JOSHUA WILLIAMS MEMORIAL ESSAY 1981

Sir Joshua Strange Williams, who was resident Judge of the Supreme Court in Dunedin from 1875 to 1913, left a portion of his estate upon trust for the advancement of legal education. The trustees of his estate, the Council of the Otago District Law Society, have therefrom provided an annual prize for the essay which in the opinion of the Council makes the most significant contribution to legal knowledge and meets all requirements of sound legal scholarship.

We publish below the winning entry for 1981.

PRIVITY OF CONTRACT: PROPOSED REFORM IN NEW ZEALAND

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I INTRODUCTION

The doctrine of "privity of contract" has been concisely defined as the principle that "a contract cannot (as a general rule) confer rights or impose obligations arising under it on any person except the parties to it".[1] The doctrine has been much criticised, for example in *Woodar Investment Development Ltd* v *Wimpey Construction UK Ltd*[2] Lord Scarman commented:[3]

> "If one had to contemplate a further long period of Parliamentary procrastination, this House might find it necessary to deal with [privity of contract] . . ." If the opportunity arises, I hope the House will reconsider *Tweddle* v *Atkinson*[4] and the other cases which stand guard over this unjust rule.

In New Zealand the Contracts and Commercial Law Reform Committee has considered privity of contract. The Committee presented its Report to the Minister of Justice on 29 May 1981. In that Report the Committee expressed dissatisfaction with privity of contract at common law, in as much as it prevents a third party suing to enforce a benefit conferred by the parties to a contract. The Committee recommended that statutory provision should be made for third parties to enforce such benefits. A draft bill which the Committee considered suitable to make that statutory provision was annexed to the Report.

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1 *Chitty on Contracts* (24th ed Guest, 1977) Vol 1 512.
2 [1980] 1 A11 ER 571.
3 Supra n 2 at 591. The first sentence of the quotation was itself quoted from *Beswick* v *Beswick* [1967] 2 A11 ER 1197, 1201 per Lord Reid.
4 (1861) 1 B&S 393; 121 ER 762.

II The Rationales for Privity of Contract

1 *General*

There are two principles upon which privity of contract is based. One is the fundamental tenet of the law of contract which requires that there be consideration which moves from the promisee. The other is mutuality, the principle that only a party to a contract has the right to sue or be sued.[5] The cases support both consideration and mutuality as the basis of privity of contract.[6] Usually the same result will follow from the application of either principle. In practical terms the notion of mutuality could be seen as a description of what follows from the application of the rules pertaining to consideration. Their origins, however, appear to be different,[7] and it has been held by the Privy Council that consideration per se is not the sole basis of privity of contract.[8] Each of these principles will be considered to ascertain why privity of contract is part of the common law.[9]

2 *Consideration Must Move From the Promisee*

In order to demonstrate the utility of the rule that consideration must move from the promisee it is appropriate to examine briefly the role of consideration at common law. This will assist in determining whether it is an integral part of the law relating to consideration, that it move from a particular person; or whether this is merely an unnecessary addition to the basic principle, which can be abandoned if it is found inconvenient to retain it.[10]

The raison d'etre for the doctrine of consideration is to select those promises which the law will require a person to fulfil. Views differ as to the principle upon which consideration selects the promises to be en-

5 In *Tweddle* v *Atkinson* supra n 4 Crompton J stated that it would be a monstrous proposition to allow a person to sue on a contract when he could not be sued himself.

6 *Price* v *Easton* (1833) 4 B&Ad 433; 110 ER 518 is a case in which different judges relied upon the different principles: Denman CJ based his judgment on consideration, Littledale and Paterson JJ based their judgments on privity. In *Tweddle* v *Atkinson* ibid all of the judgments referred to consideration although Crompton J also referred to mutuality. See also infra n 9.

7 Furmston, "Return to *Dunlop* v *Selfridge*?" (1960) 23 MLR 373, 383 suggests that consideration is the only true common law principle in privity of contract and that mutuality resulted from the unnecessary adoption of an idea developed in continental legal systems which knew nothing of consideration.

8 In *Kepong Prospecting Ltd* v *Schmidt* [1968] AC 810, 826 per Lord Wilberforce, the Privy Council held that a statutory provision allowing consideration to move from a person other than the promisee did not alter "the English conception of a contract as an agreement on which only the parties to it can sue".

9 In *Dunlop Pneumatic Tyre Co Ltd* v *Selfridge & Co Ltd* [1915] AC 847, 853 Viscount Haldane supported the view that there are two rules which govern privity of contract. Some commentators have taken the view that the two rules cannot be separated: Salmond and Williams, *Principles of the Law of Contracts* (2nd ed 1945) 99-100; Furmston, "Return to *Dunlop* v *Selfridge*?" supra n 7 at 382-384. Cf Atiyah, *Consideration in Contracts: A Fundamental Restatement* (1971) 40. For the purpose of analysing the policy justifications for the doctrine it seems that a more acute analysis will result by looking at both aspects rather than by reducing them to an analysis of the two.

10 It is not intended to question the value of consideration as a part of the law of contract; the issues thus raised go far beyond the confines of the present discussion.

forced. One view of the basis of consideration is that it only enforces promises which are part of a bargain.[11] This is also expressed by explaining consideration as the "price" of a promise.[12] If this is the basis of consideration, then at first sight it might appear that the reciprocity which is implicit in a bargain must preclude consideration moving from any person other than another party to the contract. It is submitted, however, that such a conclusion would be unsound. It is necessary to distinguish the formation of a contract from its enforcement. Consideration is concerned only with the formation of a contract. It determines which promises it is just for the courts to enforce. To permit it to govern who should enforce a contract would give the doctrine an extended role.[13] If this is correct, then it follows that the reciprocity implied by the bargain theory of consideration should determine whether it is just that a person be bound to fulfil his promise. The justice of the case would be unaffected by the individual with whom the bargain was made.[14] It would be sufficient that there was a bargain. This conclusion is strongly supported by the fact that while consideration must move from the promisee there is no requirement that it move to the promisor.[15] If the reciprocity of the bargain theory of contract were the basis of the rule that consideration move from the promisee, then logic would demand that it must also move to the promisor.

The "bargain" theory is not the only basis which has been suggested for the doctrine of consideration. Competing proposals include the view that when consideration has been given, failure to enforce a promise would allow the promisor to unjustly enrich himself or to obtain valuable consideration by a trick or deceit.[16] Another view is that where consideration is present there is justifiable or detrimental reliance by the parties and it would be unjust to refuse to enforce such a promise.[17] Finally, without attempting a comprehensive analysis, consideration may be explained as evidence of an intention that a promise is made seriously and that legal relations are to be created.[18] These alternative views do not have the superficial attraction of emphasising reciprocity. The final

11 *Anson's Law of Contract* (25th ed Guest, 1979) 121; Atiyah, supra n 9 at 27. The deficiencies in the doctrine are noted by those writers: cf Hamson, "The Reform of Consideration" (1938) 54 LQR 233, 234 who regards it as fundamental to the formation of a contract. The idea also has currency in the United States: see Corbin, *Corbin on Contracts* (1963) Vol 1 s116; *Williston on Contracts* (3rd ed Jaeger, 1957) Vol 1 s100.

12 See eg Atiyah, supra n 9 at 27.

13 Atiyah, ibid at 60; *Chitty on Contracts,* supra n 1 at 63. For an historical note on the function of consideration, see Simpson, *A History of the Common Law of Contract* (1975) 316; *Williston on Contracts,* supra n 11. Sutton, *Consideration Reconsidered* (1974) 33 concludes that "the question remains whether the function of the courts is not to apply the rule mechanically and dogmatically but to determine if a sound and sufficient reason exists for the refusal to enforce a particular promise".

14 Subject to factors that stand apart from consideration such as the requirements relating to capacity.

15 The usual example is that a person who guarantees another's bank overdraft is liable to the bank although he obtains no benefit from the transaction: see *Chitty on Contracts,* supra n 1 at 78.

16 Simpson, supra n 13 at 323-324.

17 Ibid at 324; *Williston on Contracts,* supra n 11 at s100.

18 *Anson's Law of Contract,* supra n 11 at 121; Corbin, supra n 11 at s112.

answer to the question of whether they explain why consideration must move from the promisee is however the same as that for the "bargain" theory. Each of these theories is also concerned with the justice of binding a person to a promise, apposite only to the formation and not to the enforcement of the contract itself.

The theoretical basis of consideration, whatever view one may take of it, does not appear to make it necessary that consideration should move from the promisee. It would therefore seem that this aspect of the doctrine could be abolished without necessitating any substantial change in the law.[19] It is nonetheless profitable to examine the origins and operation of the rule before rejecting it. The history of the requirement that consideration must move from the promisee does not establish that it developed as an essential part of the doctrine of consideration, or that there were compelling social factors which made it desirable that the law follow this course. The rule was established in its modern form in the nineteenth century in two leading cases *Price* v *Easton*[20] and *Tweddle* v *Atkinson*.[21] By 1884 Bowen LJ was able to state that it was "mere pedantry" to cite the earlier cases which cast doubt on privity of contract.[22] In 1915 the House of Lords confirmed the doctrine in *Dunlop Pneumatic Tyre Co Ltd* v *Selfridge & Co Ltd.*[23] Prior to these cases, however, the situation was a good deal less clear. It was not until the nineteenth century that the expression "consideration must move from the promisee" was used.[24] The principle however had its genesis in *Bourne* v *Mason*[25] where a third party failed to recover as he was a "stranger to the consideration".[26] Prior to this there was generally no obstacle to a third party suing even though he had provided no consideration.[27] The fact that the rule requiring consideration to move from the promisee only became firmly established[28] in its modern form in the

19 Hamson, supra n 11 at 234-235 supports this view, suggesting that the essence of the doctrine of consideration is the bargain theory. He takes the argument a step further by suggesting that refinements, such as requiring that consideration move from the promisee, can nullify a transaction which it is the very object of the doctrine of consideration to enforce. See also Dowrick, "A *Jus Quaesitum Tertio* By Way of Contract in English Law" (1956) 19 MLR 374, 390.

20 Supra n 6.

21 Supra n 3.

22 *Gandy* v *Gandy* (1884) 30 ChD 57, 69.

23 Supra n 9.

24 Simpson, supra n 13 at 476.

25 (1669) 1 Vent 6; 86 ER 5; 2 Keb 457; 84 ER 287.

26 At that time a close relative of the person providing the consideration was not regarded as a stranger to the consideration; see eg *Bourne* v *Mason* ibid (parent and child). This is the explanation for some of the uncertainty which followed *Bourne* v *Mason* until the position was clarified in *Tweddle* v *Atkinson* supra n 4 at 399, 764.

27 See Simpson, supra n 13 at 475-485; Stoljar, *A History of Contract at Common Law* (1975) 134-140.

28 In *Martyn* v *Hind* (1776) 2 Cowp 437, 443; 98 ER 1174, 1177 Lord Mansfield stated that it was "a matter of surprise" how a doubt could have arisen in *Dutton* v *Pool* (1677) 1 Vent 318, 332; 86 ER 205, 215 a case in which the promisor had objected that the third party and not the promisee had sued.

nineteenth century and the fact that doubts continue to be expressed[29] do little to support the doctrine.

The most recent trend has been for the courts to limit the operation of the requirement that consideration move from the promisee. The opportunity to do this has arisen where joint promisees[30] have entered into a contract in which only one has furnished the consideration.

In *Coulls* v *Bagot's Executor and Trustee Co Ltd*,[31] the plaintiff was a widow whose late husband had contracted to grant a quarrying licence in return for royalties. The contract provided for royalties to be paid to the husband and wife jointly during their lives and thereafter to the survivor. The plaintiff had signed the contract, but had no other involvement. The majority of the High Court of Australia (McTiernan, Taylor and Owen JJ) held that the plaintiff was not a party to the contract. Taylor and Owen JJ commented that if she had been, she could have enforced the contract, even though her husband had provided the consideration.[32] Barwick CJ and Windeyer J dissenting, held that the plaintiff was a party to the contract. They agreed with Taylor and Owen JJ that the fact that the plaintiff's husband had provided all the consideration did not prevent the plaintiff bringing her action.[33] Thus, four of the five judges of the High Court were prepared to abrogate the rule as to the moving of the consideration from the promisee in the joint promisee context. In *New Zealand Shipping Co Ltd* v *A M Satterthwaite & Co Ltd*[34] Lord Simon of Glaisdale supported this approach, commenting that "it seems to be an attractive proposition in respect of genuine joint promisees".[35] Textbook writers have also supported the development.[36] Professor Coote, however, has criticised this approach suggesting that *Coulls* failed to distinguish between consideration as an obligation assumed at the formation of the contract and payment in performance of the contract,[37] there being no special significance in one party settling an obligation which attaches jointly to the parties. Professor Coote also argues that the provision of consideration is an essential element in becoming a party to a contract.[38] Whether or not the joint promisee development is sound, it demonstrates an increasing willingness to question the utility of the requirement that consideration move from the promisee. This process has reached the point of open judicial criticism at the highest level with Lord Scarman's comments in *Woodar Investment Development Ltd* v *Wimpey Construction UK Ltd.*[39] Whether the House of Lords will, as

29 Lord Denning has used the unsettled history of privity of contract to attack the doctrine: see *Drive Yourself Hire Co (London) Ltd* v *Strutt* [1954] 1 QB 250. For a recent case in which it was found helpful to consider the history of the doctrine, see *Coulls* v *Bagot's Executor and Trustee Co Ltd* (1967) 119 CLR 460.

30 *Chitty on Contracts,* supra n 1 at 79.

31 Supra n 29.

32 Ibid at 486.

33 Ibid at 478-480, 492-493.

34 [1974] 1 NZLR 505.

35 Ibid at 522.

36 See Coote, "Consideration and the Joint Promisee" [1978] CLJ 301, 302.

37 Ibid at 305.

38 Ibid at 309.

39 Supra n 2.

Lord Scarman suggests, "reconsider *Tweddle* v *Atkinson* and the other cases which stand guard over this unjust rule"[40] remains to be seen. If the rule is retained it would seem that it will be because of respect for the precedents of the nineteenth and twentieth centuries, and not for reasons of policy.[41] The history of the rule and its recent treatment by the courts confirm the conclusion indicated by the analysis of the theoretical basis of the doctrine of consideration: the requirement that consideration move from the promisee is an unnecessary accretion to the law of consideration, and can be abolished without detriment to the existing law.

3 *Mutuality*

There are two consequences arising from privity of contract. First, that a stranger cannot have an obligation imposed upon him by contract,[42] and secondly, that a stranger cannot sue to enforce any benefit purportedly conferred on him by a contract.[43]

It is the rule against imposing an obligation on a stranger which is more easily explained, as is illustrated by *Haseldine* v *C A Daw & Son Ltd.*[44] The owners of a block of flats engaged the defendant to repair a lift. The contract for repair contained an exemption clause purporting to exempt the defendant from liability for accident. A third party was injured due to deficiencies in the repairs carried out. It was held that the rights of a third party could not be taken away by a contract to which the third party was a stranger.[45] The basis of this decision is clear and obvious. The third party has not consented to the agreement. It is analogous to A and B reaching an agreement that A will purchase goods from B and that C who has not consented shall pay for them. This aspect of the law is based on the most fundamental notion of the law of contract; that it enforces certain consensual arrangements. It cannot be abolished in the absence of the most radical change to the law of contract. The Committee has not recommended that this aspect of the doctrine of privity of contract should be changed.[46]

The role of mutuality or privity[47] as a rationale for the rule that a third party cannot sue to enforce a benefit conferred by a contract to which he is not a party is a matter of some difficulty. Unlike the rule that consideration is to move from the promisee, this requirement has no direct connection with a fundamental rule of law. The principle has no long

40 Ibid at 591.

41 Lord Keith, ibid at 588 concurred with Lord Scarman. The law could however be changed by allowing the promisee to sue and recover full rather than nominal damages: ibid at 583 per Lord Salmon.

42 See eg *McGruther* v *Pitcher* [1904] 2 Ch 306; *Taddy & Co* v *Sterious & Co* [1904] 1 Ch 354.

43 See eg *Scruttons Ltd* v *Midland Silicones Ltd* [1962] AC 446; *Beswick* v *Beswick* [1968] AC 58.

44 [1941] 2 KB 343.

45 Ibid at 379.

46 *Privity of Contract: Report of the Contracts and Commercial Law Reform Committee* (1981) (hereafter referred to as *Report*) para 8.1. This is also the case with proposed reforms in England, *Report,* para 1.3; Western Australia, *Report,* Appendix A; Queensland, *Report,* Appendix B.

47 In the sense that only a party to a contract may sue or be sued.

history. The best view would seem to be that mutuality or privity was used as an explanation for the rule that consideration must move from the promisee.[48] Since the decision in *Kepong Prospecting Ltd* v *Schmidt*[49] the principle has become firmly established as an independent doctrine. In these circumstances the most appropriate way to evaluate this rationale is to look at the practical reasons that give rise to the doctrine.

One of the strongest claims for the role of mutuality was made by Crompton J in *Tweddle* v *Atkinson*[50] who maintained that it would be a "monstrous proposition"[51] to allow a person to sue on a contract when he could not be sued himself. With respect, the question whether a party may be sued is not the true point at issue. There is no question of the doctrine preventing the promisor suing the promisee to ensure that the promisee fulfils his obligations. The real issue is whether the promisor should answer to the third party.[52] It is true that there may be inconvenience arising from the fact that actions on one contract may arise between different litigants but that hardly seems to warrant Crompton J's epithet that it is a "monstrous proposition". To put the situation into context, it must be remembered that the promisor has agreed to benefit the third party at the time of the formation of the contract. It cannot be said that the third party is a total stranger to the promisor. Treitel has also pointed out that the law will enforce unilateral contracts which may result in a "stranger" suing to enforce the contract.[53] The offeror will be held liable as he has created the situation himself. The analogy with a third party seems close.

There are difficulties which arise if a third party can enforce a contract. There may be some matter outstanding between the promisor and the promisee, and it may at the least be inconvenient for the promisor to begin a separate action against the promisee, after having been sued by the third party. This difficulty can be avoided by adding the promisee as a party to the first proceedings.[54] The difficulty which does arise if the third party is given a right of action is the relationship between the promisee and the third party. Since the promisee has provided the consideration and the third party is a donee there may be circumstances in which it would be unjust to deprive the promisee of rights under the contract. The promisee's right to vary the contract, with the promisor's agreement is the most likely source of tension between the promisee and the third party. Another difficulty may arise if the promisee wishes to sue and recover the benefit intended for the third party, and to retain it for himself.

48 See Andrews, "Section 56 Revisited" (1959) 23 Conv (NS) 179, 188. Furmston, supra n 9 at 383 suggests that the principle was unnecessarily transferred into English law from continental legal systems.

49 Supra n 8.

50 Supra n 4.

51 Ibid at 398; 764.

52 See Stoljar, supra n 27 at 139.

53 Treitel, *The Law of Contract* (4th ed 1975) 420.

54 Sim and Cain, *The Practice of the High Court and Court of Appeal of New Zealand* (12th ed 1978) 136-147; *Wily and Crutchley's District Courts Practice* (8th ed Crutchley, 1980) 250-256.

It is submitted that privity of contract has a sufficient rationale to justify only the rule that a burden cannot be cast upon a stranger by contract. The rule that a third party cannot sue to obtain a benefit is useful only to regulate the relationship between the third party and the promisee. Difficulties in that area can be dealt with more specifically than by prohibiting the third party from suing.

III The Need for Reform

At first sight, the need for reform of the law relating to privity of contract is not great. While the third party may not be permitted to sue,[55] the promisee can bring an action if required. The harshness of not allowing the third party to sue lies in the serious deficiencies in the promisee's right to recover on behalf of the third party.

There are several remedies which a promisee may seek,[56] but each has its own boundaries and limitations. The problems are best illustrated by considering the two most common remedies, specific performance and damages. Specific performance is a secondary remedy, available only when damages are not appropriate. As a discretionary equitable remedy there are many factors which will be taken into account. Certain types of relief will not be ordered by specific performance and in some situations relief is simply not available through specific performance.[57] In short, specific performance is a specialised remedy appropriate only to particular situations, and its limited scope is typical of the special forms of relief other than damages.[58]

The primary remedy which the promisee has available is damages. If justice is to be done it is essential that this remedy is adequate. As the law stands the remedy is inadequate as "[t]he only person who has a valid claim has suffered no loss, and the only person who has suffered a loss has no valid claim."[59] This situation has arisen because the courts have drawn a distinction between damages for the promisee's loss and damages for the third party's loss. If the promisee brings an action to recover damages for the promisor's failure to benefit the third party, the damages will be nominal only. Performance was not to benefit the promisee and he will not necessarily have suffered loss by reason of the breach. The House of Lords adopted this view in *Beswick* v *Beswick*.[60] Lord Upjohn stated that he could not see how the promisee could "in

55 If the promisee is indebted to the third party and it is intended that performance of the contract settle that debt, an independent action will lie.

56 The remedies which may be sought include: restitution of consideration, a claim for the agreed sum, injunction to enforce a negative promise and stay of proceedings: see 9 *Halsbury's Laws of England* (4th ed) para 330; *Chitty on Contracts,* supra n 1 at 519-523; *Anson's Law of Contract,* supra n 11 at 425-427; Treitel, supra n 53 at 423-425.

57 The leading authority on specific performance in privity of contract is *Beswick* v *Beswick* supra n 43. For an account of the different factors taken into account see Spry, *The Principles of Equitable Remedies* (2nd ed 1980) 51ff; In *Woodar Investment Development Ltd* v *Wimpey Construction UK Ltd* supra n 2 at 590 per Lord Scarman, the remedy was clearly not available.

58 Supra n 56.

59 *Ross* v *Caunters* [1979] 3 All ER 580, 583 per Megarry VC.

60 Supra n 43.

conformity with clearly settled principle in assessing damages for breach of contract, rely at common law on [the third party's] loss."[61] This is the crux of the problem with the rule that the third party cannot sue, although there are exceptions to the general rule in assessing damages. Where there is an actual loss to the promisee, such as where the promisor is to settle a debt owed by the promisee to a third party, damages can be substantial.[62] It may be that if the promisee gratuitously benefits the third party after the promisor's default, the promisor will be liable to compensate the promisee.[63] A recent attempt to circumvent the operation of the rule in assessing damages, however, has been unsuccessful.[64]

There will be many cases in which the existing law allows the promisee to obtain an adequate remedy. In addition there are several exceptions to the general doctrine of privity of contract.[65] Notwithstanding these cases in which justice will be done, there remains a group of cases in which all the elements necessary to form a binding agreement are present and yet it is unenforceable. Such a situation is manifestly unjust and it is not surprising that Lord Salmon has recently commented that "the law as it stands at present in relation to damages of this kind is most unsatisfactory".[66]

There has been criticism of the doctrine of privity of contract by the judiciary,[67] by textbook writers[68] and by commentators.[69] The most common criticisms are that the doctrine frustrates the contractual intentions of the parties [70] and that it is inconvenient in modern commercial conditions.[71] It is undoubtedly true that the doctrine of privity of contract frustrates contractual intentions. This is also true of many of the principles of the law of contract. The requirements of consideration,

61 Ibid at 101.

62 This is implicit in *Beswick* v *Beswick* ibid at 102 per Lord Upjohn with reference to the estate's lack of assets, implying that damages would have been awarded if the estate had been diminished by a claim from the widow as a result of the promisor's breach; see also *Jackson* v *Watson & Sons* [1909] 2 KB 193; *Radford* v *De Froberville* [1978] 1 All ER 33.

63 See *Banco de Portugal* v *Waterlow & Sons Ltd* [1932] AC 452 and a similar principle in tortious liability: *Cunningham* v *Harrison* [1973] QB 942, 952, 955, 958; *Donnelly* v *Joyce* [1974] QB 454; cf *Admiralty Commissioners* v *SS Amerika* [1917] AC 38, 41.

64 The method of assessing damages adopted by Lord Denning MR and Orr LJ in *Jackson* v *Horizon Holidays Ltd* [1975] 3 All ER 92 was rejected by the House of Lords in *Woodar Investment Development Ltd* v *Wimpey Construction UK Ltd* supra n 2, although that method of assessment may have some residuary application: ibid at 576 per Lord Wilberforce, 583 per Lord Salmon, 588 per Lord Keith, 591 per Lord Scarman, 585 per Lord Russell.

65 See *Report,* paras 5.1-5.7; *Chitty on Contracts,* supra n 1 at 526ff.

66 *Woodar Investment Development Ltd* supra n 2 at 583.

67 *Scruttons Ltd* v *Midland Silicones Ltd* supra n 43 at 486 per Lord Denning; *Beswick* v *Beswick* supra n 43 at 93 per Lord Pearce; *Woodar Investment Development Ltd* ibid at 591 per Lord Scarman.

68 Cheshire and Fifoot, *The Law of Contract* (5th NZ ed Northey, 1979) 376; *Anson's Law of Contract,* supra n 11 at 439.

69 Palmer, "The Stevedore's Dilemma: Exemption Clauses and Third Parties" [1974] Jo of Business Law 101, 102; Atiyah, "Bills of Lading and Privity of Contract" (1972) 46 ALJ 212, 216.

70 *Report,* para 6.2; Atiyah, ibid at 216.

71 Cheshire and Fifoot, supra n 68 at 376; Palmer, supra n 69 at 102.

definition of the contents of the contract, mistake, relief for duress, illegality and capacity are all rules of law which are capable of frustrating the contractual intentions of at least one party. But the important point is whether this intervention is justified. Having regard to the limited rationales for the doctrine of privity this objection does seem to be one of substance.

The claim that privity of contract is out of line with modern commercial conditions is readily illustrated, for example the inconvenience of restricting commercial concerns assigning risk for insurance purposes. It may be more efficient to extend immunity to a subcontractor so as to avoid the duplication of insurance cover but this cannot readily be achieved due to privity of contract.[72] The disadvantages[73] when weighed against the rationales for the doctrine of privity of contract indicate that reform is desirable.

IV Approaches to Reform

1 *Reform of Damages or Right of Action?*

I have argued that the injustice of the doctrine of consideration lies in the promisee's limited right to recover damages and that the doctrine's utility is that it avoids disputes between the promisee and the third party. The simplest reform would be to allow the promisee to recover damages in full.[74] As the third party is relying on an incomplete gift, his position would be no worse than that of any prospective donee. Such reform would prevent gross injustice, which can occur in some cases. The Committee has proposed a more radical reform by recommending that the third party should have the right to sue, with certain protection being provided for the parties to the contract.

The case for giving the third party a right of action has two limbs. First, as I have already argued, the restriction on the third party's right of action has a limited utility, for which provision can be made without absolute prohibition. Secondly, there are practical difficulties in the promisee suing. It may be that the very reason for providing that a third party should benefit is that the promisee has anticipated that he will be absent or unavailable to enforce the contract.[75] In some cases, the promisee may simply have a change of attitude and decline to enforce the contract. It is difficult to distinguish this from any other incomplete gift but there are some situations in which there is a change in the natural persons who constitute the promisee, for example the promisee's personal representatives after death, and the Official Assignee. In such cases the

72 See eg the difficulties faced by the court in upholding such an arrangement in *New Zealand Shipping Co Ltd* v *A M Satterthwaite & Co Ltd* supra n 34 and *Port Jackson Stevedoring Pty Ltd* v *Salmond & Spraggon (Australia) Pty Ltd* [1980] 3 A11 ER 257. See also *Greenwood Shopping Plaza Ltd* v *Beattie* (1980) 111 DLR (3d) 257; noted (1981) 59 Can Bar Rev 549.

73 For a fuller discussion of the disadvantages of privity of contract see *Report,* paras 4.1-4.10; 6.2.

74 If such a reform were instituted it would be helpful to clarify the law as to the position between the promisee and the third party: see *Chitty on Contracts,* supra n 1 at 523ff.

75 Stoljar, supra n 27 at 139.

original promisee's intentions, for which he gave valuable consideration, may be frustrated. It could even be that the promisor becomes the executor of the promisee's estate. If the parties to the contract suffer no harm from the third party's right of action, it would be better to grant it than confine reform to damages only.

2 *Dangers Inherent in Reform*

While it may be desirable to give a third party a right of action it is necessary to place some restrictions on that right. Which third parties are to have a right of action? The absence of any limitation may lead to absurd results, such as an ordinary taxpayer claiming a right to enforce a government contract on the basis that he would receive an indirect benefit. In addition it is necessary to make provision for the regulation of the promisee's rights when they conflict with those of the third party. Finally, regard should also be had to making appropriate provision for defences, set-offs and counterclaims between the promisor and the promisee.[76]

There are some general consequences of giving the third party a right of action which may be perceived as undesirable. This innovation would allow contracts to contain effective exemption clauses excluding third parties from liability. It would also allow manufacturers to create effective schemes providing minimum retail prices for their products.[77] Such arrangements can be unjust and against the public interest. Privity of contract can militate against such arrangements being effective. It does not follow, however, that this should be an impediment to reform of privity of contract. It is simply a fortunate or unfortunate accident that such schemes are frustrated. No regard is paid to the merits of the arrangements. It matters not whether the exemption clause is a well understood mutually beneficial allocation of risk for insurance purposes, by commercial entities, or a hidden exclusion of the protection provided by the law. As the merits of arrangements are not considered under the privity of contract rules, exemption clauses and price fixing would be best dealt with by specific remedial legislation.[78]

3 *Criteria for Effective Reform*

While the law relating to privity of contract may be in need of reform, the existing law is sufficiently flexible to allow parties to achieve the objective of benefiting a third party, often, for example by the use of a deed. If the promisor, promisee and third party are all parties to the

76 For a review of these and other issues see *Report,* paras 8.1-8.2.

77 A manufacturer could stipulate that a wholesaler would only resell on condition that a retailer agree to sell at a minimum price. The manufacturer would then be free to sue a retailer who breached the agreement concluded for the benefit of the manufacturer: see eg *Dunlop Pneumatic Tyre Co Ltd* v *Selfridge & Co Ltd* supra n 9.

78 See eg Unfair Contract Terms Act 1977 (UK); Resale Prices Act 1976 (UK); Commerce Act 1975 (NZ).

deed, the consideration and privity difficulties are overcome.[79] This device is of course primarily for relatively uncomplicated transactions.

The practical difficulties of operating within the doctrine of privity of contract are well illustrated by what has been the most important aspect of the doctrine to be the subject of litigation in recent years. This is the situation which arises when a marine carrier provides in his contract with the consignor that subcontractors (notably stevedores) are to have exemption from liability, such an arrangement often being made when it is customary for the consignor to insure against loss. If the stevedores are required to insure against the same risk it adds unnecessarily to the cost of their services. The House of Lords had held in *Elder Dempster & Co Ltd* v *Paterson Zochonis & Co*[80] that if a contractor performed duties in pursuance of a "head contract" he could obtain the benefit of an exemption clause in that "head contract".[81] This decision was questioned[82] and in *Scruttons Ltd* v *Midland Silicones Ltd*[83] the House of Lords effectively confined *Elder Dempster* to its own facts and reasserted privity of contract in this area. Lord Reid did, however, leave open a means of conferring the benefit of an exemption clause, without departing from settled principle:[84]

> I can see a possibility of success of the agency argument if (first) the bill of lading makes it clear that the stevedore is intended to be protected by the provisions in it which limit liability, (secondly) the bill of lading makes it clear that the carrier, in addition to contracting for these provisions on his own behalf, is also contracting as agent for the stevedore . . . (thirdly) the carrier has authority from the stevedore to do that, or perhaps later ratification by the stevedore would suffice, and (fourthly) that any difficulties about consideration moving from the stevedore were overcome.

The Privy Council approved and applied these principles in *New Zealand Shipping Co Ltd* v *A M Satterthwaite & Co Ltd,*[85] although dissenting judgments highlighted the difficulties in applying the principle to the facts of that case. The principles applied in *Satterthwaite* did in fact receive a less than enthusiastic reception in the Commonwealth and it was distinguished on a number of occasions.[86] One commentator was led

79 See *Chitty on Contracts,* supra n 1 at 15; see also Property Law Act 1952, s7 (NZ); Burrows, "Section 7 of the Property Law Act 1952" [1969] NZLJ 676. Where the third party is unascertained, or an infant at the time of the contract, a trust incorporated into a deed may be more appropriate.

80 [1924] AC 522.

81 The width of the ratio in *Elder Dempster & Co Ltd* ibid has never been finally determined: but see *Mersey Shipping & Transport Co Ltd* v *Rea Ltd* (1925) 21 LIL Rep 375, 378 per Scrutton LJ; cf Bankes LJ.

82 See eg *Adler* v *Dickson* [1955] 1 QB 158, 169 per Pilcher J, 181-183 per Denning LJ for approval of the doctrine.

83 Supra n 43.

84 Ibid at 474.

85 Supra n 34.

86 For a range of Commonwealth decisions see *Herrick* v *Leonard & Dingley Ltd* [1975] 2 NZLR 566; *Calkins & Burke Ltd* v *Far Eastern Steamship Co* (1977) 72 DLR (3d) 625; *Ceres Stevedoring Co Ltd* v *Eisen Und Metall AG* (1977) 72 DLR (3d) 660; *Lummus Co Ltd* v *East African Harbours Corporation* [1978] 1 Lloyd's Rep 317; *"The Federal Schelde"* [1978] 1 Lloyd's Rep 285; *Marubeni America Corporation* v *Mitsui OSK Lines Ltd* (1979) 96 DLR (3d) 518.

to say that *Satterthwaite* did "not expose a new route to vicarious immunity, but is an isolated decision that depends almost entirely on its own particular facts".[87]

The principle in *Satterthwaite* has recently been revived by the Privy Council's decision in *Port Jackson Stevedoring Pty Ltd* v *Salmon & Spraggon (Australia) Pty Ltd*[88] in which the Judicial Committee reaffirmed *Satterthwaite* and indicated that it should be applied without undue attention to technicality. The interest in this line of authority lies not in the legal reasoning but rather in the very fact that litigation took place.

The principle of protecting the stevedore is clearly a matter of real concern to both the carriers, who have co-operated by inserting provisions in their contracts with consignors, and the stevedores who have been prepared to follow through a series of appeals at very considerable expense. As commercial enterprises with the resources to have complex agreements drawn up and then supported in the courts, it is reasonable to suppose that such agreements would have made the best possible use of the existing law. One would expect that this section of the public would be better informed than most both as to the difficulties arising due to the doctrine of privity of contract and as to the means of avoiding those difficulties. In the cases which were litigated there is little evidence of this. The results which were only achieved at considerable expense, after the uncertain process of litigation, could have been obtained by more effective use of the existing law.

In the context of carriers and stevedores it is not possible to use the simple expedient of a deed; the stevedore who will ultimately unload the ship may well not even have been selected when the bill of lading is signed. One method of making protection more certain for the stevedore is to draft clauses in accordance with the reasoning in *Satterthwaite.* The minority in the Privy Council pointed out that there were difficulties in construing the bill of lading to have the effect ascribed to it by the majority.[89] It would clearly be possible to improve the drafting of bills of lading, with the result that there would be less need to apply policy reasons, such as for example "commercial considerations" in order to achieve the desired result.

An alternative method of providing the benefit of immunity to a third party is to stipulate that the promisor shall not sue the third party. This procedure has been used successfully in England and New South Wales. In *Gore* v *Van der Lann*[90] the English Court of Appeal held that the promisee could obtain a stay of proceedings where a promise not to sue a third party had been breached provided the promisee had a sufficient interest in enforcing the promise. This could, for example, be provided by the promisee having indemnified the third party. A somewhat wider view was taken in the later case *Snelling* v *John G Snelling Ltd.*[91] The judg-

87 Davis, "*Midland Silicones* Refulgent" (1977) 40 MLR 709.
88 Supra n 72.
89 Five of the eight appellate judges held that the clause was ineffective.
90 [1967] 2 QB 31.
91 [1973] QB 87.

ment of Ormrod J in the Queen's Bench Division is difficult to reconcile with the "sufficient interest" requirements of *Gore's* case. It has been suggested that the decision is nonetheless consistent with the principles in *Beswick* v *Beswick.*[92] In two New South Wales cases, *Broken Hill Pty Co Ltd* v *Hapag-Lloyd Aktiengesellschaft*[93] and *Sidney Cooke Ltd* v *Hapag-Lloyd Aktiengesellschaft*[94] a similar approach was taken, although only *Gore's* case was referred to, *Snelling's* case not being cited in argument or referred to by the Court. It may, however, be difficult to apply these cases in New Zealand since they are all based on a statutory jurisdiction to stay proceedings, where formerly it would have been possible to obtain an injunction to restrain the prosecution of proceedings.[95] In New Zealand, it would seem that there are three ways in which the principle could be applied. First, the promisee could seek an injunction to prohibit the promisor prosecuting proceedings.[96] Secondly, a stay of proceedings could be sought on the basis of Rule 242 of the Code of Civil Procedure which confers a general power to stay proceedings which are not brought in good faith.[97] Thirdly, the promisee could seek a stay of proceedings on the basis of the court's inherent jurisdiction, which is not excluded by Rule 242.[98] The discretionary nature of the remedies which the promisee must pursue, after stipulating that the promisor will not sue the third party, and the lack of direct New Zealand authority, does introduce an element of uncertainty into this method of avoiding problems posed by privity of contract.

A certain and effective way of conferring the benefit of a limitation of liability on a third party would be for the "promisee" to require an indemnity from the promisor. The promisee would then give an indemnity to the third party. Alternatively the promisee could require the promisor to undertake not to sue and to give an indemnity to the third party. This could be supported both on the basis of *Gore* v *Van der Lann*[99] and on general principles in an action for damages. If the promisee simply sought an indemnity without indemnifying the third party it would invite the objection that it constituted a penalty.[1] It would still be necessary for the promisee to enforce the arrangement although as promisees seem prepared to insert stipulations into contracts this should not be a major difficulty.

There is considerable scope within the existing law to achieve the object of benefiting a third party. The fact that there are many cases in which difficulties occur[2] indicates that it is unwise to expect that parties to contracts will be cognisant of refined points of law affecting their actions. This is a factor which weighs in favour of reforming the existing

92 Supra n 43.
93 [1980] 2 NSWLR 572.
94 [1980] 2 NSWLR 587.
95 Supreme Court of Judicature Act 1925, s41 (UK); Supreme Court Act 1971, s61 (NSW).
96 Specific performance and injunction are both discretionary remedies: see supra p 323.
97 Sim and Cain, supra n 54 at 257.
98 Ibid at 252ff. For a fuller discussion of the court's inherent jurisdiction see Jacob, "The Inherent Jurisdiction of the Court" (1970) 23 Current Legal Probs 23.
99 Supra n 90.
1 Treitel, supra n 53 at 430.
2 *Report,* paras 4.1-4.11.

law. It is also an element to be taken into account when making those reforms. Contractual intention and what would appear to be the natural, untutored expectations of the parties to a contract would seem to be proper and relevant principles upon which to base the law.

V The Contracts and Commercial Law Reform Committee's Proposals for Reform

As has previously been noted, the Contracts and Commercial Law Reform Committee has prepared a Draft Bill to give effect to their proposals.[3] The object of the Draft Bill is to give a third party the right to sue to obtain a benefit conferred by a contract, while preserving certain rights for the promisee to alter the contract.[4] The text of the Draft Bill is reproduced as an Appendix to this article.

1 *Action by the Promisee*

There are difficulties in the promisee suing and recovering a benefit on behalf of a third party. The Law Reform Committee noted this,[5] but stated that they were recommending changes to allow the third party to sue directly. This would of course mean that the question of assessing damages would become less important. Accordingly, the Committee thought it better to reserve that point to be dealt with in a review of the general rules relating to damages. Nevertheless the right of the promisee to sue and recover damages may still be important in at least two situations, one of which may arise where the third party declines to sue for the benefit. This would of course be unusual and for an example one has to resort to the extraordinary, such as a third party whose estate is in the hands of the Official Assignee who declines to pursue a doubtful claim. The promisee might then successfully pursue the claim which could affect the third party's discharge from bankruptcy. The more common situation will arise due to the proviso to clause 4 of the Draft Bill which provides:[6]

> [The third party's right to sue] shall not apply to a promise which, on the proper construction of the deed or contract, is not intended to create an obligation enforceable at the suit of that person.

It remains to be seen how the courts would deal with this construction problem. Nonetheless there will be a class of contracts to which the common law rules apply. As has been established, the rules relating to the quantum of damages, are capable of working the injustice that a contract, fully performed by the promisee, cannot be enforced against the promisor.[7] Indeed the Committee commented that "[i]f it is the law . . .

3 Ibid at 69ff.
4 Draft Bill, clauses 4 and 5.
5 *Report,* para 6.4.
6 Ibid at 71.
7 If there is a total failure to perform, a claim may lie for restitution of consideration; this however would be an inadequate remedy for eg a life insurance policy which had matured, since only the premiums would be refunded: see *Chitty on Contracts,* supra n 1 at 519.

then that law should be changed immediately."[8] It would, in these circumstances, be appropriate to include a provision deeming the third party's loss to be the promisee's loss. The principal difficulty lies in the position as between the third party and the promisee. If the promisee recovers substantial damages, due to the third party's loss, is it just that the promisee should retain those damages?

To incorporate the promisee's right to sue into the scheme for reform, it would seem that the only consistent way to deal with the position between the promisee and the third party is to adopt the principles implicit in the provisions of the Draft Bill. Clause 5 limits the promisee and promisor varying or discharging the benefit accruing to the third party. This effectively makes the benefit absolute[9] when the requirements of the clause are met; the requirements being that the third party has altered his position, relying on the promise or has obtained judgment. Consistency requires the same criteria to be applied when the promisee sues. Unless the third party has altered his position, the promisee should be free to deal with the damages as he wishes.[10] Allowing the promisee to sue, when he has suffered no personal loss also necessitates an order of priority for the promisee's and third party's actions. As the promisee is free to alter the contract, up until the third party obtains judgment under clause 5 it would be consistent to stay the third party's action where there are simultaneous actions (until the disposal of the promisee's action). That would of course be subject to a prior alteration of position in reliance on the promise under clause 5(1)(a).

2 *The Third Party's Right of Action*

As has been argued the principle of giving a third party the right to bring an action seems to be an appropriate reform. The adoption of contractual intention as defining which third parties can bring an action, avoids difficulties which could arise in defining how direct a benefit must be before a third party is entitled to sue for it. Clause 4 gives effect to the Committee's proposals. While the principle is sound the drafting of clause 4 could be improved. The clause is intended[11] to extend the protection of an exemption clause to a third party and for this reason clause 2 defines "benefit" as including an immunity, or limitation of rights (the promisor's rights) or obligations. Clause 4 provides that "the promisor shall be under an obligation, enforceable at the suit of [the third party] to perform that promise". If one applies the maxim *expressio unius est exclusio alterius*[12] one reaches the conclusion that the only way in which the obligation can be enforced is at the "suit" of the third party; "suit" in this context being confined to the bringing of civil legal proceedings.[13] It is submitted therefore that the natural meaning of these words is that

8 *Report,* para 6.4.
9 Subject to clauses 6 and 7 of the Draft Bill.
10 See *Chitty on Contracts,* supra n 1 at 525.
11 *Report,* para 8.1.
12 *Odgers' Construction of Deeds and Statutes* (5th ed Dworkin, 1967) 268.
13 See *Shorter Oxford English Dictionary* (3rd ed 1944); *Jowitt's Dictionary of English Law* (2nd ed Burke, 1977) Vol 2.

the third party must assert his right by bringing proceedings, rather than by defending proceedings brought against him. It can be doubted whether a court would interpret the legislation in this way, as the results would be absurd. Parliament's intention would be made clearer if clause 4 were amended to provide that "the promisor shall be under an obligation to perform that promise, *enforceable by that person by way of suit or as a defence to any legal proceedings brought by the promisor*". Consequential amendments would also have to be made to the proviso to clause 4.

The criticism of clause 4 is equally applicable to clause 8. There are, however, other objections to the latter clause, the principal one of which is that it appears to be unnecessary. Clause 8 simply sets out rather more concisely what clause 4 has already stated. It could be argued that clause 8 restricts the relief available to the third party since the clause provides that the relief which can be sought includes damages, specific performance and injunction. If it is necessary to specify the remedies that are available, why are other remedues such as a declaratory judgment or an order under section 9 of the *Contractual Remedies Act 1979* not specified? Clause 8 provides that the obligation imposed on a promisee may be enforced "at the suit of the beneficiary as if he were a party" which makes it clear that clause 9 does not authorise the defence that the promisee has suffered no loss and is not entitled to damages. However, this phrase could be incorporated in clause 4.

3 *The Protection of the Promisee's Right to Vary the Contract*

As has already been argued the most important benefit of the doctrine of privity of contract is that it permits the promisee to maintain control over "his" contract. The interests of the third party, however, cannot be ignored. The third party is named, or comes within a description. While not a party he has an interest and certain expectation. Traditionally the third party has been described as a volunteer, whose expectation relates to a gratuity. The law will not protect this interest until it is completed and has become absolute. This approach influenced the development of a "trust of a promise" as an exception to the law of privity.[14] The Committee used the illustration of a donee being generally unable to require the completion of an incomplete gift. It has also been recognised that injustice may result from creating an expectation in a person, allowing them to alter their position, in reliance on it, and then failing to fulfil the expectation. This is the basis of the doctrine of promissory estoppel.[15] There are also other areas of the law in which the injustice of alteration of position in reliance has been recognised.[16] It is this principle which the Committee adopted to restrict the rights of the parties to vary the contract, without the consent of the third party.[17] There is also provision to

14 Treitel, supra n 53 at 440.

15 Spencer Bower and Turner, *The Law Relating to Estoppel by Representation* (3rd ed 1977) 367ff.

16 See *Re Hume* (1910) 12 GLR 61; *Coles* v *Topham* [1939] GLR 485. See also Spencer Bower and Turner, ibid at 388.

17 *Report,* paras 8.3ff; see also clause 5.

prevent the parties varying the contract, after the third party has obtained judgment against the promisor. There is obviously a need to place some restriction on the parties varying the contract and a balance must be struck between the interests of the third party and the promisee. One extreme is to allow variation up to the time of judgment. This has two disadvantages, which the Committee recognised. It would encourage legal proceedings simply to secure the interest, and variation could occur after proceedings were commenced.[18] The former would place a purposeless workload on the courts and both would result in needless trouble and expense. An alternative which was considered was to prevent variation after the third party had "adopted or accepted" the benefit conferred by the contract. This would be more favourable to the third party. Which is better is a question of policy to which there is no clear answer. The adoption of alteration of position in reliance is a fair and reasonable balance. The manner in which it has been implemented in clause 5 does, however, have the potential to cause injustice in at least one situation.

The Committee recognised that "[p]ermitting variation or cancellation at any time before judgment could lead to unjust and inconvenient results".[19] One of those results was for a party to commence litigation only to have the contract varied or cancelled immediately prior to judgment. Unfortunately that result appears to be possible under clause 5 of the draft bill. If there is prior reliance, in accordance with clause 5(1)(a) legal proceedings can be commenced with confidence that there will be no alteration of the contract. The commencement of legal proceedings could be regarded as a material alteration of position in reliance on the promise. There would inevitably be expenses incurred which would encourage this view. It does not however appear that clause 5 can be interpretated in that way. Clause 5 is directed primarily at prohibiting alteration of the contract after judgment has been obtained. If the bringing of legal proceedings were an act which altered one's position in reliance on the promise the greater part of clause 5 would be redundant. The clause could be left with some residual application such as where the promisee takes the proceedings "in the third party's name" and then varies the contract.[20] If clause 5 is interpreted in this manner the third party (subject to clause 5(1)(a)) must litigate with the risk that at any time prior to judgement, the promisor's obligation could be discharged. Obviously this is unsatisfactory.

There are two ways of avoiding the difficulties of variation in the course of litigation. All the provisions relating to judgment and arbitration awards in clause 5 could be deleted. This would make it clear that the bringing of proceedings may be regarded as satisfying the requirements of clause 5(1)(a). Clause 7 could then be amended to apply only prior to judgment. An alternative would be to impose a procedural requirement that the proceedings in which the third party seeks to enforce

18 Ibid at para 8.3.3.

19 Idem.

20 Even this may not apply as the promisee may be "any other person" within the meaning of clause 5(1)(a).

the benefit be served on the promisee and to allow variation only within, for example, thirty days of service. The proceedings could be endorsed to inform the promisee of this limitation on his rights of variation. As it is possible for the third party to acquire absolute rights to the benefit under clause 5(1)(a) it would be more consistent to adopt the first of these two solutions. There does not seem to be any special reason to notify the promisee in this situation.

Clause 6 provides for variation of a contract where there is an express provision in the contract allowing variation or discharge, if the three requirements expressed in clause 6(b) are satisfied. The first requirement is simply that the contract contain an express provision and the second is that the variation or discharge be in accordance with it. It is the third requirement which is of particular interest, requiring that such a provision is "known to the beneficiary (whether or not the beneficiary has knowledge of the precise terms of the provision)". It is submitted that this is not a desirable restriction in view of what has already been identified as an important criterion for reform: that a just result will be likely, even though the parties have not adverted to the legal technicalities of their actions. If parties stipulate rights of cancellation or variation, it would not be natural to suppose that such express rights of variation would depend on whether the third party was informed of those particular provisions in the contract. It would be more just to expect the third party to make proper inquiries into the benefit upon which he was proposing to rely. The greatest injustice which this provision is likely to produce will therefore arise when the promisor stipulates unilateral rights of variation.[21] If the promisor then agrees to benefit a third party for the convenience of the promisee, he may have imperilled unwittingly his rights of variation. It may be that some relief could be obtained under clause 7, which allows the court in the exercise of its discretion to order variation or discharge which would otherwise be precluded. But in exercising that discretion one would expect the courts to pay heed to the statutory scheme, which has provided that the parties shall bear responsibility for the third party's ignorance. Furthermore, the promisor is required to bear the cost of injurious reliance by the third party. Why the promisor should always bear the cost of injurious reliance under clause 7 is not readily apparent. A more flexible approach would be to allow the courts to apportion the cost between the promisor, promisee and third party in such shares as the justice of the case requires.

4 *Restriction of the Promisor's Defences*

Clause 9 contains certain restrictions on the defences available to the promisor when a claim is made by the third party. Clause 9(2) provides, in effect, that the promisor's defences (including counterclaim and set-off) include those that would have been available if the third party were a party to the contract or if the action were brought by the promisee. This is qualified by sub-clause 3 which provides that in the circumstances of a set-off and counterclaim they are available to the promisor only if they

21 Clause 6(b) contains the phrase "By any party or parties" and therefore appears to contemplate unilateral rights of variation.

arise from the contract. It is submitted, however, that if there is a set-off or counterclaim, the promisor should be entitled to raise it whether, or not, it is part of the contract. It would be the probable expectation of parties, when they contract, that the state of account between the parties providing the consideration would govern the performance of the contract. If there were a set-off or counterclaim (especially one pre-dating the third party's rights acquired under clause 5), it would seem unjust that the third party could enforce his benefit, which arguably has not been paid for. The difficulty is that if the set-off or counterclaim is outside the scope of the contract and the promisee has an interest in it, then he must become a party to the proceedings, if justice is to be done. The simple answer is to exclude set-offs and counterclaims which do not arise in the contract. At first sight this appears to have no other effect than requiring the promisor to pursue an independent action against the promisee. Both set-offs and counterclaims are in substance separate actions, combined for procedural convenience.[22] The important difference is that only one judgment will issue[23] and accordingly there will be only one execution of the judgment, reflecting the true state of account between the parties. If there are separate judgments and executions and one is returned unsatisfied, it will not absolve the other party from settling the judgment against him. There is of course no guarantee that the money can be recovered, since there may be an execution process which has priority[24] or the judgment debtor may voluntarily discharge other debts before execution can be levied. If one accepts the premise that the statement of account between the parties providing the consideration is a valid restriction on the third party's rights, then set-offs and counterclaims should not be confined to those arising from the contract. The alternative is to require that the promisee be joined as a third party to the action, when a set-off or counterclaim arises and to allow the outcome to be reflected in the judgment.

Another difficulty which arises in this area is the application of section 93 of the Insolvency Act 1967, which applies also to company liquidation under section 307 of the Companies Act 1955.[25] This section provides for debts between creditors and insolvent individuals and companies to be set-off, with the result that a creditor is not required to pay money which he owes to the insolvent's estate and have his claim settled in accordance with the rules for priority,[26] a procedure which is much more favourable to the creditor. One of the requirements of this section is that it is only where "mutual credit or debts" exist that a set-off may be made. The concept of mutual credit seems inapposite when privity of contract has been abandoned. Again this depends upon mutuality being viewed from the point of view of the parties who provide consideration for the contract.

22 Sim and Cain, supra n 54 at 160.
23 Idem.
24 Ibid at 310ff.
25 Similar considerations apply to the Companies Act 1955, s253 which governs set-off by contributories.
26 Insolvency Act 1967, s104.

VI Conclusion

It is submitted that the doctrine of privity of contract, in as much as it prevents a third party suing to obtain a benefit, is an unnecessary restriction which need not remain part of the law of contract. The only important rationale supporting the doctrine, is in my view, the promisee's right to maintain some control over the contract, to the creation of which he has been a party. There is a real possibility of injustice due to the operation of the doctrine of privity of contract, particularly in view of the number of restrictions on the promisee's right to sue. It follows that reform of the law is desirable. Provision can be made for those factors which form the rationale of the doctrine while at the same time giving the third party a right of action on a contract to which he is not a party. I agree with the principles upon which the Committee has proceeded in its proposals for reform although I would suggest that there are some aspects of their proposals which could be reconsidered.

The only matter of substance which affects the scope of the Draft Bill is the decision not to reform the law relating to the promisee's rights to bring an action. This is an area of the law in which patent defects exist and the scope of the Draft Bill is not such that injustice can be avoided in all cases. There are four matters which I would regard as deficiencies in the detail of the Draft Bill. The first is the drafting of clauses 4 and 8. This criticism may be of minor importance as it would seem likely that the courts would interpret the provisions in the manner intended. Clause 5 appears to have a rather more serious defect. The third party could be put to the trouble and expense of legal proceedings, only to have the contract altered or discharged immediately prior to judgment. Clause 6 appears to place insufficient weight on express stipulations contained in a contract permitting variation or discharge. Finally, clause 9 appears capable of producing results not contemplated by the parties at the time they contracted, where they have liabilities which may constitute a set-off or counterclaim.

It is to be hoped that parliament will give the Committee's proposals favourable consideration and in the legislative process improve the Draft Bill which has been presented.

APPENDIX

DRAFT BILL

CONTRACTS (PRIVITY)

ANALYSIS

A BILL INTITULED

An Act to permit a person who is not a party to a deed or contract to enforce a promise made in it for the benefit of that person

1 Short Title and Commencement —
(1) This Act may be cited as the Contracts (Privity) Act 1981.
(2) This Act shall come into force on the 1st day of June 1982.

2 Interpretation — In this Act, unless the context otherwise requires —
"Benefit" includes —
(a) Any advantage; and
(b) Any immunity; and
(c) Any limitation or other qualification of rights or obligations:
"Beneficiary", in relation to a promise to which *section 4* of this Act applies, means a person (other than the promisor or promisee) on whom the promise confers, or purports to confer, a benefit:

"Contract" includes a contract made by deed or in writing, or orally, or partly in writing and partly orally or implied by law:

"Court" means —

(a) The High Court; or

(b) A District Court that has jurisdiction under *section 10* of this Act; or

(c) A Small Claims Tribunal that has jurisdiction under *section 11* of this Act:

"Promisee," in relation to a promise to which *section 4* of this Act applies, means a person who is both —

(a) A party to the deed or contract; and

(b) A person to whom the promise is made or given:

"Promisor," in relation to a promise to which *section 4* of this Act applies, means a person who is both —

(a) A party to the deed or contract; and

(b) A person by whom the promise is made or given.

3 Act to bind the Crown — This Act shall bind the Crown.

4 Deeds or contracts for the benefit of third parties — Where a promise contained in a deed or contract confers, or purports to confer, a benefit on a person who is not a party to the deed or contract (whether or not the person is identified or in existence at the time when the deed or contract is made), the promisor shall be under an obligation, enforceable at the suit of that person, to perform that promise:

Provided that this section shall not apply to a promise which, on the proper construction of the deed or contract, is not intended to create an obligation enforceable at the suit of that person.

5 Limitation on variation or discharge of promise —

(1) Subject to *sections 6 and 7* of this Act, where, in respect of a promise to which *section 4* of this Act applies, —

(a) The position of a beneficiary has been materially altered by the reliance of that beneficiary or any other person on the promise (whether or not that beneficiary or that other person has knowledge of the precise terms of the promise);
or

(b) A beneficiary has obtained against the promisor judgment upon the promise; or

(c) A beneficiary has obtained against the promisor the award of an arbitrator upon a submission relating to the promise, —

the promise and the obligation imposed by that section may not be varied or discharged without the consent of that beneficiary.

(2) For the purposes of *paragraph (b) or paragraph (c) of subsection (1)* of this section, —

(a) An award of an arbitrator or a judgment shall be deemed to be obtained when it is pronounced notwithstanding that some act, matter, or thing needs to be done to record or perfect it or that, on application to a Court or on appeal, it is varied:

(b) An award of an arbitrator or a judgment set aside on application to a Court or on appeal shall be deemed never to have been obtained.

6 Variation or discharge of promise by agreement or in accordance with express provision for variation or discharge — Nothing in this Act shall prevent a promise to which *section 4* of this Act applies or any obligation imposed by that section from being varied or discharged at any time —

(a) By agreement between the parties to the deed or contract and the beneficiary; or

(b) By any party or parties to the deed or contract if —

(i) The deed or contract contained, when the promise was made, an express provision to that effect; and

(ii) The provision is known to the beneficiary (whether or not the beneficiary has knowledge of the precise terms of the provision); and

(iii) The variation or discharge is in accordance with the provision.

7 Power of Court to authorise variation or discharge —

(1) Where, in the case of a promise to which *section 4* of this Act applies or of an obligation imposed by that section, —

(a) The variation or discharge of that promise or obligation is precluded by *section 5(1)(a)* of this Act; or

(b) It is uncertain whether the variation or discharge of that promise is so precluded, —

a Court, on application by the promisor or promisee, may if it is just and practicable to do so, make an order authorising the variation or discharge of the promise or obligation or both on such terms and conditions as the Court thinks fit.

(2) If a Court —

(a) Makes an order under *subsection (1)* of this section; and

(b) Is satisfied that the beneficiary has been injuriously affected by the reliance of the beneficiary or any other person on the promise or obligation, —

the Court shall make it a condition of the variation or discharge that the promisor pay to the beneficiary, by way of compensation, such sum as the Court thinks just.

8 Enforcement by beneficiary — The obligation imposed on a promisor by *section 4* of this Act may be enforced at the suit of the beneficiary as if he were a party to the deed or contract, and relief in respect of the promise, including relief by way of damages, specific performance, or injunction, shall not be refused on the ground that the beneficiary is not a party to the deed or contract in which the promise is contained or that, as against the promisor, the beneficiary is a volunteer.

9 Availability of defences —

(1) This section applies only where, in proceedings brought in a Court or an arbitration, a claim is made in reliance on this Act by a beneficiary against a promisor.

(2) Subject to *subsections (3) and (4)* of this section, the promisor shall have available to him, by way of defence, counterclaim, set-off, or otherwise, any matter which would have been available to him —

(a) If the beneficiary had been a party to the deed or contract in which the promise is contained;
or

(b) If —
(i) The beneficiary were the promisee; and
(ii) The promise to which the proceedings relate had been made for the benefit of the promisee; and
(iii) The proceedings had been brought by the promisee.

(3) The promisor may, in the case of a set-off or counterclaim arising by virtue of *subsection (2)* of this section against the promisee, avail himself of that set-off or counterclaim against the beneficiary only if the subject-matter of that set-off or counterclaim arises out of a right or claim conferred by the deed or contract in which the promise is contained.

(4) Notwithstanding *subsections (2) and (3)* of this section, a beneficiary shall not be liable on a counterclaim brought against him under *subsection (2)* or *subsection (3)* of this section unless the beneficiary elects, with full knowledge of the counterclaim, to proceed with his claim against the promisor.

10 Jurisdiction of District Courts —

(1) A District Court shall have jurisdiction to exercise any power conferred by *section 7* of this Act in any case where —

(a) The occasion for the exercise of the power arises in the course of civil proceedings properly before the Court; or
(b) The value of the consideration for the promise or the promisor is not more than $12,000; or
(c) The parties agree, in accordance with section 37 of the District Courts Act 1947, that a District Court shall have jurisdiction to determine the application.

(2) For the purposes of section 43 of the District Courts Act 1947, an application made to a District Court under *section 7* of this Act shall be deemed to be an action.

11 Jurisdiction of Small Claims Tribunals —

(1) A Small Claims Tribunal established under the Small Claims Tribunals Act 1976 shall have jurisdiction to exercise any power conferred by *section 7* of this Act in any case where —

(a) The occasion for the exercise of the power arises in the course of proceedings properly before that Tribunal; and
(b) The value of the consideration for the promise of the promisor is not more than $500.

(2) A condition imposed by a Small Claims Tribunal under *section 7(2)* of this Act shall not require the promisor to pay a sum exceeding $500 and an order of a Tribunal that exceeds any such restriction shall be entirely of no effect.

12 Amendments of Arbitration Act 1908 — The Second Schedule to the Arbitration Act 1908 is hereby amended by inserting, after clause 10B (as inserted by section 14(2) of the Contractual Remedies Act 1979), the following clause:

"10C The arbitrators or umpire shall have the same power as the Court to exercise any of the powers conferred by *section 7* of the Contracts (Privity) Act 1981."

13 Repeal — Section 7 of the Property Law Act 1952 is hereby repealed.

14 Savings —

(1) Subject to *section 13* of this Act, nothing in this Act limits or affects —

(a) Any right or remedy which exists or is available apart from this Act; or

(b) The Contracts Enforcement Act 1956 or any other enactment that requires any contract to be in writing or to be evidenced by writing; or

(c) Section 49A of the Property Law Act 1952; or

(d) The law of agency; or

(e) The law of trusts.

(2) Notwithstanding the repeal effected by *section 13* of this Act, section 7 of the Property Law Act 1952 shall continue to apply in respect of any deed made before the commencement of this Act.

15 Application of Act — Except as provided in *section 14(2)* of this Act, this Act does not apply to any promise, contract, or deed made before the commencement of this Act.