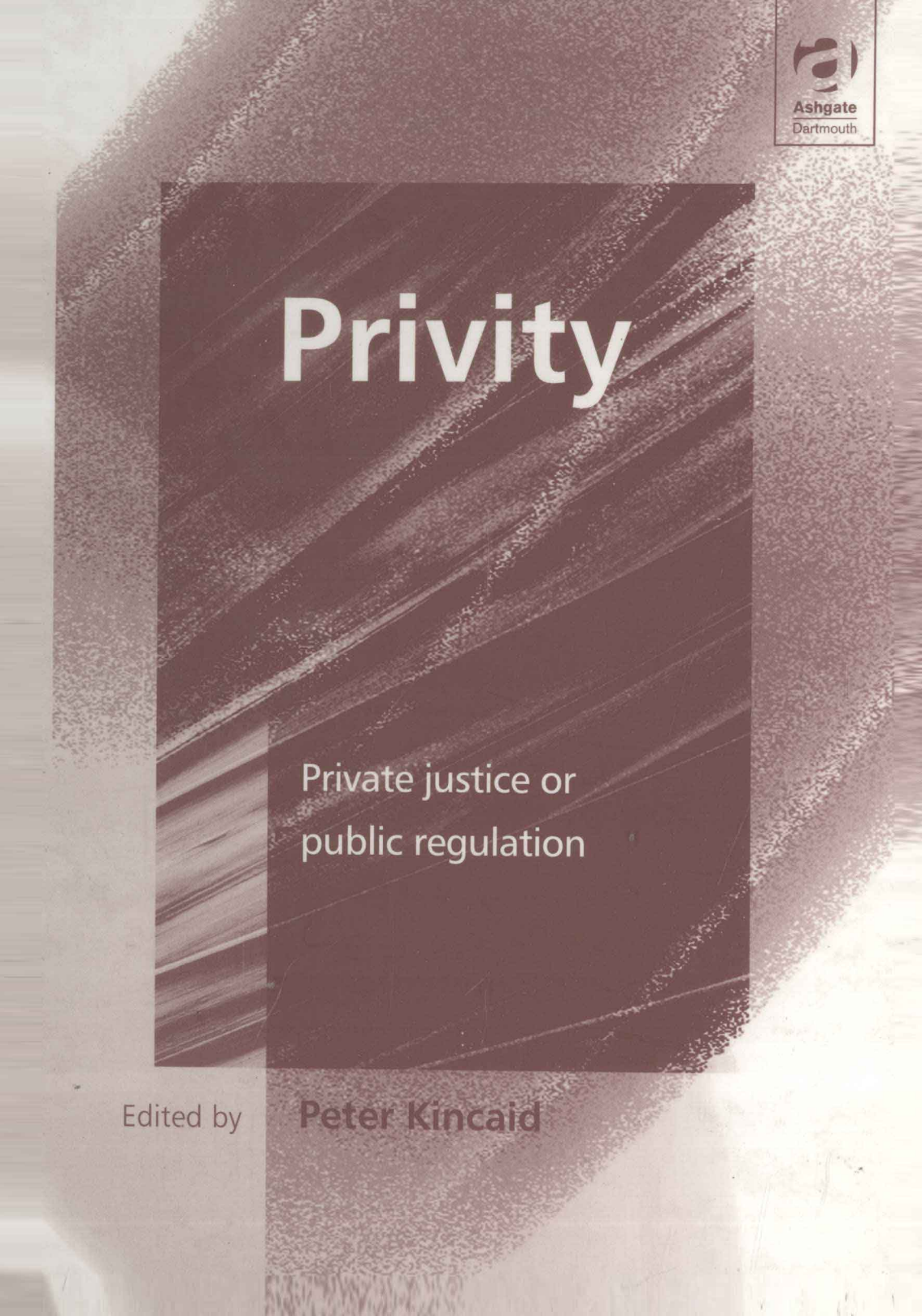
Ashgate
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Privity
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# Privity

## Private justice or public regulation

*Edited by*
PETER KINCAID
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# Preface

The idea of privity in contract means that only a party to a contract may sue on it. An application of the idea is the third-party rule: a third-party beneficiary of a contract cannot sue to enforce the promise in its favour. This rule has been subjected to criticism. It has been urged that a third-party beneficiary *should* be able to sue the promisor.

The third-party rule is only one small part of the law of contract. Yet the way the question of reform of this rule is approached indicates answers to a number of quite fundamental questions concerning the common law.

It is perhaps an exaggeration to say that privity of contract has been a burning issue for the past sixty years. But since 1937 there has been a steady stream of articles, now probably numbering in the hundreds, devoted to the question: should a third-party beneficiary of a contract be able to sue the promisor to enforce the contract made for its benefit? In that year, 1937, the Law Revision Committee in England recommended that the common law rule denying a right in third parties should be overturned. The rule had been settled (not to say established) by *Tweddle v. Atkinson* in 1861.[1]

Even before 1937 the rule had been subject to much criticism. The bulk of writing since then has supported reform. In 1996 the Law Commission in England published its final report,[2] recommending reform of the third-party rule by legislation. Those recommendations were substantially given effect in the Contracts (Rights of Third Parties) Act 1999, which was passed in November 1999 and came into full force in May 2000. A person not a party to a contract may now sue to enforce a contract if either the contract contains an express term to that effect, or the contract purports to confer a benefit on the third party, in which case it will rebuttably be presumed that the parties intend to confer a right to sue.

The common law rule has been subject to judicial criticism as well. Lord Denning argued that *Tweddle v. Atkinson* was wrong.[3] Although his

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1 (1861) 1 B. & S. 393; 121 E.R. 762.

2 Law Commission (U.K.), *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com 242, H.M.S.O., London, 1996. For a summary, see Andrew Burrows, "Reforming Privity of Contract: Law Commission Report No. 242" [1996] L.M.C.L.Q. 467.

3 *Beswick v. Beswick* [1966] Ch. 538 at 553.

interpretation of the law was not approved by the House of Lords in *Beswick v. Beswick*,[4] Lord Reid was unsympathetic to the rule and warned that if Parliament did not do something about it, the House of Lords might have to.[5] Lord Diplock has described the third-party rule as "a reproach to English private law".[6] Its most powerful recent critic in England is Lord Steyn.[7]

In New Zealand,[8] Queensland,[9] and Western Australia,[10] acts have been passed to confer a cause of action on third-party beneficiaries of contracts. There has been judicial nibbling at the rule in Canada[11] and direct if limited assault on it in Australia.[12] In the United States the rule was judicially reformed in New York in 1859.[13] Other states gradually followed suit, and the right of third parties is now recognised in all jurisdictions.[14]

Despite the clamour for reform, some small voices have made themselves heard in defence of privity. The tenacity of privity in the face of criticism may be a sign that some of the points made by its unfashionable defenders cannot convincingly be brushed aside by appealing to the "obvious injustice" of the third-party rule.[15]

The following notes (Chapter One) on what I thought were the theoretical issues raised by the privity question were sent to all prospective new contributors to the book when I invited them to contribute. I wanted to encourage writers from both sides of the debate to address those issues.

*Peter Kincaid*
*Mad Dog Acres*
*Sydney*
*August 2000*

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4 [1966] Ch. 538.

5 [1968] A.C. 58 at 72.

6 *Swain v. Law Society* [1983] 1 A.C. 598 at 611.

7 *Darlington Borough Council v. Wiltshier Northern Ltd.* [1995] 1 W.L.R. 68 at 76 per Steyn L.J.

8 Contracts (Privity) Act 1982.

9 Property Law Act 1974 s. 55(1).

10 Property Law Act 1969 s. 11.

11 *London Drugs Ltd. v. Kuehne & Nagel International Ltd.* (1992) 97 D.L.R. (4th) 261, 340-370.

12 *Trident General Insurance Co. Ltd. v. NcNiece Bros. Pty. Ltd.* (1988) 165 C.L.R. 107.

13 *Lawrence v. Fox* (1859) 20 N.Y. 268.

14 Second Restatement of the Law of Contract s. 304.

15 A not-so-small voice is that of Brennan J. in *Trident General Insurance Co. Ltd. v. McNiece Bros. Pty. Ltd.* (1988) 165 C.L.R. 107, esp. at 127, 132, and 138.

# Acknowledgments

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# Contents

# 1 Theoretical Issues Raised by the Privity Question

PETER KINCAID

## Private or Public Justice

It has frequently been said that if A and B have made a contract in which A promises B that it will confer a benefit on C, it is unjust if C cannot sue A to enforce the promise. The first issue raised by this criticism of the privity rule concerns the nature of justice in contract. Is it a private matter or a public one? And what do these terms themselves mean?

Contract as a matter of private justice can be seen as concerned with balancing the interests of the plaintiff with those of the defendant according to some criterion. The ideas of promise (invoking the trust of the promisee) and consideration (paying a requested price in exchange for a promise) are ideas which can be used to justify making the defendant promisor responsible for realising the expectations of the plaintiff promisee according to the model of contract as a matter of private justice. The rules of contract then reflect the private nature of the relationship between the parties. But private justice need not be confined to the relationship constituted by promise or exchange. An alternative is provided by estoppel: detriment suffered in reliance on an expectation of performance where the defendant has unconscionably induced the plaintiff to rely. (There is a division of opinion as to whether this is private justice *in contract*.[1]) There may be difficulty in justifying a right in a third party as a matter of private justice because of the difficulty of defining a relationship between the third party and the promisor.[2]

But the idea of justice in contract may not be concerned exclusively with private interests. The public may be said to have an interest in the efficient functioning of the economy. If so, there is a public interest in seeing contracts in general carried out. It is uncontroversial that public interests can exceptionally override private ones to deny contractual rights,

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1 See *Waltons Stores (Interstate) Ltd. v. Maher* (1988) 164 C.L.R. 387.

2 *Trident General Insurance Co. Ltd. v. McNiece Bros. Pty. Ltd.* (1988) 165 C.L.R. 107, 132.

as in the case of contracts in restraint of trade. But should public interests be recognised as having a legitimate positive role in contract, not merely a negative one? A right in a third party to sue to enforce could be justified not by any qualification by the third party in its relationship of trust, expectation, reliance, or exchange to the promisor, but by the public interest in seeing the contract carried out. Of course the public interest might be in the performance of contracts generally, or in the performance of particular types of contracts, such as insurance contracts where the promisor promises to indemnify a third party.

What is, or has been, or should be the attitude of the common law in the Commonwealth to this question of contract as a matter of public or private justice?

A related question is whether the philosophy of contract law on this issue is different in different systems. Critics of the privity rule sometimes point impatiently to the civil law of France, Germany, or Scotland, or to American law. If those systems recognise third-party rights, surely it is obvious that we should do so too. But if the nature and purpose of contract in the justice system are seen as essentially private in English law, but a mixture of public and private in other systems, it is less obvious that the rules of other systems would accord with our ideas of justice if grafted onto ours.

## Flexible v. Formal Reasoning

The above discussion assumed that a right in a third party would need to be "justified" by a process of coherent reasoning. The next issue is whether that assumption should stand. Is it instead sufficient or desirable that rules be devised and supported by a less precise, less transparent, more intuitive method of reasoning? The third-party rule is frequently described as unjust to the third party. But what this means in terms of the relationship with the promisor is usually not explained. The law commission purported to justify its proposed rule by saying that it would give effect to the intentions of the parties. What is the role of intention in contract? Is giving effect to the intentions of the parties meant to do private justice by balancing private interests, or is it meant to advance public interests?

The issue here is do those questions need to be answered? Or is it undesirable to impose a rigid requirement of reasoning from premises to conclusions to support legal rules? It may on the other hand be enough to identify a number of factors, public and private, which are thought to be relevant, without explaining precisely the role of any one of them. So it may be said (as the law commission and the High Court of Australia have

done) that the third party may reasonably have expected the contract to be performed, and may even have relied on this happening. In addition, it has been said, allowing the third party to sue gives effect to the intention of the parties. A certain fuzziness in just how these factors are relevant is not necessarily bad, if the object is simply to help the intuition of "honest men"[3] to recognise what is fair, reasonable, and just.

Another version of the same issue concerns the relevance of theoretical structure in the law. If a third-party beneficiary can be given rights indirectly by the devices of trust or agency, is it legitimate to by-pass those structures and give the third party direct rights? This is what Mason C.J. and Wilson and Toohey JJ. favoured in the *Trident Insurance Case*.[4] Agency and trust use private-law concepts to explain and justify legal relationships which can include the third party. Are these forms a sophisticated waste of effort, time, and money, or are they fundamental to rational justice?

Another issue arises from the distinction between intuitive and formal reasoning. Judges, law reformers, and writers often give the impression that they are impatient with the limitations of formal reasoning, but instead of acknowledging this impatience, they pay lip-service to formal reasoning by weak or unconvincing arguments. Is this impression correct and, if so, why is there this pretence at formal reasoning?

An example concerns the relationship between consideration and privity. Critics of privity say that privity can be removed as a requirement for a plaintiff without affecting consideration. This is because, it is explained, consideration identifies the sort of promises that can be enforced, not who can enforce them. But this explanation raises a further question (referred to above) which is seldom answered. Is contract about private justice? If it is, it has to be explained how payment of a price by the promisee does anything to justify the third party's claim against the promisor. If contract is about public justice (if such a phrase is appropriate), then it may well make sense to promote the public interest in seeing bargain exchanges carried out.

## Pragmatism v. Principle

Another issue concerns the extent to which the rules of contract, and the rules concerning third parties in particular, should be motivated by broad questions of principle or, conversely, by practical questions of what is

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[3] Lord Steyn "Contract Law: Fulfilling the Reasonable Expectations of Honest Men" (1997) 113 L.Q.R. 433.

[4] (1988) 165 C.L.R. 107 at 121.

needed to make the economy and its institutions work efficiently. An attempt could be made to justify a rule allowing third parties to sue according to principles of private justice (such as unconscionably-induced detrimental reliance). Or an equally broad principle of public interest could be used to justify the rule. The public interest in the morality of promise-keeping is an example. On the other hand, such a rule could be defended merely because it works. It makes insurance policies cheaper, for example, by reducing the number of policies and the number of actions needed for enforcement. Or it stimulates business by making easier the protection of various participants such as sub-contractors.

A related issue is whether any reform of the privity rule should be by a general rule allowing all third parties conforming to certain limitations to sue, or whether it should be by special rules peculiar to certain sorts of contract such as insurance contracts or construction contracts. If the driving force behind the reform movement is really economic pragmatism, then does that suggest that special rules should be adopted? Or can it be assumed that the practical advantages of allowing third parties to sue are the same regardless of the type of contract in question?

The law commission recommended a general rule. Did this recommendation imply a requirement of logical coherence? If so, can the recommendation be justified by reference to general principle? If not, why make a general rule? Special rules could perhaps fit in with a predominantly private-law view of contract as cases where, exceptionally, public interests override private ones.

## Nature and Source of a Third-Party Right

A number of issues arise from how a direct third-party right to enforce a contract should be characterised.

First, is it contractual or non-contractual? The question itself is slippery because it assumes that contract has an agreed meaning. If contract is defined to mean all the legal rights and duties attaching to anyone affected by an exchange transaction, then the question is answered. A third-party right would be contractual. Even those within the "circle of persons to whom the protective effect of a contract extends"[5] as recognised by German law, though not third-party beneficiaries of the primary obligations of the contract, would be exercising contractual rights.

But if contractual rights are thought to be defined and assumed by

[5] B. Markesinis, "An Expanding Tort Law - The Price of a Rigid Contract Law" (1987) 103 L.Q.R. 354, 363.

the parties, then the answer is not so clear. Is it necessary for a relationship between the third party and the promisor to be identified which justifies treating the third party as part of the exchange? Or is it sufficient that the parties to the contract have intended to confer a legal right upon the third party? The last question leads to another: Given doubts as to whether intention to create legal relations is necessary for a valid contract, is such an intention sufficient for their creation? The "intention of the parties" is often appealed to as a justification for third-party rights. What has been the role of intention in contract, and what should it be? The issue behind these questions concerns the role of the state in defining contractual rights.

If third-party rights are treated as non-contractual, then what is the justification for their recognition? If they are considered a matter of private justice outside contract, then, as mentioned above, the reliance of the third party may be a justifying factor. But can reliance stand alone, or must it be combined with legally relevant behaviour by the defendant, such as unconscionable inducement?

Another private-justice factor which has been used to justify third-party rights is the acceptance by the third-party of the promise made for its benefit.[6] Can acceptance alone be used to justify a third-party right within the idea of private justice?

If third-party rights are to be justified as a matter of public justice, then, as discussed above, the public policies supporting the rights may be moral, such as the desirability for the public in encouraging the keeping of promises, or practical, such as economic efficiency.

## Rights and Duties: the Question of Focus

Whether contract in general, or third-party rights in particular, are to be considered a matter of private or public justice, another issue concerns the relative importance of right and duty in the relationship between the plaintiff third-party and the defendant promisor.

The first possibility is to focus upon the duty of the defendant alone. The canon law was generally concerned with the promisor's duty. The attitude is reflected in the judgment of the majority in *Lawrence v. Fox*,[7] where it was said that the fact that the defendant had been paid for his promise made it his duty to pay the third party. The facts that the promise was not made to the third party, and neither had the third party provided consideration, were irrelevant. There are echoes of this approach in the

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[6] See C. Fried, *Contract as Promise* Harvard U.P., Cambridge, Mass., 1981, pp. 44-45; Queensland Property Law Act 1974 s. 55(1).

[7] (1859) 20 N.Y. 268.