

LEGISLATIVE COUNCIL BRIEF

CONTRACTS (RIGHTS OF THIRD PARTIES) BILL

INTRODUCTION

At the meeting of the Executive Council on 18 February 2014, the Council ADVISED and the Chief Executive ORDERED that the Contracts (Rights of Third Parties) Bill, at Annex A, should be introduced into the Legislative Council.

A

JUSTIFICATIONS

Implementation of the Recommendations of the Law Reform Commission of Hong Kong

2. The Law Reform Commission of Hong Kong (“LRC”) published the report on “Privity of Contract” (“Report”) in September 2005 recommending a reform of the doctrine of privity of contract by way of a detailed legislative scheme.

3. One aspect of the doctrine of privity is that a person cannot acquire and enforce rights under a contract to which the person is not a party. This prevents effect from being given to the contracting parties’ intention to benefit a third party. The LRC recommended to reform this aspect of the doctrine of privity. After careful consideration of the views and recommendations of the LRC, the Administration proposes to introduce the Contracts (Rights of Third Parties) Bill (“Bill”) so as to implement the recommendations of the LRC in full with certain necessary modifications¹.

¹ The modifications to the recommendations of the LRC as proposed by the Administration are discussed in paragraphs 12, 13 and 21.

Enhancing the contractual law regime in Hong Kong

4. The doctrine of privity has long been criticised as artificial and contrary to the 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 the party, 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. Various common law jurisdictions have reformed the doctrine of privity by way of legislation, including Australia (Western Australia, Northern Territory and Queensland), Canada (New Brunswick), England, New Zealand and Singapore. The Bill would enhance Hong Kong's contractual law regime and align it with the developments in other major common law jurisdictions.

THE BILL

5. The main provisions of the Bill are summarized below.

Test of Enforceability

6. Clause 4(1) and (3) of the 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. Clause 5 provides that a third party is entitled to any remedy that would have been available to the third party if the party had been a party to the contract.

Who is a Third Party

8. Clause 4(2) provides that a third party must be expressly identified by name, as a member of a class or as answering a particular description. Rights may 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 of the alteration on the other, Clause 6 provides for the circumstances in which a third party's rights are "crystallised", so that when those circumstances exist, the contracting parties may not rescind the contract or vary it in a way that affects the third party's rights.

Defences Available to Promisor and Protection Against Double Liability

10. Clause 8 provides for defences, set-offs and counterclaims to be available to a promisor² in proceedings brought by a third party and Clause 11 protects a promisor against double liability.

Arbitration Clauses

11. Under Clause 12(1) to (3), if a third party's right to enforce a term of a contract is subject to an arbitration agreement, the third party is treated as a party to the arbitration agreement for the purposes of enforcement of the term, unless on a proper construction of the contract, the third party is not intended to be so treated.

12. Clause 12(4) to (6) deals with situations where Clause 12(1) to (3) does not apply and where a third party is given an enforceable procedural right under a contract to submit disputes to arbitration. These provisions cover, for example, a case where the promisor brings a non-contractual claim (such as tortious or statutory claim) in connection with a contract against a third party and the contract contains an express provision providing for disputes in connection with the contract between the promisor and the third party be referred to arbitration.

13. Clause 12(4) to (6) is introduced after having studied the comments raised by the legal sector and the relevant recent development in English jurisprudence and commentary, despite the view of the LRC that it did not see any strong reasons for such provisions which deal with a "rare situation". The Administration considers that it would be useful to include Clause 12(4) to (6) which serves to give effect to the intention of

² "Promisor" is defined in Clause 2 of the Bill to mean, in relation to a term of a contract enforceable by a third party under the Bill, a party to the contract against whom a third party may enforce the term.

the contracting parties to confer on a third party an enforceable procedural right.

Scope of Application

14. The new statutory scheme does not apply to contracts entered into before the commencement of the scheme so that existing rights or remedies of a third party will not be affected (see Clause 3(1)).

15. In addition, the Bill (by Clause 3(2)) excludes certain classes of contracts where –

- (a) a third party already has an enforceable right under existing rules reflecting international conventions or where allowing third parties to claim a right of enforceability would contradict or prejudice the underlying policies of certain areas of law. This includes a bill of exchange, a promissory note, a negotiable instrument, a contract for the carriage of goods by sea or by air, a letter of credit and a covenant relating to land;
- (b) a third party has no enforceable right under existing rules but there are sound policy reasons for maintaining that position. This includes the articles of a company having effect as a contract under the Companies Ordinance and a contract of employment against an employee.

LEGISLATIVE TIMETABLE

16. The legislative timetable will be as follows –

Publication in the Gazette	28 February 2014
First Reading and commencement of Second Reading debate	26 March 2014
Resumption of Second Reading debate, committee stage and Third Reading	to be notified

IMPLICATIONS OF THE PROPOSAL

17. The proposal is in conformity with the Basic Law, including the provisions concerning human rights. It has no economic, financial,

productivity, environmental, sustainability, civil service or family implications.

18. It is not possible to estimate at this stage the additional workload on the Judiciary as a result of the implementation of the Bill. In line with the funding arrangements between the Judiciary and the Administration, the Administration will provide the Judiciary with the necessary manpower and financial resources should such a need arise in future. Where necessary, additional resources will be sought by the Administration through the established resource allocation mechanism.

19. The Bill contains no binding effect clause, since it is essentially an enabling measure which allows parties to a contract (be it a private party, a Government department or an office of the Central People's Government) to confer enforceable rights on third parties.

PUBLIC CONSULTATION

20. In October 2012, the draft Bill was sent, for consultation, to various stakeholders including the legal professional bodies, academics, political organisations, business associations as well as the banking, insurance, shipping and construction sectors.

21. The legal professional bodies do not raise any objection to the legislative proposal. The legal professional bodies and the academia raised various technical comments and drafting suggestions which have been carefully considered by the Administration. Notwithstanding LRC's recommendation not to exclude deeds of mutual covenants ("DMCs") from the new statutory scheme, the Bar Association suggested that DMCs and land covenants should be so excluded because allowing third parties' right of enforceability under the Bill would contradict or prejudice the existing regime on DMCs and land covenants. The Administration agreed with the suggestions of the Bar Association which have been reflected in the Bill.

22. A few industry sectors also raised technical comments on the application and operation of the Bill. Some of the questions raised by the industries can be resolved by building in clear provisions in their contracts such as provisions stating expressly the class of insurance contracts to be excluded from the application of the Bill. While one respondent from the construction sector suggested that the whole construction industry should be excluded from the application of the Bill, another respondent from the

same sector expressed a different view. The Administration considers that it would be best to allow contracting parties the freedom to contract out of the new statutory scheme if they so wish.

23. The Legislative Council's Panel on Administration of Justice and Legal Services was briefed on the policy aspects of the Bill at its meeting on 26 November 2013. Members of the Panel indicated support.

PUBLICITY

24. A press release is to be issued on 26 February 2014. A spokesman will be available to answer enquiries.

ENQUIRY

26. Any enquiry on this brief can be addressed to Ms Deneb CHEUNG, Senior Assistant Solicitor General, Legal Policy Division, Department of Justice, at telephone number 2867 4771.

Department of Justice
26 February 2014

Contracts (Rights of Third Parties) Bill

Contents

Clause	Page
1. Short title and commencement	1
2. Interpretation	1
3. Application	1
4. Third party's right to enforce contractual term	3
5. Remedy available to third party	3
6. Rescission and variation of contract	4
7. Power of court to dispense with third party's consent to rescind or vary contract	5
8. Proceedings brought by third party	5
9. Proceedings brought against third party	6
10. Enforcement of contract by promisee	7
11. Protection of promisor from double liability	7
12. Arbitration agreement	8
13. Exclusive jurisdiction clause	9
14. Assignment of third party right	9
15. Third party not to be treated as party to contract	10
16. Application of Limitation Ordinance	10

A BILL To

Provide for the enforcement of contractual terms by third parties and for related matters.

Enacted by the Legislative Council.

1. Short title and commencement

- (1) This Ordinance may be cited as the Contracts (Rights of Third Parties) Ordinance.
- (2) This Ordinance comes into operation on a day to be appointed by the Secretary for Justice by notice published in the Gazette.

2. Interpretation

In this Ordinance—

promisee (受諾人), in relation to a term of a contract enforceable by a third party under section 4, means a party to the contract who may enforce the term against the promisor;

promisor (許諾人), in relation to a term of a contract enforceable by a third party under section 4, means a party to the contract against whom a third party may enforce the term;

third party (第三者), in relation to a contract, means a person who is not a party to the contract.

3. Application

- (1) This Ordinance applies to a contract entered into on or after the date on which this Ordinance comes into operation.
- (2) This Ordinance does not apply to any of the following—

- (a) a bill of exchange, a promissory note or any other negotiable instrument;
 - (b) a covenant relating to land, including a deed of mutual covenant as defined by section 2 of the Building Management Ordinance (Cap. 344);
 - (c) subject to subsection (3), a contract of carriage within the meaning of the Bills of Lading and Analogous Shipping Documents Ordinance (Cap. 440);
 - (d) a contract for the carriage of goods by air governed by the Carriage by Air Ordinance (Cap. 500);
 - (e) a letter of credit;
 - (f) a company's articles having effect as a contract under seal under section 86 of the Companies Ordinance (Cap. 622).
- (3) A third party may invoke section 4 to enforce a term of a contract referred to in subsection (2)(c) that excludes or limits liability.
- (4) This Ordinance does not confer a right on a third party to enforce a term of a contract of employment against an employee.
- (5) In this section—
- bill of exchange** (匯票) means a bill of exchange within the meaning of section 3 of the Bills of Exchange Ordinance (Cap. 19);
- contract of employment** (僱傭合約) has the meaning given by section 2(1) of the Employment Ordinance (Cap. 57);
- negotiable instrument** (可流轉票據) includes any instrument embodying a monetary obligation and transferable by delivery, or by delivery and indorsement, whether or not the instrument is capable of being transferred free from equities;

promissory note (承付票) means a promissory note within the meaning of section 89 of the Bills of Exchange Ordinance (Cap. 19).

4. Third party's right to enforce contractual term

- (1) 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.
- (2) The third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description.
- (3) Subsection (1)(b) does not apply if, on a proper construction of the contract, the term is not intended to be enforceable by the third party.
- (4) The enforcement of the term by a third party under this section is subject to any other term of the contract relevant to the term.
- (5) Subsection (1) applies whether or not the third party has given consideration for the term.
- (6) Subsection (1) applies to a third party even if the third party was not in existence when the contract was entered into.

5. Remedy available to third party

- (1) There is available to a third party who enforces a term of a contract under section 4 a remedy that would have been available to the third party in an action for breach of contract if the third party had been a party to the contract.
- (2) Any law relating to the remedy applies accordingly.

- (3) To avoid doubt, the remedies available to a third party under this section include a remedy under the rules of equity.
- (4) This Ordinance does not affect a right or remedy of a third party that exists or is available apart from this Ordinance.

6. Rescission and variation of contract

- (1) If a third party may enforce a term of a contract under section 4, the parties to the contract may not, without the third party's consent—
 - (a) by agreement, rescind the contract; or
 - (b) by agreement, vary the contract so that the third party's right under the term is altered or extinguished.
- (2) Subsection (1) applies only if—
 - (a) the third party has assented to the term and the promisor has received notice of the assent (whether the assent and the notice are in writing or otherwise); or
 - (b) the third party has relied on the term and—
 - (i) the promisor is aware of the reliance; or
 - (ii) the promisor can reasonably be expected to have foreseen that the third party would rely on the term.
- (3) In addition, an express term of the contract prevails over subsection (1) if the term provides to the effect that—
 - (a) one or more parties to the contract may rescind or vary the contract without the third party's consent; or
 - (b) the third party's consent to rescind or vary the contract is required in circumstances specified in the contract instead of those set out in subsection (2)(a) and (b).
- (4) Subsection (3) applies only if, before the circumstances set out in subsection (2)(a) or (b) occur—

- (a) the third party is aware of the term referred to in subsection (3); or
- (b) one or more parties to the contract have taken reasonable steps to make the third party aware of the term.

7. Power of court to dispense with third party's consent to rescind or vary contract

- (1) This section applies if a third party's consent is required to rescind or vary a contract under section 6(1) or (3)(b).
- (2) A party to the contract may apply to the court to make an order dispensing with the third party's consent.
- (3) The court may make the order if—
 - (a) the other party or each other party to the contract agrees to rescind or vary the contract; and
 - (b) the court thinks it just and practicable to make the order.
- (4) The order may be made subject to any condition that the court thinks fit, including a condition requiring that the third party be compensated.

8. Proceedings brought by third party

- (1) Subsections (2), (3) and (4) apply if a third party brings proceedings to enforce a term of a contract under section 4.
- (2) The promisor may raise one or more of the following matters by way of defence or set-off—
 - (a) a matter that—
 - (i) arises from or in connection with the contract and is relevant to the term; and
 - (ii) would have been available to the promisor by way of defence or set-off if the proceedings had been brought by the promisee;

- (b) a matter in respect of which the following conditions are met—
 - (i) an express term of the contract provides for the matter to be available to the promisor by way of defence or set-off in proceedings brought by the third party; and
 - (ii) the matter that would have been available to the promisor by way of defence or set-off if the proceedings had been brought by the promisee;
- (c) a matter that would have been available to the promisor by way of defence or set-off if the third party had been a party to the contract.
- (3) The promisor may raise, by way of counterclaim, a matter not arising from the contract that would have been available to the promisor by way of counterclaim against the third party if the third party had been a party to the contract.
- (4) Subsections (2)(a) and (c) and (3) are subject to any express term of the contract specifying matters not available to the promisor by way of defence, set-off or counterclaim.

9. Proceedings brought against third party

- (1) In any proceedings brought against a third party, the third party may not seek to enforce under section 4 a term of a contract (including a term purporting to exclude or limit liability) if the third party could not have enforced the term had the third party been a party to the contract.
- (2) Subsection (1) applies whether the third party could not have enforced the term because of particular circumstances relating to the third party or otherwise.

10. Enforcement of contract by promisee

Section 4 does not affect the promisee's right to enforce a term of the contract.

11. Protection of promisor from double liability

- (1) Subsection (2) applies if—
 - (a) a third party may enforce a term of a contract under section 4; and
 - (b) the promisor has wholly or partly performed the promisor's obligations to the third party under the term.
- (2) The promisor is discharged from the obligations owed by the promisor to the promisee to the extent of having performed the same obligations to the third party.
- (3) Subsection (4) applies if—
 - (a) a third party may enforce a term of a contract under section 4; and
 - (b) the promisee has recovered from the promisor a sum for—
 - (i) the third party's loss in relation to the term; or
 - (ii) the expense to the promisee of making good to the third party the default of the promisor in relation to the term.
- (4) In any proceedings brought under section 4 before a court or arbitral tribunal by the third party, the court or arbitral tribunal must reduce any award to the third party to the extent to which it thinks appropriate to take account of the sum.

12. Arbitration agreement

- (1) Subsection (2) applies if a third party's right to enforce a term of a contract under section 4 is subject to an arbitration agreement.
- (2) As regards a dispute between the third party and the promisor relating to the enforcement of the term by the third party, the third party is treated as a party to the arbitration agreement for the purposes of the Arbitration Ordinance (Cap. 609).
- (3) Subsection (2) does not apply if, on a proper construction of the contract, the third party is not intended to be so treated.
- (4) Subsections (5) and (6) apply if—
 - (a) a third party may enforce a term of a contract under section 4;
 - (b) the term—
 - (i) provides that one or more descriptions of dispute between the third party and the promisor is to be submitted to arbitration; and
 - (ii) constitutes an arbitration agreement; and
 - (c) subsection (2) does not apply in relation to the arbitration agreement.
- (5) If the third party enforces the arbitration agreement under section 4, then, as regards the dispute for which the arbitration agreement is enforced, the third party is treated as a party to the arbitration agreement for the purposes of the Arbitration Ordinance (Cap. 609).
- (6) The third party is so treated immediately before the third party exercises the right to enforce the arbitration agreement under section 4.
- (7) In this section—

arbitration agreement (仲裁協議) has the meaning given by section 2(1) of the Arbitration Ordinance (Cap. 609).

13. Exclusive jurisdiction clause

- (1) This section applies if a contract contains—
 - (a) a term enforceable by a third party under section 4; and
 - (b) an exclusive jurisdiction clause.
- (2) The third party is bound by the exclusive jurisdiction clause as regards a dispute between the third party and the promisor relating to the enforcement of the term by the third party.
- (3) This section does not apply if, on a proper construction of the contract, the third party is not intended to be so bound.
- (4) In this section—

exclusive jurisdiction clause (專有司法管轄權條款) means a clause requiring that a dispute relating to the term enforceable by the third party under section 4 be resolved only in a particular jurisdiction.

14. Assignment of third party right

- (1) A third party may assign to another person a right under a term of a contract enforceable by the third party under section 4 in the same way as a party to the contract may assign a right under the contract.
- (2) Subsection (1) does not apply if—
 - (a) the contract expressly provides otherwise; or
 - (b) on a proper construction of the contract, the right is personal to the third party and is not assignable.

15. Third party not to be treated as party to contract

Despite sections 5(1), 8(2)(c) and (3) and 9(1), a third party is not to be treated as a party to the contract for the purposes of any enactment or any instrument made under the enactment.

16. Application of Limitation Ordinance

- (1) In section 4(1)(a) of the Limitation Ordinance (Cap. 347), the reference to actions founded on simple contract includes an action relating to a simple contract brought under section 4.
 - (2) In section 4(3) of the Limitation Ordinance (Cap. 347), the reference to an action upon a specialty includes an action relating to a specialty brought under section 4.
-

Explanatory Memorandum

The object of this Bill is to enable a person who is not a party to a contract (*third party*) to enforce a term of the contract. The Bill is based on the recommendations made in the Report on Privity of Contract published by the Law Reform Commission of Hong Kong in 2005. The Bill would bring about a variation in the common law rule of privity of contract as regards third party rights under a contract.

2. Clause 3 provides for the scope of application of the Bill. It excludes from the application of the Bill contracts entered into before the coming into operation of the Bill and several other classes of contracts set out in the clause.
3. Clause 4 sets out the circumstances in which a third party may enforce a term of a contract. The third party may do so if the contract contains an express term to that effect. Alternatively, if the contract contains a term which purports to confer a benefit on the third party, the third 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.
4. Clause 5 provides that the remedies available to a third party who enforces a term of a contract under clause 4 are the same as those available to a party to the contract who brings an action for breach of the term.
5. Clause 6 restricts the right of the parties to a contract to rescind or vary the contract by agreement without the consent of a third party if the third party may enforce a term of the contract under clause 4. However, the restriction can be overridden by an express term under which one or more parties to the contract may rescind or vary the contract without the third party's consent, or an express term that specifies other circumstances in which the third party's consent is required to rescind or vary the contract.

Contracts (Rights of Third Parties) Bill

Explanatory Memorandum
Paragraph 6

12

6. Clause 7 provides for the power of the court to intervene, on application by a party to a contract, in circumstances where the consent of a third party is required to rescind or vary the contract. The court may make an order dispensing with the third party's consent.
7. Clause 8 provides for the defences, set-offs and counterclaims available to a party to a contract in proceedings against the party brought by a third party under clause 4.
8. Clause 9 provides that a third party may not rely on clause 4 to enforce a term of a contract if the third party could not have enforced the term had the third party been a party to the contract.
9. Clause 10 makes it clear that a third party's right to enforce a term of a contract under clause 4 does not affect the right of a party to the contract to enforce a term of the contract.
10. Clause 11 makes provision to avoid any double liability owed by a party to a contract to a third party and another party to the contract.
11. Clause 12 provides that a third party is treated as a party to an arbitration agreement if the third party's right to enforce a term of a contract under clause 4 is subject to the agreement. However, this rule is subject to the contrary intentions of the parties to the contract. Furthermore, if a third party chooses to enforce a term of a contract under clause 4 and that term constitutes an arbitration agreement, the third party is also treated as a party to that agreement.
12. Clause 13 provides that if a third party may enforce a term of a contract under clause 4, and the contract contains a clause that requires a dispute relating to the term to be resolved only in a particular jurisdiction, that clause is binding on the third party. However, that clause is not so binding if, on a proper construction of the contract, the parties to the contract do not intend the third party to be so bound.

Contracts (Rights of Third Parties) Bill

Explanatory Memorandum
Paragraph 13

13

13. Clause 14 provides that a third party who may enforce a term of a contract under clause 4 may assign to another person a right of the third party under the term unless the contract expressly provides otherwise or, on a proper construction of the contract, that right is not assignable.
14. Clause 15 makes it clear that a third party who may enforce a term of a contract under clause 4 is not to be treated as a party to the contract for the purposes of any enactment or any instrument made under the enactment.
15. Clause 16 provides that section 4(1)(a) of the Limitation Ordinance (Cap. 347) (which specifies the limitation periods for an action founded on a simple contract) applies to an action founded on a simple contract brought by a third party under clause 4; and section 4(3) of that Ordinance (which specifies the limitation periods for an action upon a specialty) applies to an action founded on a specialty brought by a third party under clause 4.