

**立法會**  
*Legislative Council*

LC Paper No. CB(4)145/14-15

Ref : CB4/BC/2/13

**Paper for the House Committee meeting on 14 November 2014**

**Report of the Bills Committee on Contracts (Rights of Third Parties) Bill**

**Purpose**

This paper reports on the deliberations of the Bills Committee on Contracts (Rights of Third Parties) Bill.

**Background**

The doctrine of privity

2. The doctrine of privity has two aspects:

- (a) a person cannot acquire and enforce rights under a contract to which he is not a party; and
- (b) a person who is not a party to a contract cannot be made liable under it.

3. Whilst the second aspect is generally regarded as just and sensible, the first aspect prevents effect from being given to the contracting parties' intention to benefit a third party. As such, the courts 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.

## Reforming the doctrine of privity

4. In September 2005, the Law Reform Commission of Hong Kong ("LRC") published the report on "Privity of Contract" recommending a reform of the doctrine of privity, by way of a legislative scheme, so that a third party, i.e. a person not a party to a contract may, subject to contracting parties' intention, enforce the contractual terms without having to resort to the complexities of the devices presently adopted to circumvent the first aspect of the privity doctrine.

5. After consideration of the views and recommendations of the LRC to reform the doctrine of privity, the Administration proposed to implement the recommendations of the LRC in full with necessary modifications. The underlying principal 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. To reflect the recommendation that contracting parties should have the freedom to adhere to the doctrine of privity if they so choose, it has been proposed that parties may contract out of the new statutory provisions giving rights of suit to a third party.

## Consultation

6. In October 2012, the draft Contracts (Rights of Third Parties) Bill was sent, for consultation, to various stakeholders including the legal professional bodies, academics, political organizations, business associations as well as the banking, insurance, shipping and construction sectors. The Administration received 21 submissions by January 2013.

7. According to the Administration, the legal professional bodies did not raise any objection to the legislative proposal, save for some technical comments and drafting suggestions. Notwithstanding the LRC's recommendation not to exclude deeds of mutual covenants ("DMCs") from the new statutory scheme, the Hong Kong Bar Association ("the Bar Association") suggested that DMCs and land covenants should be so excluded because allowing third parties' right of enforceability under the new statutory scheme would contradict or prejudice the existing regime on DMCs and land covenants<sup>1</sup>.

8. A few industry sectors also raised technical comments on the application and operation of the legislative proposal. According to the Administration,

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1 According to the Legislative Council ("LegCo") Brief on the Contracts (Rights of Third Parties) Bill ("the Bill"), the Administration agreed with the suggestions of the Bar Association which have been reflected in clause 3(2)(b) of the Bill.

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. Whilst one respondent from the construction sector suggested that the whole construction industry should be excluded from the application of the proposal, another respondent from the same sector expressed a different view<sup>2</sup>.

## **The Bill**

9. The Bill seeks to enable a person who is not a party to a contract, i.e. a third party, to enforce a term of the contract under certain circumstances. The main provisions of the Bill are summarized below.

### Scope of application

10. The new statutory scheme only applies to contracts entered into on or after the commencement of the Bill if enacted so that existing contracts will not be affected (clause 3(1)).

11. Under clause 3(2) and (4), certain classes or terms of contracts are excluded from the application of the Bill:

- (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;
- (c) a contract for the carriage of goods by sea or by air under the Bills of Lading and Analogous Shipping Documents Ordinance (Cap. 440) and the Carriage by Air Ordinance (Cap. 500);
- (d) a letter of credit;
- (e) a company's articles having effect as a contract under seal under section 86 of the Companies Ordinance (Cap. 622); and
- (f) a term of a contract of employment against an employee.

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2 According to the LegCo Brief on the Bill, 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.

### Test of enforceability

12. Clause 4(1) and (3) sets out the limits within which a third party can enforce a term of 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 a term of a contract if the contract expressly provides that the third party may do so; 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 term is not intended to be enforceable by the third party. It follows that parties to a contract can expressly exclude the application of this new statutory scheme in their contract.

13. A third party may enforce a term of a contract whether or not the third party has given consideration for the term (clause 4(5)).

### Remedies available to a third party

14. Clause 5 provides that a third party is entitled to any remedy that would have been available to the third party if the third party had been a party to the contract (including a remedy under the rules of equity). It also provides that a right or remedy of a third party that exists or is available apart from the Bill is not affected.

### Who is a third party

15. Clause 4(2) provides that a third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description. Rights may be conferred on a third party even if the third party was not in existence when the contract was entered into.

### Assignment of third party rights

16. Under clause 14, a third party may assign to another person a right under a term of a contract enforceable by the third party unless the contract expressly provides otherwise or on a proper construction of the contract, the right is personal to the third party and is not assignable.

### Rescission and variation of contracts

17. 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 "crystallized", so that when those circumstances exist, the contracting parties may not, without the third party's consent, rescind the contract or vary it in a way that alters or extinguishes the third party's right.

### Defences available to promisor and protection against double liability

18. Clause 8 provides for defences, set-offs and counterclaims to be available to a promisor<sup>3</sup> in proceedings brought by a third party to enforce a term of a contract. Clause 11 protects a promisor against double liability, i.e. 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.

### Arbitration clauses

19. 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 the Arbitration Ordinance (Cap. 609), unless on a proper construction of the contract, the third party is not intended to be so treated.

20. 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<sup>4</sup>.

### Commencement

21. The Bill, if passed, would come into operation on a day to be appointed by the Secretary for Justice by notice published in the Gazette.

## **The Bills Committee**

22. At the House Committee meeting on 28 March 2014, members agreed to

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3 "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.

4 According to paragraph 13 of the LegCo Brief on the Bill, 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 the contracting parties to confer on a third party an enforceable procedural right.

form a Bills Committee to study the Bill. The membership of the Bills Committee is in **Appendix I**.

23. Under the chairmanship of Hon Kenneth LEUNG, the Bills Committee has held four meetings with the Administration and received views from representatives of various organizations or individuals at the meeting held on 7 May 2014. A list of the organizations or individuals which/who have given views to the Bills Committee is in **Appendix II**.

## **Deliberations of the Bills Committee**

### Clause 2 - Interpretation

24. Under clause 2, a third party, in relation to a contract, means a person who is not a party to the contract. To avoid misunderstanding on who has a right to enforce a contractual term, a member was of the view that the definition of "third party" should be made clearer with reference to clause 4(2)<sup>5</sup> of the Bill, so that a reader can easily realize that the term refers to a third party who is expressly identified in the contract to have a right to enforce a term of the contract.

25. The Administration does not consider it an appropriate approach for the following reasons:

- (g) a definition in a piece of legislation serves to clarify the meaning of a term used in the legislation. Generally, wherever the term appears in the legislation, it has the same meaning as defined;
- (h) whilst the Bill deals with a third party's rights under a contract, it does not confer those rights on all third parties to a contract automatically and unconditionally. Instead, the Bill provides that a third party may be entitled to those rights only if the specific conditions and requirements set out in the Bill are fulfilled. The Bill also sets out the circumstances under which a third party is not entitled to those rights. For example, clause 3(4) of the Bill provides that "[t]his Ordinance does not confer a right on a third party to enforce a term of a contract of employment against an employee". Therefore, it is not possible to define "third party" in the Bill with reference to clause 4(2); and

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<sup>5</sup> Clause 4(2) provides that "[t]he third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description."

- (i) as a general rule for drafting definitions in legislation, a definition should not include substantive matters. In the Bill, the circumstances and conditions relating to the enforcement of a contractual term by a third party are substantive rules, and are set out immediately after clause 3. It is not a normal practice to include those matters in clause 2 as part of the interpretation provisions.

### Clause 3 - Application

#### *Clause 3(1)*

26. Clause 3 provides for the scope of the application of the Bill. Clause 3(1) provides that "[t]his Ordinance applies to a contract entered into on or after the date on which this Ordinance comes into operation". Members have enquired about the effect on a third party's right to enforce a contractual term if a supplemental contract entered into after the commencement of the Bill contains a provision which alters a term of a contract entered into between the same parties prior to the commencement of the Bill ("the original contract"). For example, the original contract contains an express provision to confer a benefit of, say, \$1 million on a third party and the supplemental contract amends the sum to, say, \$1.2 million on the same third party. Another example is that the original contract contains an express provision to exclude a third party from the application of the Bill and the supplemental contract contains an express provision made under clause 4(1)(a) of the Bill to provide the same third party a right to enforce a term of the original contract.

27. The Administration has responded that 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. In respect of the two examples referred to in paragraph 26 above, the Administration has advised that the third party would have the right to enforce a term of the contract according to the supplemental contract. However, if the original contract contains an express provision excluding the application of the Bill and the supplemental contract does not alter this express provision, it would be difficult for the third party to enforce the relevant term. The Administration has explained that under general contract law, a supplemental agreement entered into between the contracting parties is to be read together with the original contract.

*Clause 3(2)(b)*

28. Clause 3(2)(a) to (f) excludes several classes of contracts from the application of the Bill. Under clause 3(2)(b), a covenant relating to land, including a DMC as defined by section 2 of the Building Management Ordinance (Cap. 344), is excluded from the application of the Bill. Members note that the Bill is modelled on the Contracts (Rights of Third Parties) Act 1999 in the United Kingdom ("UK Act"). Members further note that the UK Act does not exclude DMCs on building property from the scope of the Act and the Contracts (Rights of Third Parties) Act 2001 of Singapore, which is broadly similar to the UK Act, also does not exclude DMCs. Members have asked about the reason for the exclusion of DMCs from the application of the Bill.

29. The Administration has advised that the circumstances of Hong Kong and other jurisdictions such as the UK and Singapore are different. The reason for not excluding DMCs from the application of the UK Act may be that the number of such DMCs drawn up in the UK is not high because of the relatively small number of multi-storey buildings in the UK. Although many buildings in Singapore are multi-storey ones, the Administration considers that the circumstances of Hong Kong and Singapore are different. The Administration considers that excluding DMCs from the application of the Bill is appropriate for the following reasons:

- (a) the law relevant to building management and enforcement of rights under a DMC consist of a range of applicable legal provisions under the Building Management Ordinance (Cap. 344), the Conveyancing and Property Ordinance (Cap. 219) and the common law. These applicable legal principles create a unique and intricate legal regime which sets clear limits on the enforceability of land covenants;
- (b) under the current law, a co-owner in a building (being a successor-in-title) can enforce his rights under a DMC against another co-owner (another successor-in-title). However, it would not be possible to do so under the Bill as the Bill would not enable third parties to enforce rights against each other;
- (c) further, the Bill only enables contracting parties to confer enforceable rights on a third party but does not impose any burden on a third party. This is also different from the existing legal regime of a DMC which entails rights as well as burden; and

- (d) the current legal regime for the enforcement of a DMC has over the years developed specifically in response to the needs of regulating the occupation and management of multi-storey buildings and estate developments in Hong Kong. Any change to the DMC regime will affect a large number of people and it would be inappropriate for the Bill to alter or relax the legal regime of DMC without full consultation specifically aimed at reform of this branch of the law.

30. Query was raised as to whether excluding DMCs from the application of the Bill would render tenants of private buildings and users of common parts of private buildings who are not owners of the private buildings unable to rely on the Bill to enforce a term of the DMC.

31. The Administration has advised that tenants of private buildings and users of common parts of private buildings are not owners of the private buildings and hence, are generally not entitled to bring an action under a DMC. The exclusion of a DMC from the application of the Bill does not add to or diminish their rights under the DMC. Neither does the exclusion preclude contracting parties, if they so intend, from conferring an enforceable right of action upon a tenant or a user of the common parts of a private building so long as the requirements under other applicable laws are complied with.

32. Members note that a third party can presently seek to enforce a contract from the court through devices such as agency and trust. Members have sought clarification as to whether the rights of the third party to enforce a contract would be diminished following the implementation of the Bill.

33. The Administration has advised that the Bill, if implemented, would provide the third party with an additional channel, which is more convenient, to enforce the contract if it is the contracting parties' intention to permit a third party to enforce the contract. The objective of the present reform is to confer rights on a third party rather than to derogate from them. Thus, the existing rights of a third party under statute law and at common law would not be affected after the implementation of the Bill (see clause 5(4)).

*Clause 3(2)(f)*

34. Under clause 3(2)(f), a company's articles having effect as a contract under seal under section 86 of the Companies Ordinance (Cap. 622) is excluded from the application of the Bill.

35. A member has enquired about the rationale for excluding such company's

articles from the application of the Bill.

36. The Administration has responded that a company's articles having effect as a contract under seal under section 86 of the Companies Ordinance (Cap. 622) is a contract created between a company and its members and is not intended to confer rights upon third parties. The Administration does not consider it appropriate for the Bill to be applicable to a company's articles.

*Clause 3(4)*

37. Clause 3(4) provides that "[t]his Ordinance does not confer a right on a third party to enforce a term of a contract of employment against an employee". A member has asked whether the rights and interests of employees would be enhanced arising from the implementation of the Bill.

38. The Administration has pointed out that the implementation of the Bill would not vary or alter the contractual agreements entered into between employers and employees in the capacity of parties to an employment contract. The Bill would provide the contracting parties freedom to include a term in the contract to protect the employees of a party to the contract who are third parties to the contract by, say, exempting the employees of that party from any legal liability arising from the performance of the contract, if the contracting parties so wish. However, where an employee enters into a tripartite agreement with an employer to work for a third party, the employee is a party to the contract and clause 3(4) would not apply.

*Exclusion of other classes of contracts from the application of the Bill*

39. Members note that the insurance sector has suggested the exclusion of insurance contracts from the application of the Bill and raised technical comments on the operation of the Bill.

40. The Administration has advised that many of the questions raised by the insurance sector 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 and provisions for the enforceability of cut-through clauses in the context of reinsurance agreements. The Administration has also advised that compliance with clause 6(4)<sup>6</sup> should not pose difficulties to the insurance sector due to the fact that under clause 6(3), contracting parties are free to provide express terms for rescission or variation

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<sup>6</sup> Under clause 6(4), clause 6(3) applies only if before crystallization a third party is aware of any express term on rescission or variation of the contract without the consent of the third party or that reasonable steps have been taken by one or more parties to bring that term to the notice of the third party.

of a contract without the consent of the third party or provide that the third party's consent is required only in circumstances specified by the parties. In this regard, the Administration would encourage the contracting parties to carefully consider the purpose of the new statutory scheme and customize the terms of their contract, in order to fully reflect their intention, taking into account all relevant considerations and seeking legal advice where necessary.

41. Members note that a deputation from the construction sector has suggested that the whole construction industry should be excluded from the application of the Bill as the industry already has tried and tested methods for benefiting third parties and providing them with enforceable rights when the contracting parties so intend. The Bill would unlikely provide additional rights to those which would have been provided by collateral warranties. Members also note that another deputation from the same sector has expressed a different view.

42. The Administration has advised that:

- (a) the Bill would enable contracting parties to incorporate terms in collateral warranties into their contract without the burden of entering into separate contracts and classes of third parties would be protected without the need of assignment of collateral warranties to them. Hence, the Bill would provide a third party with a more straight-forward and convenient channel to enforce his rights under a contract as opposed to collateral warranties; and
- (b) the Bill would help remove the anomalies of the common law doctrine of privity of contract which are apparent in the construction industry and in addition, the industry would benefit under the present reform which would, for example:
  - (i) allow a main contractor to include in the contract with the employer exclusion clauses limiting liability for his own benefit and that of sub-contractors; and
  - (ii) enable a sub-contractor to sue the employer direct for payment if the relevant contract so provides.

The Administration considers that the Bill allows contracting parties the freedom to confer an enforceable right on a third party if they so wish. It would be up to the parties to formulate terms of their contracts which fit their needs, including the specific needs of a particular industry or type of contract.

Clause 4 – Third party's right to enforce contractual term

*Clause 4(1) and (3)*

43. Clause 4(1) and (3) sets out the circumstances under which a third party may enforce a term of a contract. Members note that if the contracting parties would otherwise like to exclude the enforcement of rights under the contract by a third party, they are free to expressly state so in their contract. Members have asked about the effect on a third party's right to enforce a term of the contract in the circumstance where inconsistent terms are contained in the same contract. For example, the contracting parties provide expressly for a certain third party to enforce a term of the contract and then provide in the same contract that that third party cannot enforce the contract or has an express provision excluding the application of the new statutory scheme.

44. The Administration has pointed out that a third party would have the right to enforce a term of a contract so long as either limb of the test of enforceability under clause 4(1) is satisfied. In respect of the example referred to in paragraph 43 above, the normal objective approach to contract interpretation would apply. After all, 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.

45. Members note that the English text of the sentence "[s]ub-section (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" in clause 4(3) is rendered as "如按經恰當解釋的有關合約，可由上述第三者強制執行有關條款，並非立約用意，則第(1)(b)款不適用" in the Chinese text. Suggestion was made that the Chinese text of clause 4(3) should be improved to make it more easily understood.

46. The Administration has replied that the Chinese text of clause 4(3) has been carefully worded to reflect the policy intent appropriately and to give the same communication effect as that of the English text of the same clause.

47. A member has expressed concern on the lack of consumer protection legislation in Hong Kong. Suggestion was made that the two-limb test of enforceability under clause 4(1) and (3) can be relaxed for consumer third parties so that a third party may enforce a contract on which he justifiably and reasonably relies, regardless of the intention of the parties; or a third party may

enforce a contract which actually confers a benefit on him, regardless of the purpose of the contract or the intention of the parties.

48. The Administration takes the view that it is not appropriate to relax the two-limb test of enforceability for the reason that a more lenient test for consumers may enable a consumer to enforce a promise made by the promisor even when it is contrary to the promisor's wishes. Such a test would thus deviate from the principle of freedom of contract.

49. As there may be more than one third party expressly identified in a contract under clause 4(1)(a) or (b) of the Bill, concern was raised about different competing interests amongst third parties.

50. The Administration has advised that as provided under clause 4(4), the enforcement of a term of the contract by a third party would be subject to any other term of the contract relevant to the term. Hence, enforcement of a contractual term by a third party or third parties would be subject to any relevant conditions provided by the terms of the contract.

#### Clause 5 – Remedy available to third party

##### *Clause 5(3)*

51. Clause 5(1) provides that "[t]here 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". Query was raised as to whether the remedy is limited to, say, specific performance of the contract.

52. The Administration has advised that clause 5(3) provides that a third party is entitled to any remedy that would have been available to the third party, including a remedy under the rules of equity, if the third party had been a party to the contract.

##### *Clause 5(4)*

53. Clause 5(4) provides that "[t]his Ordinance does not affect a right or remedy of a third party that exists or is available apart from this Ordinance".

54. A member has enquired about the interrelationship between existing rights or remedies of a third party under the existing common law rules and statutory provisions and those the third party may obtain under the Bill. For example, in the case of a chain of contracts where a certain third party, as a third

party to a contract between the contracting parties A and B ("head contract"), has been conferred a benefit greater than that in another contract to which the third party is a party. The member has asked whether the third party would be entitled to enforce his right under the head contract which would result in a larger remedy.

55. The Administration has advised that under clause 5(4), the right or remedy of a third party that exists or is available apart from the Bill would not be affected. The object of the Bill is to enable a third party to enforce a term of the contract if this is the intention of the contracting parties. In the example discussed in paragraph 54, where the contracting parties have agreed that the third party would be entitled to such a greater benefit (or larger remedy) and to confer such enforceable rights on the third party, such intention should be given effect to. As long as the relevant conditions including the test of enforceability under clause 4 are satisfied, the third party would be able to enforce the rights conferred on him under the head contract.

#### Clause 6 - Rescission and variation of contract

##### *Clause 6(1) and 6(2)(a)*

56. Clause 6 provides for the circumstances in which a third party's rights are "crystallized", so that when those circumstances exist, the contracting parties may not, without the third party's consent, rescind the contract or vary it in a way that alters or extinguishes the third party's right.

57. Under clause 6(1) and (2)(a), if a third party may enforce a term of a contract, the contracting parties' unilateral right to rescind or vary their contract by agreement would come to an end when the third party has assented to the term and the promisor has received notice of the assent. A member has asked about the effect on the right of the third party if the term is not made known to him.

58. The Administration has pointed out that if a contractual term conferring a benefit on a third party is not made known to him, this would render the third party unable to give consent and clause 6(1) may not apply. However, under clause 6(2)(b), if the third party has relied on the relevant term and the promisor is aware of or can reasonably be expected to have foreseen the third party's reliance, clause 6(1) would still apply.

*Clause 6(2)(a) and (b)*

59. Query was raised as to what would constitute an assent to the term given by a third party to the promisor under clause 6(2)(a) and a reliance on the term by a third party under clause 6(2)(b).

60. The Administration has advised that under clause 6(2)(a), if a third party has communicated his assent by word or conduct to the promisor, the third party's right under the contract cannot be rescinded or varied without the third party's consent. An assent sent to the promisor under clause 6(2)(a) would only be regarded as having been communicated to the promisor after actual receipt by him and the postal rule would not apply. As for reliance, once a promise has been made by a promisor to the promisee, it is possible for the third party to have expectations that the promise would be performed and, in relying on the promise, regulate his affairs accordingly. Under clause 6(2)(b)(i) and (ii), where a promisor is aware that the third party has relied on the promise, or a promisor can reasonably be expected to have foreseen that the third party would rely on the promise and the third party has indeed relied on it, the parties cannot rescind or vary the contract without the consent of the third party. Generally speaking, it would be a matter for the third party to assert that the contracting parties' right to rescind or vary the contract has come to an end. The burden is thus on the third party to prove that the promisor is aware of the third party's reliance or can reasonably be expected to have foreseen that reliance. As for the "can reasonably be expected to have foreseen" limb of the reliance test, this issue can be left to the courts to determine. The courts routinely carry out such types of objective assessment.

*Clause 6(3)*

61. Members note that clause 6 is consisted of four subclauses, with an expression "[i]n addition," at the beginning of subclause (3).

62. In reply to members' enquiry about the use of "in addition" at the beginning of clause 6(3) of the Bill, the Administration has advised that 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.

Under the aforesaid 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. The Administration believes that the presence of the expression would be conducive to the reader's comprehension of the clause. This kind of narrative style, being a recent trend in the drafting of legislation, is commonly adopted in other jurisdictions such as Australia.

*Clause 6(3) and (4)*

63. Query was raised as to whether contracting parties are allowed to reserve their rights to rescind or vary a contract even after a third party has assented to, or relied on, the benefit conferred.

64. The Administration has advised that under clause 6(3) and (4), contracting parties can, by virtue of an express contractual term, rescind or vary the contract in accordance with the parties' intention so long as the third party is aware of the term or one or more of the contracting parties have taken reasonable steps to bring the term to the notice of the third party before the circumstances set out in clause 6(2)(a) or (b) occur.

65. Given that a third party may be an infant or may not be in existence at the time of the original contract, or even when the additional contractual term is inserted, members note that contracting parties may have genuine difficulty to advise the third party of the existence of that contractual term.

66. The Administration has advised that under clause 6(3), contracting parties would be free to provide express terms for rescission or variation of the contract without the consent of the third party or provide that the third party's consent is required only in circumstances specified by the parties. Therefore, contracting parties would have autonomy to ensure the practicability of the relevant terms, including how clause 6(4) may be met in the case of a third party being an infant. In the context of insurance contracts, an insurer (as promisor) may stipulate in the contract that the insured (the promisee) should bear the responsibility of informing third parties of that contractual term.

Clause 8 - Proceedings brought by third party

67. Clause 8 provides for defences, set-offs and counterclaims to be available to a promisor in proceedings brought by a third party to enforce a term of a

contract.

*Clause 8(2)(c)*

68. Under clause 8(2)(c), a promisor may raise a matter that would have been available to him by way of defence or set-off if the third party had been a party to the contract. A member has enquired about whether a promisor may raise a defence which questions the validity or enforceability of the contract because the promisor has been induced to enter into the contract by the third party's misrepresentation.

69. The Administration has pointed out that under clause 8(2)(c), a promisor may raise a defence which questions the existence, validity or enforceability of the contract because the contract is void for mistake or voidable for misrepresentation, or because of the promisee's repudiatory breach. The subclause covers not only situations where misrepresentation is made by the promisee, but also by the third party.

*Clause 8(3)*

70. Clause 8(3) provides that "[t]he 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".

71. A member has asked about the policy consideration for limiting the counterclaims raised by a promisor against a third party to those matters not arising from the contract.

72. The Administration has advised that the object of the Bill is to enable contracting parties to confer enforceable rights on a third party without imposing any burden on the third party. Allowing a promisor to raise a counterclaim against a third party in the enforcement of the third party's right under the contract would impose a burden on the third party. Hence, clause 8(3) limits the counterclaims raised by a promisor against a third party to those not arising from the contract.

Clause 11 - Protection of promisor from double liability

73. Clause 11 seeks to protect a promisor against double liability when the promisee and the third party are allowed to enforce the contract.

74. Under clause 11(2), a 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. Members have pointed out the possibility of a promisee having sued the promisor and recovered damages from the promisor first. To safeguard the interest of the third party, suggestion was made that there should be a specific provision under which a promisee is under a duty to account to the third party for the amount recovered by the promisee.

75. The Administration has pointed out that there are two situations where double liability for the same loss may arise. The first situation is where a promisee sues the promisor for the third party's loss and recovers damages for that loss (clause 11(3)(b)(i)). The promisee would then be under a duty to account for the damages to the third party. The second situation is where a promisee recovers damages from the promisor for making good the latter's default to the third party (clause 11(3)(b)(ii)). In this case, the damages recovered by the promisee represent his own loss, since he has accepted liability to the third party. The view of the LRC was 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 a duty to account to the third party for the sum that the promisee has recovered. The Administration agrees with the view of the LRC. To this end, the objective of clause 11(3)(b) is to implement the recommendation of the LRC to protect a promisor against the possible double liability. The Administration has further pointed out that under clause 11(4), 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.

#### Clause 12 - Arbitration agreement

76. 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. Clause 12(4) to (5) allows the contracting parties to give a third party an enforceable procedural right which the third party may choose to exercise.

77. Members are generally supportive of clause 12 which strikes a fair balance that if the contracting parties' intention is that the third party should enforce the right conferred on him by arbitration, the third party, in choosing to enforce the right, must do so by means of arbitration. A member has asked about why a specific provision on arbitration is made in clause 12 but specific provision on mediation is not made in the Bill.

78. The Administration takes the view that a specific provision on mediation is not necessary. By virtue of clause 4(4), the enforcement by a third party of a

term of a contract is subject to any other term of the contract relevant to that term. This would include procedural conditions such as enforcement by way of arbitration or any other means of alternative dispute resolution including mediation.

#### Clause 13 - Exclusive jurisdiction clause

79. Under clause 13, where a contractual term conferring substantive rights on a third party is conditional upon the third party enforcing that term in a specified jurisdiction, the third party would be bound by the exclusive jurisdiction clause as regards disputes between himself and the promisor relating to the enforcement of the substantive rights by the third party.

80. A member has asked about the operation of clause 13 in the circumstance where the contracting parties include in their contract a non-exclusive jurisdiction clause.

81. The Administration has advised that under clause 13, if contracting parties intend the third party to enforce the right conferred on him in a particular jurisdiction, the parties would be free to impose such a condition. The third party, if he chooses to enforce the right, may do so in that jurisdiction specified in the non-exclusive jurisdiction clause or the third party may bring an action in any other jurisdiction in accordance with the relevant jurisdiction rules.

#### Implementation and commencement of the Bill

82. Members note that the present reform of privity of contract would of itself result in a major change of Hong Kong contract law. Suggestion was made that guidelines and standard forms of contractual provisions should be developed for contracting parties to facilitate their understanding about the operation of the two-limb test of enforceability under clause 4 of the Bill.

83. The Administration does not see the need to do so, as contracting parties themselves should be in the best position to ensure the contract is drafted in a way that fully reflects the intention of the contracting parties, taking into account all relevant considerations and seeking legal advice as necessary. Nevertheless, the Administration would step up publicity efforts in this regard with a view to assisting the general public and various stakeholders in preparing for the implementation of the Bill. The Administration has advised that subject to members' view, the Administration agrees to consider the feasibility of bringing the new legislative regime into operation one year after the passage of the Bill.

84. A member has asked whether government departments would be encouraged to take the lead to include in their building and service contracts an express provision to confer enforceable rights on third parties.

85. The Administration has advised that this would be a matter for the contracting parties to decide whether they wish to benefit or not to benefit a third party under their contract. Nonetheless, it is pointed out by the LRC that the Government, as the sole supplier of land in Hong Kong and a major employer in construction development, may, together with major property developers and building contractors in Hong Kong, take the lead in adopting a code of practice and standard forms of contract whereby building contractors agree to certain of their covenants being enforceable by consumers. The Administration has agreed to draw this to the attention of relevant policy bureau(x) concerned.

### **Committee Stage amendments**

86. Members note that the Administration will move Committee Stage amendments ("CSAs"):

- (a) to amend clause 3(2) so as to clarify that all provisions in a DMC as well as a covenant relating to land were to be excluded from the application of the Bill. This would address the concern raised by the Bar Association that a DMC might contain terms not relating to land; and
- (b) to amend the English text of clause 8(2)(b)(ii) to improve the presentation of that subclause.

87. A full set of the CSAs to be moved by the Administration and agreed by the Bills Committee is in **Appendix III**.

### **Resumption of the Second Reading debate**

88. The Bills Committee supports the resumption of the Second Reading debate on the Bill at the Council meeting of 26 November 2014.

### **Advice sought**

89. Members are invited to note the deliberations of the Bills Committee.

**Bills Committee on Contracts (Rights of Third Parties) Bill**

**Membership List**

**Chairman** Hon Kenneth LEUNG

**Members** Hon James TO Kun-sun  
Hon TAM Yiu-chung, GBS, JP  
Hon Andrew LEUNG Kwan-yuen, GBS, JP  
Hon Ronny TONG Ka-wah, SC  
Hon Cyd HO Sau-lan (up to 16 June 2014)  
Hon Starry LEE Wai-king, JP  
Hon Paul TSE Wai-chun, JP  
Hon Alan LEONG Kah-kit, SC  
Hon Dennis KWOK  
Ir Dr Hon LO Wai-kwok, BBS, MH, JP  
Hon Tony TSE Wai-chuen, BBS

(Total : 11 Members)

**Clerk** Miss Mary SO

**Legal adviser** Mr Timothy TSO

**Bills Committee on Contracts (Rights of Third Parties) Bill**  
**List of organizations/individuals that have given views to the**  
**Bills Committee**

1. Construction Industry Council
2. Mr Lee MASON, Assistant Professor of the Faculty of Law of The University of Hong Kong
3. The Hong Kong Confederation of Insurance Brokers
4. The Chartered Institute of Arbitrators (East Asia Branch)
5. The Life Underwriters Association of Hong Kong Limited
6. The Chartered Institute of Building (Hong Kong)
7. Hong Kong Construction Association
8. Consumer Council\*
9. The Hong Kong Federation of Insurers\*
10. The Hong Kong Association of Banks\*

\* Written submission only

Contracts (Rights of Third Parties) Bill

Committee Stage

Amendments to be moved by the Secretary for Justice

<u>Clause</u>	<u>Amendment Proposed</u>
3(2)(b)	By deleting “a covenant relating to land, including”.
3(2)	By adding— “(ba) a covenant relating to land;”.
8(2)(b)(ii)	In the English text, by deleting “that”.