

ANSWERS - SELF-TEST – PRIVACY OF CONTRACT AND THIRD PARTY RIGHTS

1. What is the doctrine of privity of contract? (2)

The doctrine of privity of contract determines who may enforce the contract and provides that only the parties to a contract may enjoy the benefits of that contract (1) or suffer burdens under it (1).

2. What were the two difficulties in establishing an argument that the contracting party in fact contracted as agent for the third party? (2)

The 2 difficulties in establishing the agency argument were

(a) establishing that the third party (principal) gave authority to the agent to act in that capacity. (1)

(b) establishing that the principal provided consideration to support the promisor's promise. (1) Example is Dunlop Pneumatic Tyre v Selfridge.

3. In what circumstances under the Contracts (Rights of Third Parties) Act 1999 can a third party rely on an exemption clause in a contract to which he is not a party? (3)

How does this differ from the previous position at common law? (4)

A third party (i.e. a person who is not a party to a contract containing an exemption clause) may enforce that clause under s.1(6) of the Contracts (Rights of Third Parties) Act 1999 if either (a) the contract expressly states that the third party shall have this right of enforcement (1) or (b) the exemption clause purports to protect the third party and (on a proper construction of the contract) there is nothing to indicate that the contracting parties did not intend the term to be enforceable by that third party (s.1(1)(2)). See *Nisshin Shipping v Cleaves* (2003) for explanation of s.1(1)(b) and s.1(2). (1)

In addition, the third party must be expressly identified in the contract either by name, or as a member of a particular class or description e.g. "independent contractors" but need not be in existence at the time the contract was entered into (s.1(3)).(1)

This test inevitably limits the scope of the legislation and the position of third parties. However, with time it was envisaged that contracts would be drafted so as to give third parties protection via an express right to enforce (s.1(1)(a)), where this was the parties' intention. This doesn't appear to have happened and, if anything, parties are contracting to avoid the Act's application.

At common law the third party could potentially have used Lord Reid's criteria in Scruttons v Midland Silicones, as applied by the PC in New Zealand Shipping v Satterthwaite in order to rely on an exemption clause. Thus it would have to be established that:

- (a) The main contract made it clear that the third party was intended to be protected by the clause.
- (b) The main contract made it clear that the contracting party was acting as agent for the third party for the purpose of obtaining the benefit of the clause.
- (c) The contracting party must have had authority from the third party to act as his agent.
- (d) The third party must have provided consideration for the main contract promise of exemption. (2)

The agency link has now disappeared under the new legislation but factor (a) above is still relevant. (1) Problems had existed at common law with the application of (c) above in cases where the third party was not in existence at the time the main contract was entered into. This limitation has now been expressly removed by s.1(3) of the 1999 Act. (1)

4 What is the significance, if any, of *Jackson v Horizon Holidays*? (2)

Jackson (as refined by Lord Wilberforce in Woodar v Wimpey) is authority for the fact that a contracting party who, for reasons of convenience, contracted for the benefit of others may be able to recover damages to compensate him for not only his own loss but also the loss suffered for the others for whose benefit he contracted (1). This type of contract is said to be a "contract calling for special treatment". (1)

5. How does the HL in the *St Martin's Property* appeal reach its conclusion that substantial damages are available to a person who has not suffered loss? (3)

The original owner of the land is the party to the building contract and although he successfully transferred ownership of the land to the new owner, he did not succeed in transferring the benefit of the building contract. Since privity requires that a person be a party to a contract in order to recover damages for breach, AND it is only possible to recover damages for loss actually suffered by that party, the original owner was technically only entitled to recover nominal damages for breach. The new owner, who had suffered the loss, was not a party to the contract. (1)

The *St Martins Property* principle allows the original owner to recover substantial damages (for the benefit of the new owner) on the basis that it was contemplated all along that the property (on which the building work was taking place) might be transferred to another person (who would not be a party to the building contract) but who would suffer the loss in the event of defective performance. (2) [*“Narrow ground” principle*]

6. Explain Lord Griffiths’s “broad ground” for decision in the *St Martin’s Property Appeal*? (4)

Lord Griffiths was stating that where the contract broken is a contract for the supply of work and materials (1), the promisee does not need to show that he retains a property interest in the subject matter of the contract at the date of the breach in order to be able to recover damages for the breach (2). The loss suffered by the promisee is the fact that he does not receive the performance for which he contracted (1) – and it does not matter whether he owns the goods in question.

7. Explain the collateral contract and the way in which it has been used to avoid privity problems. (3) Is it likely to be relevant following the 1999 Contracts (Rights of third Parties) Act? (2)

The collateral contract essentially amounts to the creation of a contract between persons who are not parties to the main contract in order to impose liability e.g. for statements/promises made. (1) The consideration for this contract is the making of the main contract. (1) Examples include *Shanklin Pier v Detel* and the collateral contract between e.g. car dealers and customers covering statements made by the dealer which induce the hire purchase contract between the customer and the finance company. The making of the hire purchase contract is the consideration for the collateral contract. [(1) *for an example*].

Following the 1999 Act the significance of the collateral contract device will be reduced *only* if the third party is covered by the Act and can enforce the provision directly, i.e. expressly identified in the contract by name, a class member or by a particular description and only if the test of enforceability is satisfied (s.1(1)-(3)) – i.e. it must be clear that the parties’ intended this third party to be able to enforce a particular provision or purported to give him some benefit (2). That may be unlikely in the typical scenario in which the collateral contract is useful, e.g. statements by car dealers when the contract is between the customer and the finance company.

8. Can the promisee still pursue an action for breach of contract where a third party has enforceable rights under the 1999 Act? (2) How does the Act deal with the priorities question? (3)

Yes, the promisee can still pursue an action for breach despite the fact that a third party may have enforceable rights under the 1999 Act (1) since s.4 states that section 1 does not affect any right of the promisee to enforce any term of the contract. (1)

On the priorities question, the Act prohibits double recovery by promisee and third party in respect of the same loss (1). Section 5 states that where the promisee has already recovered a sum in respect of the third party's loss, the recovery allowed to a third party must be reduced to take account of this sum(1). However, there is no express provision requiring the promisee to hold this sum on trust for the third party (1). This may be because this would arise at common law.

Points scored [maximum of 30] =