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WORKING GROUP FOR THE PREPARATION OF
PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS

Chapter […]

THIRD PARTY RIGHTS

(Revised draft prepared by Professor M. Furmston in the light of the discussions of the Working Group at its 5th session held in Rome, 3-7 June 2002)

Rome, April 2003

Article 1
(*Contracts in favour of third parties*)

(1) Parties (the "promisor" and the "promisee") may confer by express or implied agreement a right on a third party (the "beneficiary").

(2) The existence and content of the beneficiary's right against the promisor are determined by the agreement of the parties and are subject to any conditions or other limitations under the agreement.

COMMENT

Usually contracts are intended by the parties to create rights and obligations between the parties. In such cases only the parties will acquire rights and duties under the contract. The mere fact that a third party will benefit from the performance of the contract does not by itself give that third party any rights under the contract.

Illustration

1. Professor A makes a contract with the University of Utopia under which he agrees to give forty 1-hour lectures comparing the Utopian and Ruritanian laws of contract. Professor A only appears for twenty lectures and does not mention Ruritanian law in the lectures. T, a student, does not acquire rights under the contract between Professor A and the University.

However, third parties are not always left without rights. The underlying principle is the autonomy of the parties, who should be free if they wish to create rights in a third party. The parties may state expressly that this is their intention but this is not essential since the intention to benefit the third party may be implicit in the contract. In cases where implied intention is alleged, the decision will turn on all the terms of the contract and the circumstances of the case.

Illustrations of implicit intention are the following:

Illustrations

2. A takes out a policy of insurance on his fleet of lorries which are regularly driven by his employees. The contract provides that the insurance company will cover anyone driving a lorry with A's consent. An employee, T, has an accident while driving the lorry. T is covered.

3. A sells his business to B on the terms that B will pay A £1000 a month for the rest of his life and will pay A's wife, T, £500 a month if A predeceases her. A dies. B refuses to pay T anything. T is entitled to the £500 a month.

4. T, the International World University, wishes to build a new law library on land owned by the University. For legitimate tax reasons the contract for the erection of the library is made by Denning Ltd, a company wholly owned by the University, although the contractor well knows that when completed the library will be occupied and used by T. The building has been badly done and it will cost US $ 5,000,000 to complete it satisfactorily. T can recover the cost of the remedial work.

5. A instructs his lawyer, X, to prepare a will, the main effect of which will be to divide his property equally between his wife and his sister, T. By gross professional incompetence x prepares a will which is invalid. The effect is that A dies intestate and under the relevant succession law, all his property goes to his wife. T can sue X for the breach of his contract to employ reasonable care in the preparation of the will.

Illustrations where there is no such implicit intention unless the circumstances clearly indicate otherwise are the following:

Illustrations

6. A goes to an expensive furrier and selects and buys a coat. He tells the assistant (truthfully) that he is buying it for his wife T. By the side of the coat is a prominent card saying “It looks like mink, it feels like mink but is guaranteed man made.” A gives the coat to his wife. In fact, owing to a mistake by the store, the coat is a real mink coat and T is ostracised by her friends. T has no enforceable contract right.

7. A buys a new car, which is the subject of warranties both by the manufacturer and by the dealer. After he has had the car a month without any problems, he allows his wife T to drive it. Without warning the brakes fail and T is seriously injured. T has no enforceable contract right.

8. A, a company with a large factory, makes a contract with a company operating the local sewage system. Under the contract, A is entitled to discharge its waste into the sewer but undertakes not to discharge certain types of waste. In breach of this undertaking, A discharges waste which blocks the sewer and causes damage to T, another user of the sewer. T has no enforceable contract right.

9. A, a Japanese firm, sells materials to B, a Swiss firm. A knows that B plans to resell the materials to T, a German pharmaceutical firm, which will use the materials for the manufacture of a new drug under a contract which will effectively limit B’s liability to T to $ US 1 million. The materials are defective and T’s losses greatly exceed $ US 1 million. T has no enforceable contract right.

In a number of examples it is likely that there will be tort claims in some jurisdictions. This possibility is outside the scope of the Principles.

It follows from the scheme of this Article that an express statement that the parties do not intend to create rights in a third party will be effective. It also follows that the promisor and promisee enjoy broad powers to shape the rights created in favour of the beneficiary. In this context the word "rights" should be liberally construed.

Article 2
(Third Party Identifiable)

The beneficiary must be identifiable with adequate certainty by the contract but need not be in existence at the time the contract is made.

COMMENT

The parties may well wish to make a contract in which the identity of the third party is not known at the time the contract is made but a mechanism is provided by which it will become known by the time performance is due. This might be by providing that the parties, or one of them, can identify the beneficiary at a later date or by choosing a definition of the beneficiary which later circumstances will serve to make the identity clear.

Illustrations

1. A married man with children but no grandchildren makes a contract with the XYZ insurance company under which A pays £10 a month to the insurance company and they promise to pay £10,000 to each of his grandchildren on his death. Grandchildren born after the date of the contract but before A's death are entitled to £10,000.

2. Company A launches a takeover bid for company B, a public company whose shares are traded on leading Stock Exchanges. Company B engages C, a leading firm of accountants to prepare a report on Company B for distribution to shareholders. The contract between company B and C requires C to produce an honest, thorough and competent report. Owing to incompetence C produces a report which is much too favourable to company B. As a result the majority of shareholders (T1) vote to reject Company A's offer. Some shareholders show copies of the report to friends (T2) who buy shares in Company B. T1 can acquire rights under the contract between B and C but T2 cannot.

Article 3
(Exclusion and Limitation Clauses)

For the purposes of this chapter, the conferment of rights in the beneficiary includes the right to invoke a clause in the contract which excludes or limits the liability of the beneficiary.

COMMENT

Contractual provisions limiting or excluding liability of those who are not parties to the contract are very common particularly in contracts of carriage, where they often form part of a settled pattern of insurance. Perhaps the best known example is the so-called Himalaya clause, which in some form is very widely to be found in bills of lading. In general the autonomy of the parties should be respected in this area too.

Illustration

A, the owner of goods, makes a contract with a sea carrier to carry them from Zenda to Xanadu. The bill of lading is subject to the Hague Rules and purports to exclude the liability of (a) the master and crew; (b) stevedores employed in loading and unloading the cargo; and (c) the owners of ships onto which the goods may be transhipped. These Exclusions will be effective.

Another situation which would be covered by this Article arises where the promisor and promisee agree that the beneficiary shall be released from an obligation which he owed to the promisor.

Article 4
(Defences)

The promisor may assert against the beneficiary all defences which the promisor could assert against the promisee.

COMMENT

Under Article 1 the content of the beneficiary's right may be made subject to any conditions or limitations devised by the parties. The promisor and promisee may devise a contract in which the position of the beneficiary is significantly different from that of the promisee. The parties' autonomy is in principle unlimited but they may well not provide expressly for all possibilities. The normal default rule will therefore be as stated in the present Article.

Illustration

A takes out a policy of life insurance with B Insurance Co in favour of T. The contract provides for the payment of premiums for 25 years but after 5 years A stops paying premiums. The position of T will be modelled on that of A if the policy had been in his favour. Such policies do not usually deny all return on the premiums paid. If, however, the policy had been liable to be set aside by the insurance company, for instance because A had not made material disclosure, then B insurance company would normally be entitled to raise this defence against T.

Article 5
(Revocation)

The contracting parties may modify or revoke the rights conferred by the contract on the beneficiary until the beneficiary has accepted them or acted in reliance on them

COMMENT

It might be the rule that the promisors and promisee were free to revoke the third party's rights at any time or, contrariwise, that the third party's rights were immutable once the contract is concluded. It appears that few systems adopt either of these extreme positions. The solution adopted is that the third party's rights become irrevocable once the third party has either accepted the rights or has relied on them. It will, of course, be open to the parties to provide for a different regime in the contract either by making the beneficiary's rights irrevocable sooner or by preserving a right of revocation even after the beneficiary has relied on the rights. There may well be situations where a right of revocation is given only to one party, for example, in a contract of life insurance it might be provided that the insured could change the beneficiary. There might be relevant usages which limited the possibility of revocation.

Illustration

A, the main contractor on a major construction contract, takes out a policy of insurance with the B insurance company to cover damage to the work in progress. The policy is expressed to cover the interests of all sub-contractors involved in the contract and sub-contractors are all told of the policy. T, a sub-contractor, does not take out any insurance himself but does not tell A or B. Absent clear words to the contrary, T's reliance makes the contract between A and B irrevocable.

Article 6
(Renunciation)

The beneficiary may renounce a right conferred on it.

COMMENT

The scheme of this chapter assumes that, absent contrary provision, the contract between promisor and promisee creates rights in the beneficiary at once without any need for acceptance by the beneficiary.

Although the third party will usually welcome the benefit which the parties had conferred upon him, he cannot be forced to accept it. It follows that the third party may expressly or impliedly renounce the benefit.

However, once the beneficiary has done something which amounts to acceptance, it should not normally be entitled to renounce.

Illustration

On the facts given in the illustration to Article 5, T, a sub-contractor, may not wish to take advantage of the insurance taken out by the main contractor because he already has relevant insurance in place (and he knows that there will be difficulties if there are two insurances covering the same risk). T is entitled to renounce.