

CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

Summary

The Contracts (Rights of Third Parties) Act 1999 reforms the rule of “privity of contract” under which a person can only enforce a contract if he is a party to it. The rule means that, even if a contract is made with the purpose of conferring a benefit on someone who is not a party to it, that person (a “third party”) has no right to sue for breach of contract.

The Act sets out the circumstances in which a third party is to have a right to enforce a term of the contract (section 1), the situations in which such term may be varied or rescinded (section 2) and the defences available to the promisor when the third party seeks to enforce the term (section 3). It makes it clear that section 1 does not affect the promisee’s rights, or any rights that the third party may have which are independent of the Act (sections 4 and 7(1)). The Act does not apply to certain contracts (whether wholly or partially) (section 6).

Effective Dates

The Act came into force on 11 November 1999. The provisions of the Act do not apply to any contract entered into before that date.

The Act will only apply to contracts that were entered into during the six-month period after it came into force if the contract expressly provides for it to do so. Without such an express provision it will not apply to contracts entered into during this six-month period.

The Act applies to all contracts, except those detailed in section 6, entered into after the expiry of the six-month period (i.e. from 11 May 2000).

Right of Third Party to Enforce a Contractual Term

The central purpose of the Act is to give the right to a Third Party to enforce a term of a contract to which that Third Party is not a party.

A Third Party may only enforce a term of a contract if –

- (a) the contract expressly provides that the Third Party may do so; or
- (b) the term of the contract purports to confer a benefit on that Third Party.

Provision (b) above does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party.

The Third Party must be expressly identified in the contract –

- (a) by name; or
- (b) as a member of a class; or
- (c) as answering a particular description

but need not be in existence when the contract was entered into.

Under the Act, a Third Party is only given the right to enforce a term of a contract subject to and in accordance with any other relevant terms of the contract. It is open to the parties to the contract to limit or place conditions on the Third Party's right. So, for example a Third Party wishes to enforce a right he is to do so by way of arbitration and not litigation.

When enforcing a right a Third Party may be awarded 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. As such, the rules relating to damages, injunctions, specific performance and any other relief shall all apply accordingly. Such rules act to place the burden in respect of causation and remoteness on the Third Party as well as imposing a duty upon him to mitigate his loss.

As well as enabling a Third Party to enforce a 'positive' right the Act also applies so as to allow a Third Party to take advantage of an exclusion or limitation clause in the contract. 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 sub-contractors" and is to be enforceable by these groups.

Variation and Rescission of Contract

Where a Third Party has a right to enforce a term of a contract, the contracting parties may not, by agreement, rescind or vary the contract in a way which affects the Third Party's right without his consent if –

- (a) the Third Party has communicated his assent to the term to the Promisor;
- (b) the Promisor is aware that the Third Party has relied on the term; or
- (c) the Promisor can reasonably be expected to have foreseen that the Third Party would rely on the term and the Third Party has in fact relied on it.

The use of the term 'variation' in the Act is strictly in its legal sense to mean a variation of the terms of an agreement by further agreement between the parties to the original agreement.

It must be emphasised that this restriction does not affect the terms of a construction contract which allow one of the parties to that contract unilaterally to alter, or 'vary', the details of the work to be carried out. Such a 'variation' is made 'under' the contract, not 'to' the contract.

The assent referred to in (a) above may be by words or conduct, and if sent to the Promisor by post or other means, shall not be regarded as communicated to the Promisor until received by him.

The Act allows the contracting parties to rescind or vary an agreement where the agreement contains an express term permitting them to do so without the consent of the

Third Party. Alternatively, the agreement may contain terms which specify the circumstances in which the consent of the Third Party is required before the agreement can be either rescinded or varied.

The Act provides certain powers to the court or arbitral tribunal to dispense with any consent that may be required under certain circumstances. In such an event the payment of compensation to the Third Party may be ordered if the tribunal thinks it fit.

Defences Available to the Promisor

The Act enables the Promisor, in a claim by the Third Party, to rely on any defence or set-off arising out of the contract and relevant to the term being enforced, which would have been available to him, had the claim been by the Promisee. The Promisor may also rely on any defence or set-off, or make any counterclaim, where this would have been possible had the Third Party been a party to the contract.

These available defences can be categorised in three groups for which examples are given below.

Defence 1

The Promisor shall have available to him by way of defence or set-off any matter that arises from or in connection with the contract and is relevant to the term, and would have been available to him by way of defence or set-off if the proceedings had been brought by the Promisee.

Example 1

P1 (the Promisor) and P2 (the Promisee) contract that P2 will sell goods to P1, who will pay the contract price to P3 (the Third Party). In breach of contract, P2 delivers goods that are not of the standard contracted for. In an action for the price by P3 (just as in an action for the price by P2), P1 is entitled to reduce or extinguish the price by reason of the damages for breach of contract.

Defence 2

The Promisor shall have available to him by way of defence or set-off any matter if an express term of the contract provides for it to be available to him in proceedings brought by the Third Party, and it would have been available to him by way of defence or set-off if the proceedings had been brought by the Promisee.

Example 2

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

Defence 3

The Promisor shall have available to him by way of defence or set-off any matter, and by way of counterclaim any matter not arising from the contract, that would have been available to him by way of defence or set-off or, as the case may be, by way of counterclaim against the Third Party if the Third Party had been a party to the contract.

Example 3A

P1 contracts with P2 to pay P3 £1,000. P3 already owes P1 £600. P1 has a set-off to P3's claim so that P1 is only bound to pay P3 £400.

Example 3B

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

It must be noted that the availability of Defence 1 and Defence 3 may be narrowed by an express term within the contract.

Enforcement of the Contract by the Promisee

The rights of the Third Party do not affect any right of the Promisee to enforce any term of the Contract.

Protection of the Promisor from Double Liability

The Act provides that where the Promisee has recovered damages (or an agreed sum) from the Promisor in respect of either the Third Party's loss or the Promisee's expense in making good that loss, the court or arbitral tribunal shall reduce any award to the Third Party enforcing a term in accordance with the Act to take account of the sum already recovered.

It must be noted that whilst this provision prevents the Promisor from paying the same damages twice, it also makes it clear that even though the Promisor and Promisee may have settled, between themselves, the matter over which the Third Party subsequently takes action, that action is not prevented. The settlement of a dispute between the contracting parties in respect of an obligation owed to a Third Party does not provide the Promisor with a defence against a subsequent action by the Third Party.

Exceptions

The Act excludes the rights of Third Party's in respect of several matters including:

1. a contract on a bill of exchange, promissory note or other negotiable instrument;
2. a contract binding on a company and its members under section 14 of the Companies Act 1985;
3. any term of a contract of employment against an employee;

4. any term of a worker's contract against a worker (including a home worker);
5. any term of a relevant contract against an agency worker;
6. a contract for the carriage of goods by sea;
7. a contract for the carriage of goods by rail or road, or for the carriage of cargo by air, which is subject to the rules of the appropriate international transport convention.

Supplementary Provisions Relating to the Third Party

The Act does not affect any existing right or remedy of the Third Party and allows for the judicial development of third party rights.

The Act prevents a Third Party from invoking Section 2(2) of the Unfair Contracts Terms Act 1977 to contest the validity of a term excluding or limiting the Promisor's liability under the Act to the Third Party for negligently caused loss or damage (other than personal injury or death).

The Act applies the standard limitation periods for actions for breach of contract by third parties (see Sections 5 and 8 of the Limitation Act 1980).

The Act makes it clear that the Third Party shall not be considered as a party to the Contract for the purposes of any other Act.

Arbitration Provisions

In the event that the Contract under which the Third Party is enforcing a right contains an arbitration agreement then the Third Party shall be treated as a party to that arbitration agreement. This provision applies where the arbitration agreement is in writing for the purposes of Part I of the Arbitration Act 1996.

Contracting Out of the Act

At Section 1(2) of the Act it states that "*if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party*" then the provisions of the Act will not apply. In other words, unlike the Construction Act, the parties can either by express words or by implication choose to contract out of the provisions of the Act.

It is suggested that the use of express words is the preferred method of opting out of the provisions as relying on an implied term runs the risk of the court finding that such a term does not exist or is not required.

The Position under Standard Forms of Contract

The JCT have introduced amendments to all the 1998 editions of all their Standard Forms of Contract by which the parties contract out of the provisions of the Act. For example,

the contracting out provision has been introduced as Clause 1.9 of the JCT 1998 With Contractor's Design Form by Amendment No.1 thereto.

The New Engineering Contract Engineering and Construction Contract 2nd Edition (NECECC) has been provided with Option Y(UK)3, which provides a clause to contract out of the provisions. As with all secondary options under NECECC this option will need to be referred to in the Contract Data Part One in order to be effective.

As to the ICE family of contracts similar provisions have been incorporated into the latest reprints of the both the 7th Edition and the Design and Construct Contract.