

For discussion
on 26 November 2013

LegCo Panel on Administration of Justice and Legal Services

Contracts (Rights of Third Parties) Bill

I. Purpose

The Administration proposes to introduce legislation to implement the recommendations of the report on “Privity of Contract” (“**Report**”) published by the Law Reform Commission of Hong Kong (“**LRC**”) in September 2005 so as to reform the doctrine of privity of contract by a detailed legislative scheme. This paper seeks the preliminary views of Members on the policy aspects of the legislative proposal set out in the Contracts (Rights of Third Parties) Bill (“**Consultation Bill**”¹).

II. Reforming the Doctrine of Privity of Contract

2. One aspect of the doctrine of privity is that a person cannot acquire and enforce rights under a contract to which he is not a party. This prevents effect from being given to the contracting parties’ intention to benefit a third party. As such, the court may need recourse to devices such as agency and trust to allow a third party to enforce a right conferred on him, or in some other cases, a third party may have to resort to a large number of separate contracts with extra cost, complexity and inconvenience.

3. The LRC recommended to reform the rule that only parties to a contract may enforce rights under the contract by way of a legislative scheme. After careful consideration of the views and recommendations of the LRC, the Administration proposes to implement the recommendations of the LRC in full. Under the proposal, a third party, i.e. a person not a party to a contract, may enforce the contractual terms subject to contracting parties’ intention without having to resort to the complexities of the devices presently adopted to circumvent the privity doctrine.

¹ A copy of the Consultation Bill is annexed to the Consultation Paper on the subject issued by the Department of Justice in October 2012 and made available at the website of the Department: <http://www.doj.gov.hk/eng/public/pdf/2012/consulte.pdf>.

4. The underlying principle feature of the proposal is to effectuate contracting parties' intention so that a third party should be able to enforce a contract where the contracting parties intended to create a legal obligation enforceable by the third party.

5. To reflect the recommendation that contracting parties should have the freedom to adhere to the doctrine of privity if they so choose, it is proposed that parties may contract out of the new statutory provisions giving rights of suit to a third party.

III. Key Features of the Consultation Bill

Test of Enforceability

6. The Consultation Bill sets out the limits within which a third party can enforce a contract. It provides for a two-limb test and the satisfaction of either limb will permit a third party who is not a party to the contract to enforce it : (a) a third party may enforce the contract if the contract contains an express term to that effect; or (b) if the contract contains a term which purports to confer a benefit on the third party, that party may enforce that term unless on a proper construction of the contract, the parties to the contract do not intend that the third party may do so. It follows that parties to a contract can expressly exclude the application of this new statutory scheme in their contract.

7. The Consultation Bill further provides that a third party's right to enforce a contractual term is subject to other relevant terms of the contract. A third party is entitled to any remedy that would have been available to him in any action for breach of contract if he had been a party to the contract.

Who is a Third Party

8. The Consultation Bill provides that a third party should be expressly identified by name, as a member of a class or as answering a particular description. Rights may also be conferred on a third party who is not in existence when the contract is entered into.

Rescission and Variation of Contract

9. To strike a balance between the contracting parties' freedom to alter the terms of the contract in accordance with their intention on the one hand and the interests of a third party who may suffer as a result on the other, the Consultation Bill provides for the circumstances in which a third party's rights

are “crystallised”, thereby putting an end to the contracting parties’ rights to rescind or vary the contract.

10. The restriction to rescind or vary the terms can be overridden by an express term under which one or more parties to the contract can rescind or vary the contract without the third party’s consent, or an express term that specifies the circumstances in which the third party’s consent is required. For such an express term to have effect, the third party must be aware of it or reasonable steps have been taken to notify the third party of the express term before the third party’s rights are crystallised.

11. The Consultation Bill also provides the court with a wide discretion to authorise rescission or variation of the contract without the consent of the third party if it is just and practicable to do so.

Issue of Consideration

12. The Consultation Bill contains an express provision to the effect that the third party can be a volunteer provided that the promisee has given consideration to the promisor for the contract.

Defences Available to Promisor

13. As for the defences available to a promisor in proceedings brought by a third party to enforce a term of the contract, the Consultation Bill provides that the promisor may rely on (a) any defence or set-off which arises from or in connection with the contract and is relevant to the term, and would have been available to the promisor had the proceedings been brought by another party to the contract by whom the term is enforceable, i.e. the promisee; or (b) any defence, set-off or counterclaim not arising from the contract, which would have been available to the promisor had the third party been a party to the contract.

Protection of Promisor from Double Liability

14. The Consultation Bill protects a promisor against double liability. If a promisor has performed his obligations, wholly or partly, to the third party, the promisor will be discharged, to the extent of that performance, from his obligations to the promisee.

15. The Consultation Bill further provides that if the promisee has recovered from the promisor a sum in respect of the third party's loss or the promisee's expense in making good the promisor's default, in any subsequent proceedings brought by the third party, the court must reduce any award to the third party to an appropriate extent.

Arbitration and Jurisdiction Clauses

16. The Consultation Bill states that if a third party's right to enforce a term of the contract is conditional upon the third party enforcing that term by arbitration or in a specified jurisdiction, the third party is bound to enforce the term by arbitration or in the specified jurisdiction, unless on a proper construction of the contract, the third party is not intended to be so bound.

Scope of Application

17. The new statutory scheme shall not apply to contracts entered into before the commencement of the scheme when enacted so that existing rights or remedies of a third party will be not affected.

18. In addition, the Consultation Bill excludes certain classes of contracts where:

- (a) a third party already has an enforceable right under existing rules reflecting international conventions. This includes a bill of exchange, a promissory note, a contract on a negotiable instrument, a contract for the carriage of goods by sea and by air and a contract on a letter of credit;
- (b) a third party has no enforceable right under existing rules but there are sound policy reasons for maintaining that position. This includes the memorandum and articles of a company having effect as a contract under the Companies Ordinance and a contract of employment against an employee.

IV. Consultation

19. In October 2012, the Administration consulted various stakeholders including the legal professional bodies, academics, political organisations, business associations as well as the banking, insurance, shipping and construction sectors on the legislative proposal set out in the Consultation Bill. The Administration received 21 submissions by January 2013.

20. The legal professional bodies do not raise any objection to the legislative proposal. The legal professional bodies, government departments and the academia have raised various technical comments and drafting suggestions which would be taken into account by the Administration when finalising the Consultation Bill, including the suggestion that provision should be made to exclude instruments relating to land covenants from the application of the new statutory scheme.

21. A few industry sectors have also raised technical comments on the application and operation of the Consultation Bill. Whilst some of those comments have been discussed and dealt with in detail by the LRC in the Report, the Administration has carefully considered all the comments received. Some of the questions raised by the industries can be resolved by building in clear provisions in their contracts such as the class of insurance contracts to be excluded from the application of the proposal. One respondent from the construction sector suggested that the whole construction industry should be excluded from the application of the proposal whereas another respondent from the same sector had another view. The Administration considered that it would be best to allow contracting parties the freedom to contract out of the new statutory scheme if they so wish.

22. The Administration would take into account specific comments from some respondents in the course of the legislative exercise, including the comment from the relevant industry sectors that adequate lead time should be provided before the proposal would be brought into operation so that the relevant industries (for example, the banking, insurance and construction sectors) which usually need to execute elaborate contractual framework would have sufficient time to make due preparations for the new legislative scheme.

V. Way Forward

23. Subject to Members' views on the legislative proposal, we aim to finalise the Consultation Bill with a view to introducing it into the Legislative Council in early 2014.