

## Chapter 9

**PRIVITY OF CONTRACT DOCTRINE****9.1 DEFINITION & RATIONALE**

“The doctrine of privity means that a contract cannot, as a general rule, confer rights or impose obligations arising under it on any person except the parties to it” (G H Treitel, *The Law of Contract*). In *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd* [1915] AC 847, the claimants sold tyres to Dew & Co, wholesale distributors, on terms that Dew would obtain an undertaking from retailers that they should not sell below the claimants’ list price. Dew sold some of the tyres to the defendants, who retailed them below list price. The claimants sought an injunction and damages. The action failed because, although there was a contract between the defendants and Dew, the *claimants* were not a party to it and “only a person who is a party to a contract can sue on it” (per Lord Haldane).

The rationale behind this rule is that the law only seeks to enforce bargains supported by consideration moving from the promisee. Thus, in *Tweddle v Atkinson* (1861) 1 B&S 393, the fathers of a husband and wife agreed, in writing, that both should pay money to the husband, adding that the husband should have the power to sue them for the respective sums. The husband’s claim against his wife’s father’s estate was dismissed, the court justifying the decision, largely because no consideration had moved from the husband.

**9.2 LIMITED REMEDIES AVAILABLE TO A PERSON SUING ON A CONTRACT TO WHICH HE IS NOT A PARTY**

In *Woodar Investment Development Ltd v Wimpey Construction UK Ltd* [1980] 1 WLR 277, the House of Lords held that, where a contracting party (A) has made a contract with B for C’s benefit, A can sue B, but can only recover substantial damages for his *own* loss, not for the loss sustained by a third party (C). In *Forster v Silvermere Golf and Equestrian Centre Ltd* (1981) 125 SJ 397, the claimant had transferred land to the defendant who undertook to build a house on it and to allow the claimant and her children to live in it, rent free, for life. It was held that she could recover damages only for her own loss, but not for the loss of the rights of occupation, which her children might have enjoyed after her death.

However, the court may be prepared to award specific performance instead of damages. This remedy will be discussed in Chapter 11.

**9.3 EXCEPTIONS TO THE RULE ON PRIVACY**

As seen in the previous paragraph, if the doctrine of privity was inflexibly applied, it would cause considerable injustice and inconvenience. Many exceptions to the rule that only a party to the contract can enforce a contract have, therefore, been developed.

**9.3.1 CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999**

The major exception is the Contracts (Rights of Third Parties) Act 1999, which came into force in May 2000, and has the effect of allowing third parties to enforce contracts made for their benefit, even if they are not a party to the contract.

Subsection (1) of the 1999 Act 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. In *Nisshin Shipping Co Ltd v Cleaves & Co Ltd* [2004] 1 All ER (Comm) 481, the effect of a joint commission clause was to confer a benefit (to the extent of 1% commission) on one claimant broker alone, because the brokers were entitled to enforce the commission clauses, in their own right, by reason of s. 1 of the 1999 Act. In *Laemthong International Lines Co Ltd v Artis and Others (The "Laemthong Glory")* (No. 2) [2005] EWCA Civ 519, a receiver's letter of indemnity purported to confer a benefit upon ship owners, under s. 1(1)(b) of the 1999 Act. They were held to be the charterers' agents in delivering the cargo and, on a proper construction, the receivers' letter of indemnity was intended to be enforceable by the owners. 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)).

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 which, although in the process of formation, has not yet been incorporated.

Potentially, this means that, where goods and equipment are supplied under a contract for the intended use or operation by a specific third party, or a class of third party, then that third party or class could enforce the terms intended for his benefit, such as standards and performance levels. If the contract is neutral on the issue, then the Contracts (Rights of Third Parties) Act 1999 operates. However, where the contract does not expressly identify third parties, there can be no claim by such parties. Thus, in *Themis Avraamides and another v Colwill* [2006] EWCA Civ 1533, Mr Colwill purchased a business from B Trading Ltd. Colwill had undertaken to complete outstanding customer orders and to pay all liabilities incurred by the company. Avraamides was a dissatisfied customer of the company and brought a claim against Colwill, arguing that the transfer agreement had conferred an enforceable benefit on Colwill. The Court of Appeal held that no such identification of the third parties had occurred in this case. By holding that the use of the word "express" in s. 1(3) of the 1999 Act, "...simply does not allow a process of construction or implication...", *Themis Avraamides* appears to indicate that, if the entire clause, as written, does not satisfy the requirements of s. 1(3), then no part of the clause will be able to satisfy the requirements of s. 1(3).

In the above case, the action failed, but no doubt all parties will have been involved in considerable expense and disruption of business. If a supplier wishes to avoid costly litigation by third parties not known to him, he needs to ensure that the 1999 Act is excluded from the supply contract. The supplier should state, clearly, those persons or organisations that can benefit from the contract under the 1999 Act. If he can, he should describe them by name or, at the least, as a class of, say, first user or such a term. He should then expressly exclude all others not named or defined. Alternatively, and as is common practice in the construction industry, he could exclude the 1999 Act altogether. In *Prudential Assurance Co Ltd v Ayres and Others* [2008] EWCA Civ 52, a tenant on an assigned underlease entered into a deed with the immediate landlord, which contained a clause that limited the landlord's capacity to recover monies due under the underlease. The tenant defaulted on the lease and the landlord sought to enforce a guarantee given by previous tenants in respect of obligations under the lease. The High Court held that, despite the limitation on liability, not containing an express provision allowing the previous tenants to rely on it, they were entitled to the benefit of the restriction, by virtue of s. 1(1)(b) of the 1999 Act. The Court of Appeal allowed the landlord's appeal. The context of the arrangement meant that it was questionable that any restriction on the tenant's liability operated in a way that would limit the landlord from pursuing claims against the former tenants.

Subsection (5) of the 1999 Act makes it clear that the courts may award all the standard contractual 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.

Subsection (6) makes it clear that the 1999 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" and to be enforceable by these groups.

Therefore, if Alfie enters into a contract with Bertie, a builder, to build a penthouse for his father, Charlie, and the contract contains an exemption clause which seeks to exclude Bertie's liability for negligent construction work, then, in the event that Bertie carries out the work defectively, and as a result the roof of the penthouse collapses, if Charlie sues Bertie as a third party to the contract, Bertie will be able to rely on the exemption clause, no matter how unreasonable.

The 1999 Act thus has the potential to make significant changes in the way in which contracts can be enforced by third parties. It protects third parties in a situation where a contract envisages money being paid to such parties, but this is not honoured by the parties to the contract. It may also cover holiday contracts and the like, where only one person enters into the contract, enabling the other holiday makers travelling with him to pursue a claim for breach of contract. However, the main contracting parties are still in control and can, thus, agree to exclude the application of the provisions of the new Act.

#### **Example:**

If, in a building contract, an employer and contractor agree that a *subcontractor* will be paid directly by the employer, in certain circumstances, without the benefit of the Act, the subcontractor could not enforce that right against the employer (unless he had a direct contract). Under the Act, however, it will be possible to draft the building contract so that the subcontractor can enforce the right against the employer.

Or, if the conditions of engagement of an architect acting for a developer state that he will cooperate in providing information to allow a tenant and his designers to prepare fit-out drawings, neither the tenant nor the designers can enforce that obligation directly against the architect. Under the Act, however, it will be possible to draft the conditions of engagement, so that the right can be enforced directly.

Since the Act does not enable *burdens* to be imposed unilaterally on third parties, in the first example above, the subcontractor could be given the right to be paid directly, but the employer could not impose a warranty regarding his work. (Although what the employer could do is provide that the subcontractor is entitled to be paid directly for work, provided that the contract administrator has agreed that the work has been carried out correctly.)

### **9.3.2 OTHER EXCEPTIONS**

Other exceptions to the rule on privity, generally of narrow application, include:

- **Collateral contracts:** Illustrated by the case of *Shanklin Pier v Detel Products* [1951] 2 All ER 471. The claimant pier owners relied on the defendant paint manufacturers' promise that if the defendants' paint was used to re-paint their pier, it would endure for

seven years. The claimants subsequently instructed contractors, who had undertaken the re-painting, to purchase and use the defendants' paint. However the paint started to degenerate after only three months. While the claimants had no remedy against the defendants for the sale of the paint, since the claimants had provided no consideration for the promise given by the defendants, they were allowed to bring a claim against the defendants based on collateral contract; consideration for the promise as to the paint's resilience was the instruction by the claimants to the contractors to buy the defendants' paint. There must, however, be an intention to create a collateral contract before that contract can be formed.

- **Agency:** An agent may contract on behalf of his principal with a third party and form a binding contract between his principal and the third party. In such a case, the agent is not privy to the contract and cannot, generally, sue or be sued upon it; see *Scruttons Ltd v Midland Silicones Ltd* [1962] AC 446; [1962] 1 All ER 1.
- **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. Thus, in *Tulk v Moxhay* (1848) 41 ER 1143, the claimant sold a garden to "Elms" who covenanted that he would maintain its present condition and continue to allow individuals to enjoy the garden. The land was sold to the defendant who knew of the restriction contained in the contract between the claimant and Elms. When the defendant announced that he was going to build on the land, the claimant, who owned several adjacent houses, successfully obtained 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.

Another case held that an assignee of land can claim the benefit of positive and negative covenants touching and concerning the land (*Smith and Snipes Hall Farm Ltd v River Douglas Catchment Board* [1949] 2 KB 500). Similarly, any covenant which touches and concerns the land contained in a lease can be enforced against an assignee, by the doctrine of privity of *estate* (this forms an exception to the rule that a person cannot, generally, be sued on a contract to which he is not a party).

- **Statutory exceptions:** For example s. 151 Road Traffic Act 1988, under which an injured party may recover compensation from an insurance company, once he has obtained judgment against the insured person.
- **Tort:** In *Lumley v Gye* (1853) EWHC QB J73, the claimant had employed J. Wagner as an opera singer, whereupon the defendant induced her to refuse to perform, desiring that she sing in his opera house. He was held liable for the tort of wrongful interference with another's contractual rights.