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WORKING GROUP FOR THE PREPARATION OF  
PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS

THIRD PARTY RIGHTS UNDER CONTRACT

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## POSITION PAPER ON THIRD PARTY RIGHTS UNDER CONTRACT

### 1. The Central Question

I assume that no-one wants to follow the English example and have a general prohibition on third party rights subject to exceptions, especially as England has now decided to abandon the rule and legislation for this purpose has recently been introduced into Parliament. On the other hand, I also assume that third parties will not be entitled to enforce all contracts which they might wish to see performed. A line has to be drawn between those contracts which can be enforced by third parties and those which cannot. How is this line to be drawn?

#### 1.1 Express Declaration

One solution is to say that a third party can enforce the contract if the contract expressly so states. This was basically the rule proposed in 1937 by the Law Revision Committee in England but never enacted. It has the great advantage of simplicity and, if we assume that the parties have competent lawyers, it may not be necessary to go further. I assume that everyone would want to go at least this far.

Question 1. Should it be stated that third parties can enforce contracts wherever the contract expressly so states?

Question 2. Does it follow that if the contract expressly states that third parties cannot enforce the contract, that is its effect?

Most legal systems appear to go further than express declaration and for most systems the test appears to be whether the contract is intended to benefit the third party. So, the American Restatement at para 302 distinguishes between intended and incidental beneficiaries and this is the provision in the McGregor Code para. 604 and the basic strategy adopted by the proposed English legislation.

Question 3. Should a general rule be adopted that third parties can enforce the contract where the parties intended them to do so?

There are situations where it is very easy to see that the transaction is intended for the benefit of a third party. So, if I make a contract with an insurance company which covers my driving the family car but also covers the car being driven by my wife and daughters it is easy to see, given that in England driving uninsured is a crime, that the contract is intended to confer rights on my wife and daughters and, similarly, if I insure my life in favour of my grandchildren, it is easy to see that the contract is for the benefit of the grandchildren. However, the American case law has gone far beyond such straight forward situations and I am bound to say that I do not find it at all easy to tell which way a court will decide on the question of intention. It is striking that this section of the Restatement has no fewer than 20 illustrations. The English legislation introduces presumptions to give the court help in deciding which way to jump.

Question 4. If intention to benefit is the test, can we formulate any guides which will help the decision maker to reach clear and predictable results?

As I understand it, some civil law systems appear to allow enforcement of the contract even though it is hard to see that the contract was made, in any realistic sense, for the benefit of the third party. I have in mind, for instance, the 1954 decision of the French *Cour de Cassation* where a hospital asked the defendant, a blood transfusion centre, to provide a donor of blood for the plaintiff patient at the hospital and the centre, without fault on its part, provided a donor who had syphilis which was transmitted to the plaintiff. The court held that there was an implicit stipulation in favour of the plaintiff in the contract between the hospital and the Centre.

Question 5. Should we go beyond the test of benefit and, if so, in what circumstances?

## 2. The Scope of the Rule

One of the "benefits" of the English rule is that it has forced English courts to consider the scope of the rule and there is therefore a wealth of case law. It may be that none of this need be addressed but I shall be grateful for guidance on this point.

### 2.1 Exemption Clauses

Contracts which seek to limit the liability not only of the contract parties but of others involved in the performance of the contract are very common. So, it is often the case that contracts seek to protect servants or agents of the contracting party and, in international carriage of goods by sea, it is normal to seek to protect stevedores who load and unload the goods and other carriers who may be involved in the case of trans-shipment. After first saying that non-parties could not rely on such clauses, *Scruttons v Midland Silicones* (1959), the English courts have made a gentle U-turn so that, in practice, it is usually the case that such parties can rely on the clause, particularly on the ground that the plaintiff has consented to them handling the goods on the same terms as the contracting parties. In practice, where the damage is to goods which are invariably insured, the policy against allowing the goods owner or his insurance company to subvert the contractual allocation of risk is very strong.

Question 6. Do we need to make an express provision as to the effectiveness of exemption or limitation clauses?

2.2 There is a rather similar line of cases in which similar results have been reached but by a different line of reasoning which may be described as seeing the tort position in the contractual setting. The typical cases involved insurance arrangements in a construction contract. In a contract for the refurbishment of an existing building, it would be common to provide that the owner of the building is to insure and not the contractor (sensible, because the owner will of course be insured in any case). Courts have been prepared to hold, at least in some cases, that the result of the insurance position is to relieve the contractor from any liability if the building is damaged by negligence and in some cases they have gone further and held that the insurance provisions as between the owner of the building and the contractor control the tort liability of the subcontractor on the basis that a duty of care should not be imposed on the sub-contractor if he enters on the work knowing that it is insured by the owner of the building. This would be on the basis that such a sub-contractor would not feel obliged to insure the works himself.

Question 7. Do we need to say anything about the impact of the contract on the tort position of both parties?

- 2.3 It is normal in English law to say that a contract cannot impose burdens on a third party and I assume this to be the general rule in other systems. However, there are some difficult questions involving the borderline between contract and property law. So it is clear that if I sell part of my land and impose on the purchaser a contractual requirement that he does not build a factory on it, that requirement will in principle be enforceable against further purchasers of the land and on behalf of someone who purchases the land for me. English law is quite unclear about whether bargains of this kind, which are well established in relation to land, can apply to other forms of property. It is standard practice, for instance, for offices to rent rather than buy photocopiers typically for periods of up to 5 or 7 years. Suppose company A has entered into such contracts with many offices which are expressed to last for five years and then after twelve months sells all the photocopiers to company B, is company B entitled to retake possession of the photocopiers leaving the customers with their probably ineffective rights against company A?

Question 8. Do we need to deal with problems of this kind?

- 2.3 Damages suffered by third parties

In a leading case of *Beswick & Beswick (1968)* an uncle sold his business to his nephew on the basis that the nephew would pay £6 a week to the uncle during the uncle's life and £5 a week to his aunt after the uncle died. After the uncle died, the nephew paid one instalment to the widow and refused to pay any more. The House of lords held that an action could be maintained on behalf of the uncle's estate, which was the contracting party, and made an order for specific performance requiring the nephew to pay the money to the aunt. In the reasoning, it was assumed that specific performance was necessary because, if a damages action had been brought, the uncle's estate would only have recovered for damage to the estate and not for damage to the aunt. This case itself presents no problem under a regime which allows the widow to sue in her own right since she can then recover her loss. However, there would probably be cases where the loss is suffered by the third party but the third party is not able to sue. Later English case law suggests that in some cases an action can be brought by the contracting party to recover the loss of a party who cannot itself sue but the boundaries of this are far from clear.

Question 9. Is this a problem which needs to be addressed and, if so, what solution should be offered?

### 3. Limitations on the Third Party's Rights

- 3.1 Defences

I assume that, in general, a defence which would be available against the contracting party will be equally available against the third party. So, if I enter into a contract of insurance on behalf of my grandchildren and stop paying the premiums, this must affect the rights of the grandchildren, as well as my rights.

Question 10. Is it a general proposition that the defences available against the contracting party will also be available against the third party?

- 3.2 At what point do the rights of the third party crystallize?

It is a possible view that the third party's rights are complete as soon as the contract is made. It is another possible view that they can be revoked by the contracting parties at any time before performance. In practice, systems which allow third parties to get rights under contract do not appear to adopt either of these extreme positions but the most common positions appear to be that the third party's rights cannot be divested once the third party has done something to accept the rights or where the third party has done something in reliance on the contract which would make it unfair to allow the parties to change their minds.

Question 11. When do the contracting parties lose their right to change their minds and divest the rights of the third party?