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Attn: Ms Sandy SZETO

Re: BILLS COMMITTEE ON THE CONTRACTS (RIGHTS OF THIRD PARTIES) BILL

COMMENTS ON THE BILL

14th May 2014

Further to the submissions made in deputation at the Committee meeting on 7th May 2014, please find written comments below:

❖ **NO PROVISION OUSTING THE APPLICATION OF s.7(2) OF CECO**

Where there is an *exemption* clause in the main contract which excludes or limits the promisor's liability to the third party for breach of a contractual duty of care,¹ this clause will be subject to the 'reasonableness test' in s.3 of the Control of Exemption Clauses Ordinance (Cap 71) ('CECO') by virtue of s.7(2) of CECO.

Section 7(2) of CECO:

'In the case of other loss or damage, a person cannot so exclude or restrict his liability for negligence except in so far as the term or notice satisfies the requirement of reasonableness.'

In other words, s.7(2) of CECO is wide enough to possibly *prevent* the promisor from excluding or limiting his liability to the third party for breach of a contractual duty of care if the relevant exemption clause *fails* to satisfy the reasonableness test in s.3 of CECO. Whereas, in the UK's Contracts (Rights of Third Parties) Act 1999 ('UK Act'), there is a provision² specifically *dis*-applying the UK's equivalent of s.7(2) of CECO,³ thereby preventing the third party from having the promisor's exemption clause avoided for being 'unreasonable'.

Although the Bill may, therefore, appear more third party friendly, it creates uncertainty for the contracting parties, most particularly the promisor whose liability to the third party may ultimately *not* be exempted, despite himself and the promisee having freely agreed that it should. Clearly, this runs contrary to the main driving

¹ Section 2(1)(a) of CECO defines negligence as being a breach of any of any obligation, arising from the terms of a contract, to take reasonable care or exercise reasonable skill in the performance of the contract.

² Section 7(2) of the UK Act.

³ Section 2(2) of the UK's Unfair Contract Terms Act 1977.

force for privity reform: namely, giving effect to the intentions of the contracting parties.⁴

Given that the contracting parties are able to decide whether to give a third party an enforceable right *at all*, it seems only fair that they should also be able to exclude or limit those rights if they do indeed decide to confer such rights on a third party. Therefore, it would seem contrary to the goal of respecting the intentions of the contracting parties if a statutory reasonableness test could be relied upon by the third party (who had had his conferred right deliberately restricted by the contracting parties) so as to have a clause (agreed on by the contracting parties) which exempted the promisor's liability to him for loss or damage (other than death or personal injury) as a result of his negligence (i.e. his breach of a contractual duty of care) to be struck out.⁵ Again, this is something which is worthy of attention given that the UK Act *expressly* deals with this issue by ousting the application of the UK's equivalent of s.7(2) of CECO with regard to third party rights.

Essentially, if s.7(2) of CECO is not disapplied, then the promisor is actually open to more potential liability than he contractually bargained for with the promisee.

❖ **SECTION 11: PROTECTION OF PROMISOR FROM DOUBLE LIABILITY**

▪ ***Promisee's recovery for his own personal loss***

Under s.11(4) of the Bill, the court (or arbitral tribunal) must reduce any award made to the third party (to the extent to which it thinks appropriate) to take account of the sum [*recovered by the promisee*].⁶ First, this provision should include the words 'recovered by the promisee' at the end of the sentence so as to make clear to *which* sum the court (or arbitral tribunal) is to take account of.⁷

Secondly, to the extent that s.11 is designed to protect the promisor from double liability, it does so only insofar as preventing double *recovery* (by the promisee and third party) for the *same* loss. There may, however, be occasional circumstances where the promisee suffers *personal* loss as a result of the promisor's breach (non-performance) and this loss is *separate* to the third party's loss. This seems to have

⁴ Indeed, despite the Law Reform Commission ('LRC') considering that the 'foremost criticism' of the privity doctrine was that it thwarted the intentions of the contracting parties (see LRC Report, para 2.13), they then went on to *withdraw* their initial recommendation to disapply s.7(2) of CECO (see LRC Report, para 4.127).

⁵ NB: there does not appear to be a problem with the *other* provisions in CECO since, other than the ones which cannot be excluded or limited in any event whatsoever (e.g. s.7(1)), CECO only deals with exemption clauses as between the *contracting* parties.

⁶ The words in square brackets do not appear in the s.11(4).

⁷ Cf: s.5 of the UK Act.

been overlooked by the LRC; at para 4.146 of their Report they agreed with the English Law Commission ('ELC') that a promisee would be left with no corresponding loss outstanding once the third party had recovered damages. However, this may not always be the case: if the third party claims and recovers damages *before* the promisee (on which the Bill is silent), then that promisee should still be able to recover for any personal loss of his own, over and above any damages previously recovered by the third party.

Furthermore, the provision should make clear that even if the promisee claims damages for his personal loss (*first*), then any subsequent award to the third party should not take into account the sum representing that personal loss. This could be achieved by including in s.11(4) a reference to the sums recovered of the type listed in s.11(3)(b)⁸.

Thirdly, although s.11(4) intends to prescribe that any of the third party's damages should be off-set against any (previous) recovery (for the same loss) by the promisee, there is no *express* provision dealing with the promisee's duty to *account* to the third party for those damages recovered (in relation to the third party's loss). At para 4.143 of the LRC Report, the LRC recommended that the duty to account should be left to the courts to determine. Although this could, indeed, reasonably be left to the common law as a restitutionary claim by the third party against the promisee, an express provision that the promisee *will* account to the third party for such damages should make the position clearer and, arguably, reduce the likelihood of litigation.

❖ **SECTION 12: ARBITRATION AGREEMENT**

▪ ***Do arbitration agreements confer a burden on third parties?***

As the Committee is well aware, the equivalent provision in the the UK Act is s.8. However, although eventually finding its way into the UK Act, there was no such recommendation for this from the ELC in its 1996 Report; rather, the ELC recommended that arbitration agreements should fall outside of the then proposed legislative reform. In fact, out of the main common law jurisdictions of Australia, Canada, England & Wales, New Zealand and Singapore, only England & Wales and Singapore have such a statutory provision specifically on arbitration agreements.

Although there is some case law in England (most recently, *Fortress Value Recovery Fund I LLC and others v Blue Skye Special Opportunities Fund LP and others* [2013] EWCA Civ 367) which can be drawn on by the Hong Kong courts for guidance, there

⁸ i.e. (i) the third party's loss, or (ii) the expense to the promisee of making good to the third party that default of the promisor

may still be some concern about the possibility of a *burden* being conferred on the third party (as opposed to a mere 'conditional benefit'), most particularly with regard to *exemption* clauses.

❖ **NO PROVISION DEALING WITH MEDIATION AGREEMENTS**

It is noted that there is no provision dealing with a third party right which is enforceable only by recourse to mediation (before going to arbitration). At the last Committee meeting (7th May 2014), the Drafters considered that s.4(4) of the Bill is wide enough to cover mediation agreements. However, given the growing importance of mediation in Hong Kong (most notably with the recent coming into force of the Mediation Ordinance (Cap 620)), such mediation agreements are surely worthy of their own specific provision, rather than being relegated to the status of an apparent 'after thought' through inclusion via the very general provision that is s.4(4) of the Bill. Indeed, a provision dealing specifically with mediation agreements would bolster the status of mediation in Hong Kong and would be seen as further Administration support for, and recognition of, this efficient dispute resolution process.

❖ **SECTION 13: EXCLUSIVE JURISDICTION CLAUSE**

▪ ***Do exclusive jurisdiction clauses confer a burden on third parties?***

As the Committee is well aware, none of the main common law jurisdictions have a legislative provision dealing specifically with exclusive jurisdiction clauses (and neither were they recommended for inclusion by the ELC). Nevertheless, based on academic opinion,⁹ the UK Act is thought to cover such clauses, albeit not expressly.

The main problem or, at least, uncertainty seems to be in the context of *exemption* clauses where the promisor brings an action in *tort* against a third party. If the third party wants to rely on an exemption clause (which was conferred on him for his benefit), does it mean that such a third party is subject to the *burden* of being forced to defend himself in the jurisdiction agreed in the main contract?

Since reform of the privity doctrine is not intended to allow burdens to be conferred on third parties, it must mean that, although the *promisor* is bound to sue in the stipulated jurisdiction, the third party is *not* bound to submit to that jurisdiction (rather, it is at his option). If the third party chooses not to submit to that

⁹ e.g. R. Merkin, 'Privity of Contract: The Impact of the Contracts (Rights of Third Parties) Act 1999' (2000) LLP at 5.124; C. MacMillan, 'A Birthday Present for Lord Denning: The Contracts (Rights of Third Parties) Act 1999' (2000) 63 MLR 721 at 733.

jurisdiction, the court of that jurisdiction would (unless they are able to find jurisdiction on some other ground) have to stay the proceedings, thereby resulting in the promisor only having the option of bringing the proceedings in a court which *does* have jurisdiction over the dispute.

(Of course, it seems that the third party may choose to make use of the jurisdiction clause if he is being sued by the promisor in a jurisdiction different to the one agreed in the main contract.)

Nevertheless, the actual position is unclear since s.13 does not have a 'tried and tested' legislative equivalent in the other common law jurisdictions.

❖ **POSITIVE RIGHTS v. NEGATIVE RIGHTS**

Related to both s.12 and s.13 of the Bill, the Drafters should perhaps reconsider the interplay between exemption clauses and third parties. In other words, to take a closer look at the potential problem arising from a third party seeking to enforce a *negative* right as opposed to a (more usual) positive right.

❖ **A DECADE ON...**

As the Committee is well aware, the LRC Report is almost a decade old.¹⁰ Naturally, views can change over time and it may be a missed opportunity if the Department of Justice felt bound to rigorously follow the recommendations in this 2005 Report. Rather, it is hoped that they will entertain some of the various views expressed on the Bill which are not necessarily congruent with the recommendations in the Report but which may, if followed, produce a better piece of legislation for the benefit of both the contracting parties and third party beneficiaries.



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¹⁰ Cf. In the UK, the ELC published its Report in 1996 and the UK Act came into force only three years later, in 1999.