Bills Committee on Contracts (Rights of Third Parties) Bill

Administration's Responses to the Written Submissions of (1) Mr. Lee MASON, Faculty of Law, the University of Hong Kong; (2) the Law Society of Hong Kong; and (3) the Hong Kong Association of Banks

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1. **Mr. Lee MASON, Assistant Professor of Faculty of Law, The University of Hong Kong**	
(a) Mr. MASON noted that section 7(2) of the United Kingdom's Contract (Rights of Third Parties) Act 1999 ("**UK Act**") disapplied section 2(2) of the Unfair Contact Terms Act 1977 and queried why the Bill contained no equivalent provision to disapply section 7(2) of the Control of Exemption Clauses Ordinance (Cap. 71). The contracting parties should be free to decide whether to exclude or limit a third party's enforceable right.	(a) The Administration notes that the Law Reform Commission of Hong Kong ("**LRC**") has considered the issue (paras. 4.125-4.127 of the LRC's Report on Privity of Contract published in September 2005) ("**Report**") and did not recommend that section 7(2) of Cap. 71 be disapplied. We agree with the comments of the LRC that there exists no compelling reason for distinguishing promisees from third parties where the protection of section 7(2) of Cap. 71 is concerned. We consider it appropriate that section 7(2) of Cap. 71 should apply where a third party sues the promisor under the Bill for negligence which consists of a breach of a contractual obligation.

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(b) Mr. MASON suggested that the words "recovered by the promisee" be added at the end of Clause 11(4), so as to qualify the "sum" that the court or arbitral tribunal was to take account of.	(b) Clause 11(3) and (4) must be read together as subclause (3) sets out the circumstances under which subclause (4) would be applicable. The sum in question is clearly described in Clause 11(3)(b) and no other sum is mentioned in Clause 11(3). Therefore, it is sufficiently clear that the reference to "the sum" in Clause 11(4) relates to the sum referred to in Clause 11(3), and no further elaboration or qualification seems necessary.
(c) Mr. MASON considered that if the third party had recovered damages before the promisee, the promisee should still be able to recover for any personal loss of its own. He also suggested that the Bill should expressly provide for the promisee's duty to account to the third party for the sum the promisee recovered from the promisor.	(c) Clause 11 does not prevent a promisee from recovering personal loss which he suffers. Contract law principles would apply to such a claim as between the promisee and the promisor. Further, we agree with the comments of the LRC as set out in para.4.146 of the Report that no express provision is necessary to deal with the situation where the third party has recovered damages from the promisor first. The promisee would then be left with no corresponding loss outstanding and the promisor would not face double liability for the same loss. We also 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

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	account for the damages recovered from the promisor to the third party (see para. 22 of the Administration's letter to the Assistant Legal Adviser dated 22 April 2014 (LC Paper No. CB(4)599/13-14(01)). We agree with the LRC (para 4.143 of the Report) that it should be for the courts and arbitral tribunals, rather than the legislature, to determine the circumstances under which a promisee may be under duty to account to the third party for the sum that the promisee has recovered.
(d) Mr. MASON took note of the case of *Fortress Value* **Recovery Fund**. He considered that there might still be concern that arbitration agreements might have conferred a burden on a third party as opposed to a mere conditional benefit.	(d) The English Court of Appeal decision in *Fortress Value Recovery Fund* [2013] EWCA Civ 367 is helpful in illustrating the operation of section 8 of the UK Act, on which Clause 12 of the Bill was modelled. The Administration has discussed the case in paras. 25-27 of its letter to the Assistant Legal Adviser dated 22 April 2014 (LC Paper No. CB(4)599/13-14(01)). The LRC (at para 4.155 of the Report), having taken into account the English approach, considered that third parties' enforcement of rights subject to a written arbitration clause is based on the "conditional benefit" approach instead of a mere burden approach.

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(e) Mr. MASON queried why no specific provision had been made to deal with the question whether a third party would be bound to enforce his rights by way of mediation if the contract contained a mediation agreement.	(e) Under Clause 4(4), a third party's right of enforcement of a term of the contract is subject to any other term of the contract relevant to the term. This would include procedural conditions such as enforcement by way of arbitration or other means of alternative dispute resolution including mediation. We therefore consider that a specific provision on mediation is not necessary.
(f) Mr. MASON considered that there might be uncertainty in the application of an exclusive jurisdiction clause in the context of exemption clauses when the promisor brought an action in tort against the third party.	(f) The LRC considered that their recommendation on arbitration clauses should apply analogously to exclusive jurisdiction clauses and it would be undesirable to leave the issue open (para. 4.158 of the Report). Clause 13 of the Bill reflects the recommendation of LRC in this aspect (Recommendation 15). As regards the application of an exclusive jurisdiction clause in the context of exemption clauses when the promisor sues the third party in tort, since the exclusive jurisdiction clause requires the promisor to sue in the agreed jurisdiction and the third party to defend himself in that jurisdiction, the clause operates as a burden imposing a positive obligation on the third party and accordingly the clause would not be binding on the third party. We see it appropriate to leave the matter to

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	be determined according to the jurisdiction rules of the relevant court.
(g) Mr. MASON commented that the Report was almost a decade ago and the Bill should take into account views that might not be congruent with the recommendations of the Report.	(g) Apart from the Report, the Administration has taken into account views received from the consultation exercise as well as jurisprudence developed in other common law jurisdictions when preparing the Bill.
2. **The Law Society of Hong Kong ("Law Society")**	
(a) The Law Society suggested that the new legislative scheme should not be applicable to variation or rescission to an agreement entered before the commencement of Bill when passed to avoid the argument that this would be a collateral contract to which the scheme would be applicable.	(a) Clause 3(1) seeks to provide that Bill would not affect contracts entered into prior to the commencement of the Bill. We see that the Bill is not intended to alter the general principles of contract law governing variation or rescission of contracts. The Bill would apply to a contract (including a "supplemental" contract) entered into on or after the date on which the Bill comes into operation. However, it would be open to the parties to make clear their contractual intention in accordance with Clause 4(1) and (3) of the Bill.

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(b) The Law Society suggested that Clause 6[(2)(a)] should be replaced by "the third party has communicated his assent to the term to the promisor". The Law Society also commented that the requirement of actual receipt by the promisor of third party assent required further refinement and this would be sufficiently achieved by adding the word "actually" before "received" in Clause 6[(2)(a)]. Alternatively, the equivalent provision in the UK Act may be adopted: "The assent referred to in subsection (1)(a), if sent to the promisor by post or other means, shall not be regarded as communicated to the promisor until received by him."	(b) We have duly considered the comments and suggestions of the Law Society on Clause 6(2)(a). We consider that Clause 6(2)(a) is sufficiently clear to displace the postal rule.
(c) The Law Society commented that the reference to "a party" in Clause 6(3) suggested that if there was express provision in the contract for one party to unilaterally rescind or vary the contract, that party should have the right to do so in accordance with the relevant provisions of the Bill. The Law Society noted that the equivalent section in the UK Act only referred to "the parties" but not "a party" but is of the view that the reference to "a party" in the Draft Bill is not particularly objectionable.	(c) We take note of the Law Society's comments. Clause 6(3)(a) of the Bill now clearly provides that "one or more parties to the contract may rescind or vary the contract without the third party's consent".

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(d) In respect of Clause 6(4), the Law Society took the view that the express contractual intention of the parties to qualify the rights of the third party would easily be defeated if the third party had communicated assent to, or relied on, the relevant term. Also, Clause 6(4) may create contractual uncertainty as regards whether an express term communicated to the third party would be enforceable at all, and under what circumstances the third party would be deemed to have "relied on" the relevant term. The Law Society suggested that reference may be made to the Contracts (Privity) Act 1982 of New Zealand which required a third party to have "materially altered" his position in reliance on the term in the contract.	(d) The LRC has considered the relevant provisions in New Zealand's *Contracts (Privity) Act 1982*. The New Zealand Act adopts different tests of crystallisation, i.e. the "material reliance" test (section 5(1)(a)) and "already obtained judgment or arbitral award" test (sections 5(1)(b) and (c)). We agree with the conclusion of the LRC (at para 4.69 of the Report) that the material reliance test does not offer sufficient certainty as what amounts to "material" would be ambiguous and hence would invite arguments. We take the view that the "material alteration" test for variation or rescission of a third party's right stipulated in section 6 of the New Zealand Act would not sit well with the crystallisation test provided in Clause 6 of the Bill which is very similar to the model adopted in the UK Act.
(e) In respect of Clause 7, the Law Society considered it desirable that the court should be given a wide discretion to impose consequential direction upon dispensing with third party's consent to authorise variation or rescission of contract, as it would accord greater flexibility to the court in dealing with potential novel situations.	(e) We take note of the Law Society's comments. Clause 7 reflects the wide discretion of the court to authorise rescission or variation of the contract without the consent of the third party and to impose such conditions as it thinks fit.

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(f) The Law Society took the view that Clauses [11(1) and (2)] may be dispensed with as [they] seemed to state the obvious and it would not be necessary for that to be explicitly spelt out in the Bill.	(f) We share the view that the rule of protection of promisor from double liability reflected in Clauses 11(1) and (2) is self-evident. We agree with the observation of the LRC that this self-evident principle should be spelt out explicitly in the proposed legislation for the avoidance of doubt (para. 4.139 and Recommendation 12 of the Report).
(g) The Law Society took the view that a potential problem may arise from Clauses [11(3) and (4)] where payment was made to another third party either under Clause 4 of the Bill or through third party rights laws including the Employees' Compensation Ordinance (Cap. 282), the Motor Vehicles Insurance (Third Party Risks) Ordinance (Cap. 272), the Third Parties (Rights Against Insurers) Ordinance (Cap. 273) and the Married Persons Status Ordinance (Cap. 182). It suggested that Clause [11(3)] could be amended to specifically take account of these payments.	(g) It is our policy intent that the Bill should not apply to contradict existing rules governing third party rights as reflected in Clause 5(4). Nothing in the Bill limits the right of a third party to claim under any other existing statutory regimes. It appears that the Law Society is concerned about payment received by *"another"* third party whilst it is not clear who that "*another*" third party is referred to. As considered by the LRC (para. 4.140 of the Report), where the benefits are owed to the third parties jointly, the release by one of the third parties should release the promisor's obligation towards the other third party. It is also possible that the promisor owes separate obligations towards several third parties under the same term. In that case, payment received by a third party does not affect a promisor's

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	obligation towards the other third party.
(h) The Law Society commented that if a third party's right to enforce a term of contract was conditional upon the third party enforcing that term by mediation, then the third party would be bound to enforce the term by mediation.	(h) We take note of the Law Society's comments. As explained in point (e) under item 1 of this table, under Clause 4(4), a third party's right of enforcement of the relevant term of the contract is subject to the contract's other terms which would include procedural conditions such as enforcement by way of arbitration or other means of alternative dispute resolution including mediation. We consider that a specific provision on mediation is not necessary.
3. **The Hong Kong Association of Banks ("HKAB")**	
(a) The HKAB commented that adequate lead time should be provided before the operation of the new legislative scheme and provision should be made for the application of the scheme to contracts entered into six months after the enactment of the Bill.	(a) The Administration appreciates the concern on the provision for adequate lead time to enable the relevant industries to make due preparations for the operation of the Bill when enacted. As explained in paragraph (b) under item 5 of the table set out in the Administration's paper to the Bills Committee (LC Paper No. CB(4)710/13-14(01)), we plan to bring the Bill into force six months after the Bill has been

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	passed by the Council, subject to further views of the stakeholders and the Bills Committee.
(b) The HKAB suggested a specific reference to a cheque be included in Clause 3(2)(a) as it is the most important and widespread negotiable instrument.	(b) We are of the view that the current definition of "negotiable instrument" in Clause 3(5) should be clear enough to cover cheques.
(c) The HKAB commented that the way in which the definition of "negotiable instrument" in Clause 3(5) was drafted had the effect that the wording "whether or not the instrument is capable of being transferred free from equities" may only apply to other negotiable instruments as set out in Clause 3(2)(a). They suggested a revision to the effect that the "whether or not" wording should apply to cheques, bills of exchange, promissory notes and other negotiable instruments. This is because each of these types of document has the possibility of not being transferrable free from equities.	(c) The "whether or not" wording is relevant to the definition of "negotiable instrument". The terms "bill of exchange" and "promissory note" are defined separately with reference to the Bills of Exchange Ordinance (Cap. 19) and we consider those definitions sufficiently clear.

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(d) The HKAB took the view that it should not be open to the courts to allow third parties to have rights which they do not have under the legislation and suggested that Clause 5(4) should be deleted.	(d) The Bill seeks to reform the privity rule by giving effect to the contracting parties' intention to benefit a third party rather than to take away the rights of a third party. It follows that the existing rights of a third party, whether under other legislation or at common law, should not be affected by the Bill. Clause 5(4) should therefore be retained to reflect this policy intent.
(e) In respect of Clause 6(2)(a), the HKAB suggested that as assent may be by conduct, it would be arguable that notice of the conduct on the part of the third party may amount to notice of it, thereby creating an obligation not to vary the contract or rescind it simply by notice of the existence of conduct. The HKAB preferred the requirement of "communication" of the assent.	(e) Clauses 6(2)(a) and (b) seek to implement Recommendation 6 of the LRC which respectively reflect the alternative tests of "acceptance" and "reliance" adopted in the UK Act and that the communication of the assent can be by word or conduct. We envisage that it would likely be the third party who asserts that the contracting parties' right to rescind or vary the contract has come to an end and it follows that it would be the third party's burden to prove the satisfaction of either the "acceptance" test (Clause 6(2)(a)) or the "reliance" test (Clause 6(2)(b)). It appears to be open for the third party to prove that the promisor has received notice of the conduct of the third party which represents an assent for the purpose of Clause 6(2)(a). We have considered the formulation of

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	"communication of the assent" and we think the current formulation adopted in Clause 6(2)(a) is sufficiently clear in reflecting our policy intent.
(f) The HKAB believed that Clause 6(4) should be deleted as the whole purpose of the legislation was to give effect to the intentions of the parties, the effect of Clause 6(4) would vary the express terms agreed between the parties such that notwithstanding the parties have agreed to the basis on which a contract may be varied or rescinded, that may under certain circumstances be not given effect to.	(f) Clauses 6(1) and (2) stipulate the statutory rule of "crystallization" (i.e. the alternative tests of "acceptance" and "reliance") and that a third party's right may not be altered or extinguished after "crystallisation". Clause 6(3) seeks to provide that contracting parties may, by an express term in the contract, lay down their own test of "crystallisation" which may be different from that under Clauses 6(1) and (2). However, this would be subject to Clause 6(4) which requires that the third party is aware of the express term or that reasonable steps have been taken to bring the express term to the notice of the third party. Clause 6(4) seeks to strike a balance between respecting contracting parties' autonomy to vary or rescind the contract on the one hand and protecting third parties' rights on the other (including alleviating uncertainty for the third party). This reflects Recommendation 7 of the Report. We take the view that Clause 6(4) is necessary to give effect to our policy

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	intent.
(g) The HKAB commented that the ability of the court to dispense with the third party's consent to a rescission or variation should also include: ● where consent cannot be obtained because the whereabouts of the third party cannot be ascertained; ● where the third party is mentally incapable of giving consent; ● where it cannot reasonably be ascertained whether or not the third party has in fact relied on the term.	(g) It is our policy intent that the court should be given flexibility and a wide discretion to authorise variation or rescission of contract without the third party's consent. It appears that the situations suggested by the HKAB could fall under the test of "just and practicable" provided in Clause 7(3). As explained in para. 18 of our letter to the Assistant Legal Adviser dated 22 April 2014 (LC Paper No. CB(4)599/13-14(01)), we note that the situations suggested by the HKAB have been set out in sections 2(4) and (5) of the UK Act. However, the approach adopted in the UK Act 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.
(h) The HKAB suggested that Clauses 11(3) and (4) should make specific provision under which the promisee should be under a	(h) We agree with the observation of the LRC that it should be for the courts and arbitral tribunals, rather than the legislature,

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duty to account to the third party for the sum that it has recovered.	to determine the circumstances under which a promisee may be under a duty to account to the third party for the amount recovered by the promisee (see para. 4.143 of the Report). As discussed in point (c) of item 1 of this table as well as in para. 22 of the Administration's letter to the Assistant Legal Adviser dated 22 April 2014 (LC Paper No. CB(4)599/13-14(01)), 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.
(i) The HKAB commented that the Bill should contain a "for avoidance of doubt provision" to protect the promisor from dual liability where the third party recovered damages from the promisor first to protect the promisor from dual liability at the suit of the promisee.	(i) As explained in para. (c) of item 1 of this table, we agree with the comments of the LRC as set out in para.4.146 of the Report that no express provision is necessary to deal with the situation where the third party has recovered damages from the promisor first.
(j) The HKAB noted that the UK Act does not contain provisions equivalent to Clauses 12(3) and 13(3) and suggested that consideration should be given to deleting them. It seemed a	(j) Clauses 12(3) and 13(3) seek to implement the relevant recommendations of LRC (Recommendations 14 and 15). We consider that these clauses are consistent with the Bill's

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remote likelihood that a contract would have a proper construction to the effect that the arbitration agreement was intended to apply to the parties to the contract but not to any third parties.	underlying policy of giving effect to the contracting parties' intention. The clauses do not prevent contracting parties from providing in the contract that the arbitration agreement or exclusive jurisdiction clause was intended to apply to the parties to the contract only but not to the third party.
(k) The HKAB suggested that consideration should be given to Clause 13 applying to non-exclusive jurisdiction clauses as these would be far more common than exclusive jurisdiction clauses.	(k) We consider that both exclusive and non-exclusive jurisdiction clauses could be covered under Clause 4(4) under which a third party's right of enforcement of the relevant term of the contract is subject to the contract's other terms including procedural conditions. Clause 13 seeks to implement LRC's recommendation in respect of the applicability of exclusive jurisdiction clause to a third party (Recommendation 15). We consider that a specific provision on non-exclusive clause is not necessary.

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