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By Fax (2110 9788)

9 April 2014

Ms Deneb CHEUNG
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Legal Policy Division
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66 Queensway, Hong Kong

Dear Ms CHEUNG,

Contracts (Rights of Third Parties) Bill

We are scrutinizing the legal and drafting aspects of the above Bill.
We would be grateful if you could clarify the following matters.

Clause 3

It is noted that there is a definition of "contract of carriage" in section 2(1) of the Bills of Lading and Analogous Shipping Documents Ordinance (Cap. 440). However, in clause 3(2)(c) relating to contracts of carriage, the usual drafting approach of saying "as defined by section 2(1) of the Bills of Lading and Analogous Shipping Documents Ordinance (Cap. 440)" is not used. Please clarify whether there is any difference between this approach and the one adopted in clause 3(2)(c) (namely by using "within the meaning of the Bills of Lading and Analogous Shipping Documents Ordinance (Cap. 440)"). Please also explain why the latter approach is preferred.

Please clarify why only "subsection (2)(c)" relating to contracts of carriage under Cap. 440 (but not also "subsection (2)(d)" relating to contracts for the carriage of goods by air) is included in clause 3(3).

It appears that the term "negotiable instrument" has not been defined in any other Ordinances. Please let us know if the definition in clause 3(5) is based on any case law or overseas provision(s) (and if so, please let us have the details).

Clause 4

Under clause 4(1) and (3), a third party may enforce a term of a contract (including a term that excludes or limits liability) if -

- (a) the contract expressly provides that the third party may do so; or
- (b) the term purports to confer a benefit on the third party unless on a proper construction of the contract, the term is not intended to be enforceable by the third party.

This clause sets out the only circumstances under which a third party may enforce a term of a contract. However, it is noted that in paragraph 6 of the LegCo Brief, it is stated that parties to a contract can expressly exclude the application of the new statutory scheme in their contract. Please clarify whether this statement in the LegCo Brief is only applicable to the scenario mentioned in (b) above or it is anticipated that parties to a contract can expressly exclude the application of the new statutory scheme even if the contract expressly provides that the third party may enforce a term of the contract.

If it is envisaged that a contract may have both an express provision on a third party's right to enforce a term of the contract and an express provision excluding the application of the new statutory scheme, which provision would prevail? Please clarify the legislative intent.

Clause 6

Please clarify whether the words "In addition" in the beginning of clause 6(3) are necessary.

Clause 7

Under clause 7(3)(b), the court may make an order dispensing with the third party's consent if the court thinks it just and practicable to make the order. Please clarify what circumstances would be "just and practicable".

It is noted that section 2(4) and (5) of the United Kingdom's Contracts (Rights of Third Parties) Act 1999 (the UK's Act) sets out the circumstances under which the court or arbitral tribunal may dispense with the third party's consent, e.g. if the third party's consent cannot be obtained because the third party's whereabouts cannot reasonably be ascertained, the third party is mentally incapable of giving consent, or it cannot reasonably be ascertained whether or not the third party has in fact relied on the term. Please clarify why such similar circumstances are not expressly specified in clause 7.

Clause 8

Please clarify whether the word "that" in clause 8(2)(b)(ii) is necessary.

Clause 11

It appears that under clause 11(3)(b)(i), it is possible for the promisee to recover from the promisor a sum for the third party's loss. If the promisee has in fact recovered from the promisor a sum for the third party's loss, please clarify whether and how the third party may recover the said sum from the promisee.

It appears that clause 11(3) and (4) is modelled on section 5 of the UK's Act. Are there any cases in the UK on how section 5 of the UK's Act operates in practice? Have there been any cases in which the court in the UK allowed the promisee to recover from the promisor a sum for the third party's loss but the third party subsequently had difficulties in recovering the said sum from the promisee?

Clause 12

It appears that clause 12(4) to (6) is modelled on section 8(2) of the UK's Act. According to paragraph 13 of the LegCo Brief, clause 12(4) to (6) is introduced after having studied the comments raised by the legal sector and the recent developments in English jurisprudence and commentary. Please elaborate further on these matters for Members' reference. Please also give example(s) as to how clause 12(4) to (6) would operate in practice.

Clause 13

In clause 13(3), the sentence "[t]his section does not apply if, on a proper construction of the contract, the third party is not intended to be so bound" is rendered as "如按經恰當解釋的有關合約，上述第三者如第(2)

款所述般受約束，並非立約用意，則本條不適用" in the Chinese text. Please clarify if its plain meaning is simply: "如有關合約的恰當解釋，是無意使上述第三者受第(2)款所述般約束，則本條不適用". Please also clarify if other similarly drafted provisions of the Bill (by using the formula of "if, on a proper construction of the contract, is not intended to be") could be so understood, e.g. clauses 4(3) and 12(3).

We would appreciate it if you could let us have your reply (in both Chinese and English and with soft copy to Miss Joey LEE at jmylee@legco.gov.hk) before the first meeting of the Bills Committee (tentatively fixed to be held on 24 April 2014).

Yours sincerely,



(Timothy TSO)
Assistant Legal Adviser

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22 April 2014

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By Fax (No. 2877 5029)

Dear Mr. Tso,

Contracts (Rights of Third Parties) Bill

Thank you for your letter dated 9 April 2014. We set out below our responses to the matters raised in your letter.

Clause 3

Drafting approach relating to Clause 3(2)(c)

2. There are different approaches to define terms or expressions in legislation. In the present case, it is considered appropriate to define “contract of carriage” by reference to the meaning given to it in another enactment so as to avoid excessive repetition. As rightly pointed out in your letter, the expression is defined in section 2(1) of the Bills of Lading and Analogous Shipping Documents Ordinance (Cap. 440) as follows:

“contract of carriage (運輸合約)-

- (a) in relation to a bill of lading or sea waybill, means the contract contained in or evidenced by that bill or waybill; and
- (b) in relation to a ship's delivery order, means the contract under or for the purposes of which the undertaking contained in the order is given[;]”.

3. However, the definition is not complete on its own. Three major elements of the definition, namely “bill of lading”, “sea waybill” and “ship’s delivery order”, are separately defined in the same section as follows:

“bill of lading (提單), sea waybill (海運貨單) and ship's delivery order (船舶交貨單) shall be construed in accordance with section 3[;]”.

4. The meaning of “contract of carriage” is therefore dependent on additional construction provisions appearing elsewhere than in the interpretation section of Cap. 440. We consider that in these circumstances, the “within the meaning of” approach can better reflect the fact that the meaning of “contract of carriage” is not completely spelt out in section 2(1) of Cap. 440, and is therefore a more appropriate approach.

Clause 3(3)

5. The Administration was asked to explain the reason why Clause 3(3) refers to “subsection 2(c)” only (i.e. in relation to contracts of carriage under Cap. 440) but not “subsection 2(d)” (i.e. in relation to contracts for the carriage of goods by air under Cap. 500).

6. Clause 3(2)(c) and (d) respectively excludes from the application of the legislative proposal a contract of carriage within the meaning of Cap. 440 and a contract for the carriage of goods by air governed by the Carriage by Air Ordinance (Cap. 500). Clause 3(2)(c) is made subject to Clause 3(3) which states that a third party may enforce a term that excludes or limits liability under a contract of carriage under Cap. 440.

Contracts of carriage under Cap. 440

7. The scheme under Cap. 440 is different from the legislative scheme under the Bill in at least two aspects. Under Cap. 440, a third party (such as a holder of a bill of lading) who seeks to take the rights under a contract of carriage would also become liable to the promisor (a carrier) for the liabilities of the original consignor. In addition, the promisee (a shipper) would have no rights of enforcement against the promisor. Under the Bill, however, a third party takes the benefits but not the burdens of the contract (except to the extent that the benefits are conditional) and the promisor is liable to both the promisee and the third party.

8. We take the view that Cap. 440 is tailored to meet the particular needs of the shipping industry and in order not to undermine the underlying

policy of Cap. 440, it is appropriate to exclude Cap. 440 from the legislative proposal. However, Cap. 440 is not concerned with the enforceability of exclusion or limitation clauses and there is no clash of policy between Cap. 440 and the Bill in this aspect. Accordingly, we take the view that a third party should be allowed to rely on the Bill to enforce an exclusion or limitation clause in a contract of carriage within the meaning of Cap. 440. Clause 3(3) is introduced to give effect to this policy.

Contracts of carriage of goods by air under Cap. 500

9. Contracts for the carriage of goods by air are regulated by the Carriage By Air Ordinance (Cap. 500). A third party acquiring rights under Cap. 500 to enforce a contract of carriage by air takes the burdens under the contract. To allow such a third party to have rights under the Bill would conflict with the underlying policy of Cap. 500 in that the Bill enables the creation of enforceable rights, but not the imposition of burdens, on a third party.

10. Cap 500 gives effect to certain Conventions concerning international carriage by air applicable to Hong Kong. Article 25A of the Warsaw Convention which appears in Schedule 1 to Cap. 500 enables certain third parties, being servants or agents, to avail themselves of an exclusion or limitation clause. Similar exclusion clauses also appear in Article 30 of the Montreal Convention (Schedules 1A and 3 to Cap. 500) and Article V of the Guadalajara Convention (Schedule 2 and Part 2 of Schedule 4 to Cap. 500). The effect is that under these Conventions as implemented by Cap. 500, certain third parties (but not all) are entitled to avail themselves of an exclusion or limitation clause. By contrast, the legislative scheme introduced by the Bill deviates from these Conventions in that all types of third parties are treated in the same manner. We take the view that these exclusion or limitation clauses form part of a package of negotiated outcome in international conferences and should not be disturbed by the Bill. Accordingly, unlike the case of carriage of goods by sea, the enforcement by a third party of an exclusion or limitation clause, which forms part of Cap. 500, should be excluded from the Bill in the case of carriage of goods by air.

Definition of “negotiable instrument” in Clause 3(5)

11. The definition of “negotiable instrument” in Clause 3(5) is proposed having taken into account the comments made in the report on “Privity of Contract” published by the Law Reform Commission of Hong Kong (“LRC”) in September 2005 (see para. 4.171 of the LRC’s Report). It is specifically mentioned that LRC has adopted a broader sense of the expression, which is described in Goode, Commercial Law, 2004 3rd Edition, at 477 n11 as follows,

“any instrument embodying a monetary obligation and transferable by endorsement and delivery, whether or not capable of being transferred free from equities”. We consider the definition adopted in the Bill duly reflects the relevant recommendation of the LRC.

Clause 4

12. As set out in para. 6 of the LegCo Brief, Clause 4(1) and (3) of the Bill sets out a two-limb test and the satisfaction of either limb will permit a third party to enforce the contract. The two limbs are as follows: (a) a third party may enforce the contract if the contract contains an express provision to that effect; or (b) if the contract contains a term which purports to confer a benefit on the third party, the third party may enforce the term unless on a proper construction of the contract, the contracting parties do not intend that the third party may do so.

13. Your letter referred to a hypothetical situation wherein the contract contains an express provision providing for a third party’s right to enforce a term of the contract on the one hand and another express provision excluding the application of the new statutory scheme on the other. We envisage that it is possible for the contracting parties to provide expressly that a certain third party (“Third Party A”) may enforce a term of the contract (“Contract Term X”). The contracting parties then provide in the same contract that save for Third Party A who may enforce Contract Term X, no third parties may enforce any terms in the contract in accordance with the Contracts (Rights of Third Parties) Ordinance. Afterall, this is a matter of drafting and proper construction of the contract in question. Generally speaking, if there are any disputes arising from inconsistent terms in a contract, they may have to be left to the court to interpret and ascertain the real intention of the parties in case the parties cannot resolve the dispute.

Clause 6

14. Clause 6 has been drafted in a narrative style to present the substance of the clause in the following manner:

- (a) subclause (1) sets out a general rule;
- (b) subclause (2) qualifies the operation of the rule;
- (c) subclause (3) sets out a further qualification; and
- (d) subclause (4) limits the operation of the further qualification.

15. Under this drafting approach, the whole clause consisting of four subclauses can be read as one narrative. The expression “[i]n addition” is added at the beginning of subclause (3) to promote the linkage between the

subclauses and to give the reader a sense of continuity within clause 6. We believe that the presence of the expression would be conducive to the reader's comprehension of the clause.

Clause 7

16. The Administration was asked to clarify what circumstances would be "just and practicable" under Clause 7(3)(b) and why circumstances similar to section 2(4) and (5) of the United Kingdom's Contracts (Rights of Third Parties) Act 1999 ("UK Act") are not expressly specified in Clause 7.

17. We take the view that the court should be given a wide discretion to authorise variation or rescission of the contract without the consent of the third party when the court considers it "just and practicable" to do so. We envisage that the following circumstances would likely be considered to be "just and practicable": (a) the third party cannot be found; or (b) the number of third parties is so substantial that it would be impossible to locate each third party; and (c) the third party is mentally incapable of giving consent.

18. We note that section 2(4) and (5) of the UK Act provides the specific circumstances under which the court can order to dispense with the consent of a third party. This approach does not give a residual power to the court and is not adopted by the LRC (see. para. 4.92 of the Report). Clause 7(3) seeks to implement the relevant recommendation of the LRC (Recommendation 8) and it duly reflects our policy intent that the court should have a wide discretion to authorise variation or rescission when it is "just and practicable" to do so.

Clause 8

19. The word "that" is not strictly necessary in Clause 8(2)(b)(ii). The existence of the word there, however, does not make the provision ungrammatical, and neither would it affect the legal effect of the provision. That said, we will consider further whether the removal of the word will improve the presentation of the provision.

Clause 11

20. Clause 11 seeks to protect the promisor from double liability. Clause 11(3) deals with two situations specifically. The first situation is where a promisee has recovered a sum representing the third party's loss (Clause 11(3)(b)(i)). The second is where the promisee has recovered a sum for the expense in making good to the third party the promisor's default

(Clause 11(3)(b)(ii)). In either situation, the court or arbitral tribunal must in any proceedings brought by the third party reduce any award to the third party to the extent to which it thinks appropriate to take account of the sum.

21. In the first situation where a promisee sues the promisor for the third party's loss and recovers damages for that loss, the promisee would be under a duty to account for the damages to the third party or to hold the damages on trust for the third party¹. It has been suggested that the promisee's duty to account means that after paying damages to the promisee, the promisor would not be liable, at common law, to the third party as the third party would have no loss to recover from the promisor². The LRC recommended to put this beyond doubt in the proposed legislation and hence Clause 11(3)(b)(i) is introduced to implement the relevant recommendation of the LRC.

22. We are not aware of any case law on section 5 of the UK Act upon which Clause 11(3) and (4) is modelled. We note that none of the common law jurisdictions which have enacted legislation reforming the doctrine of privity have introduced any provisions on the duty of the promisee to account for the damages recovered from the promisor to the third party.

Clause 12

23. As rightly pointed out in your letter, Clause 12(4) to (6) is modelled on section 8(2) of the UK Act. The Administration has received specific comments from the legal profession that a provision equivalent to section 8(2) of the UK Act would be useful in enabling a third party to arbitrate a certain dispute with the promisor. Clause 12(4) to (6) allows the contracting parties to give a third party an enforceable procedural right which the third party may choose to exercise. In contrast, Clause 12(1) to (3) concerns with the enforcement of a substantive right by a third party subject to a procedural condition of being bound to enforce that right by arbitration.

24. The operation of Clause 12(4) to (6) may be illustrated by the following example:

¹ Robert Merkin, Privity of Contract, the Impact of the Contracts (Rights of Third Parties) Act 1999, LLP, 2000, at para. 5.68

² Para. 4.143 of LRC's Report, citing para. 11.17 of the Report on Privity of contract: Contracts for the Benefits of Third Parties published by the Law Commission of England and Wales in 1996 (Law Commission Report No. 242)

- A entered into a contract with B.
- The contract contains an arbitration agreement which provides that all disputes between A and B or between A and B's affiliates (say a director of B) must be submitted to arbitration.
- B's affiliates are not parties to the contract.
- A brings tortious claims against one of B's affiliates in court proceedings.
- B's affiliate can exercise his right to arbitrate pursuant to Clause 12(4) to 12(6) of the Bill and to stay the court proceedings brought by A in favour of arbitration.
- Clause 12(1) to (3) is not applicable as B's affiliate does not seek to enforce a substantive term of the contract to defend against the tortious claims that have been brought against him.

25. The recent decision of the English Court of Appeal in April 2013 in ***Fortress Value Recovery Fund I LLC and Ors v Blue Skye Special Opportunities Fund LP and Ors*** [2013] EWCA Civ 367 is also helpful in illustrating the operation of, among others, section 8(2) of the UK Act.

- In ***Fortress Value***, the claimants brought proceedings in the English court against the defendants who were managers of an investment structure. The investment structure, called the Blue Skye Fund, was based around an English limited partnership. The Fund was regulated by a Deed of Limited Partnership.
- The claimants alleged that the defendants, acting in concert with three other individuals and twelve corporate entities, designed and implemented a dishonest scheme under which the Fund would be reorganised with the intention of diminishing or eliminating the rights of the claimants.
- The claims brought were English tort claims on the basis of, among others, conspiracy, unlawful interference and dishonest assistance.
- The defendants were not parties to the Deed, but the Deed contained indemnities and exclusion clauses the benefit of which the defendants were entitled to.
- The Deed also contained an arbitration clause referring disputes to arbitration in London.

- The Deed made an express reference to the application of the UK Act.
- The defendants applied to stay the claim in favour of arbitration.
- The Court of Appeal unanimously held that the defendants were not entitled to a stay. Tomlinson LJ held that the question of whether the right to benefit from a contractual exclusion clause by a third party was subject to the obligation to arbitration under section 8(1) of the UK Act was a matter of construction of the contract. The judge held that very clear language was required to bring about the result that the right of a third party to avail himself of an exclusion clause in the contract to which he was not a party was in turn subject to an arbitration clause in the same agreement and there was no such clear language in the Deed of Partnership.
- In respect of section 8(2) of the UK Act, the defendants argued that in the context of the UK Act, notwithstanding that the arbitration clause of the Deed referred to the “parties hereto”, the arbitration clause in the Deed would encompass any disputes with third parties arising out of or connected with the agreement.
- The argument was rejected by the Court of Appeal as it was inconsistent with other express words of the Deed, which defined references to “parties” as the parties to the Deed. As per Toulson LJ, had the parties intended the managers to have a contractual right to refer disputes to arbitration (and therefore be captured by Section 8(2) of the UK Act), express wording could easily have been included to that effect and in the absence of such wording in the Deed, it could not be read into the language of the Deed.

26. The case of **Fortress Value** emphasised the need for very clear drafting of arbitration clauses if contracting parties do intend that disputes involving third parties should be referred to arbitration.

27. Having considered the relevant comments of the legal profession and the judgment of **Fortress Value**, we take the view that Clause 12(4) to (6) would be helpful in giving effect to the intention of the contracting parties to confer on a third party an enforceable procedural right. Without Clause 12(4) to (6), a third party cannot exercise a procedural right to arbitrate (say

to apply for a stay of court proceedings in favour of arbitration) even if the contracting parties had intended that the third party to refer disputes to arbitration by clear wording to that effect in the contract.

Clause 13

28. We are asked to clarify the Chinese equivalent of the following sentence in Clause 13(3): “[t]his section does not apply if, on a proper construction of the contract, the third party is not intended to be so bound”.

29. In the process of construing a contract, a court would look at the circumstances surrounding the term or provision in question to find out what the parties have intended when the contract was entered into. “立約用意” in the Chinese text of Clause 13(3) reflects what the court seeks to find out in the process. The suggested words “無意” may not be precise or specific enough to reflect the meaning of “not intended” in the context. Moreover, the suggested version “如有關合約的恰當解釋，是無意使[...]” may convey an unintended meaning of “the construction ... is not intended”.

30. Further, the words “so bound” in “the third party is not intended to be so bound” in Clause 13(3) should be reflected in the Chinese text. Hence, the Chinese expression “上述第三者如第(2)款所述般受約束” is clear and appropriate. We therefore consider that the current Chinese text reflects the meaning of the provision adequately.

31. Kindly note that a Chinese version of this letter will be sent to you as soon as it is ready.

Yours sincerely,



(Deneb Cheung)

Senior Assistant Solicitor General

Copy:

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Ms. Angie LI, Senior Government Counsel