to the intentions of the contracting parties and meting out justice. The helpful theory of collateral contract would have to be thrown out in the face of a well-articulated "duality" theory, in that consideration is distinct from privity. Hence reform in this area is certainly long overdue. It would in my opinion, be wrong to say, however that the rule of privity should be abolished. As is apparent in the preceding parts, in England the third party has been given the right to enforce a contract from which he is intended to derive a certain benefit but the circumstance in which he will be able to do so have been categorized and certain measures have been taken to restrict mass claims and opening of flood gates. Truly, the core of my proposal is that the intention of the parties should override other policy considerations coupled with the injustice suffered by the third party in not being able to enforce a benefit he was intended to receive, is to be given effect as has been done by The Contracts (Rights of Third Parties) Act 1999 of England by amending the Contract Act of 1872.[73]

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73. Facts of certain cases in this article have been taken from: Contract Law: Text, Cases and Materials, Ewan McKendrick