



**DEPARTMENT OF JUSTICE'S CONSULTATION PAPER
Contracts (Rights of Third Parties) Bill 2013**

Law Society's Submissions

The Law Society has reviewed the Department of Justice's Consultation Paper Contracts (Rights of Third Parties) Bill 2013 dated October 2012 and has the following comments.

Where appropriate, reference is made to the provisions in the United Kingdom Contracts (Rights of Third Parties) Act 1999 (the "UK Act") and the New Zealand Contracts (Privity) Act 1982 (the "New Zealand Act"), which the Draft Bill is largely modelled after.

Clause 3 Application

Draft Bill	Comment
<i>(1) This Ordinance applies to a contract entered into on or after the commencement date of this Ordinance.</i>	<p>The Ordinance should not be applicable to variation or rescission to an agreement entered before its commencement.</p> <p>The scheme does not apply to contracts entered into before the commencement of the Ordinance. The Bill should provide that this includes any variation or rescission to an agreement to avoid any argument that this is a collateral contract to which the scheme then applies. Clause 3 (1) could be amended to make this clear.</p>

Clause 6 Rescission and variation of contract

Draft Bill	Comment
<p>(1) <i>If a third party has a right under section 4 to enforce a term of a contract, the parties to the contract may not, by agreement, rescind the contract, or vary it in a way that extinguishes or alters the third party's entitlement under that right without the third party's consent if—</i></p> <p>(a) <i>the third party has by words or conduct assented to the term and communicated the assent to the promisor; or</i></p> <p>(b) <i>the third party has relied on the term and —</i></p> <p>(i) <i>the promisor is aware of the reliance; or</i></p> <p>(ii) <i>the promisor can reasonably be expected to have foreseen that the third party would rely on the term.</i></p>	<p>Comment 1: The phrase “assented to the term” in Clause 6(1)(a) is redundant and may be deleted.</p> <p>If the third party communicates his assent (to a term of the contract) to the promisor, his assent is necessarily implied. “<i>Communicated his assent to the term</i>” is sufficient to convey the intended meaning of this sub-clause.</p> <p>The equivalent provision in the UK Act simply reads as follows: “<i>the third party has communicated his assent to the term to the promisor</i>”. The UK provision is more concise, and should be adopted without modification in the Draft Bill.</p>
<p>(2) <i>For the purposes of subsection (1)(a), an assent is communicated to the promisor when it is received by the promisor.</i></p>	<p>Comment 2: The requirement of actual receipt by the promisor of third party assent requires further refinement.</p> <p>This sub-clause sets out the requirement that assent by a third party is only valid upon actual receipt of the communication by the promisor.</p> <p>It is recommended that this sub-clause be re-worded to clarify that the test is actual receipt, and the normal presumptions regarding service by post (section 8, Cap.1) do not apply.</p> <p>It is submitted that this is sufficiently achieved by adding the word “<i>actually</i>” before received.</p>

	<p>Alternatively, the equivalent provision in the UK Act may be adopted to explicitly displace the postal rule:</p> <p>“s.2(2) <i>The assent referred to in subsection (1)(a) –</i></p> <p style="padding-left: 40px;"><i>(b) if sent to the promisor by post or other means, shall not be regarded as communicated to the promisor until received by him.</i>”</p>
<p>(3) <i>Subsection (1) is subject to any express term of the contract under which -</i></p> <p style="padding-left: 20px;"><i>(a) the contract may be rescinded or varied by a party or the parties to the contract without the consent of the third party; or</i></p> <p style="padding-left: 20px;"><i>(b) the third party’s consent to the rescission or variation is required in circumstances specified in the contract instead of those set out in subsection (1)(a) and (b).</i></p>	<p>Comment 3: Express terms authorising unilateral rescission or variation of contract may require further consideration.</p> <p>The reference to “<i>a party</i>” in this sub-clause suggests that if there is express provision in the contract for one party to unilaterally rescind or vary the contract, that party shall have the right to do so in accordance with the relevant provisions of the Bill.</p> <p>The equivalent section in the UK Act only refers to “<i>the parties</i>” but not “<i>a party</i>”.</p> <p>While there is a difference between the Draft Bill and the UK Act, the reference to “<i>a party</i>” in the Draft Bill is not particularly objectionable. In the rare event that the parties have seen fit to include an express provision for a contract to be unilaterally rescinded or varied, the parties’ contractual intention is clear and there is no reason to preclude enforcement of such provision.</p>
<p>(4) <i>Subsection (3) applies only if, before the circumstances referred to in subsection (1)(a) or (b) occur -</i></p> <p style="padding-left: 20px;"><i>(a) the third party is aware of the express term referred to in subsection (3); or</i></p> <p style="padding-left: 20px;"><i>(b) reasonable steps have been taken to bring that term to the notice of the third party.</i></p>	<p>Comment 4: The circumstances in which an express term for rescission or variation of contract without consent of the third party may require further refinement and detail.</p> <p>Sub-clause (4) lays down a dual requirement before an express term for a contract to be rescinded or varied without the consent of the third party may be enforced.</p> <p>The first requirement goes to knowledge of the third party and is met when the third party is aware of the express term or reasonable steps have been taken to bring that term to the notice of the third party.</p> <p>The second requirement is one of assent or reliance, as set out in sub-clause (1) (above). As long as the third party has communicated his assent or relied on a term in the contract conferring a benefit or right of enforcement on the third party, the requirement is met and rescission or variation of the contract is barred.</p> <p>The purpose of this sub-clause is to strike a balance between contractual autonomy and protection of third party rights by qualifying the right of the parties to the contract to vary or</p>

	<p>rescind any term that would affect the rights of the third party.</p> <p>By simply referring back to sub-clause (1), the Draft Bill does not require the third party to have suffered any detriment in reliance on the relevant term in the contract. In this regard the Draft Bill favours protection of third party rights more than the equivalent section in both UK and New Zealand Acts.</p> <p>The problem with this is twofold:</p> <p>First, the express contractual intention of the parties to qualify the rights of the third party will easily be defeated if the third party has communicated assent to, or relied on, the relevant term. This is regardless of whether the third party has suffered any detriment or changed his position at all.</p> <p>Secondly, this sub-clause may create contractual uncertainty as regards whether an express term communicated to the third party will be enforceable at all, and under what circumstances the third party will be deemed to have “<i>relied on</i>” the relevant term.</p> <p>It is submitted that as a matter of policy it may be worth further consideration whether contractual intention should be given more weight. Additionally the circumstances in which the express intention of the contracting parties may be defeated by third party rights should be expressly defined in greater detail to avoid unnecessary uncertainty.</p> <p>Reference may be made to the New Zealand Act, which requires a third party to have “<i>materially altered</i>” his position in reliance on the term in the contract before an express term allowing the parties to the contract to rescind or vary the contract without the consent of the third party will be defeated (section 6).</p>
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Clause 7 Power of court to dispense with third party’s consent to rescission or variation of contract

Draft Bill	Comment
<p>(1) <i>If the consent of a third party is required under section 6(1) or (3)(b) for the rescission or a variation of a contract, the court may, on an application by a party to the contract, make an order</i></p>	<p>The court’s wide discretion to impose consequential direction upon dispensing with third party consent to authorise variation or rescission of contract is desirable, as it accords greater flexibility to the court in dealing with potential novel situations.</p> <p>Sub-clause 2 confers upon the court a wide power to impose any order it thinks fit upon dispensing</p>

<p><i>dispensing with the consent if -</i></p> <p>(a) <i>the other party to the contract agrees to, or if there is more than one other party to the contract, all those other parties agree to, the rescission or variation; and</i></p> <p>(b) <i>the court thinks it just and practicable so to do.</i></p> <p>(2) <i>An order under subsection (1) may be made subject to any condition that the court may impose as it thinks fit, including a condition requiring the payment of compensation to the third party.</i></p>	<p>with third party consent to authorise the rescission or a variation of contract.</p> <p>The equivalent subsection in the New Zealand Act restricts the court’s discretion to make an order for compensation to circumstances where the third party beneficiary has been “<i>injuriously affected by the reliance of the beneficiary or any other person on the promise or obligation</i>” (section 7(2)). Further, the court is only authorised to direct monetary payments by way of compensation.</p> <p>A wide discretion is desirable and will unlikely lead to uncertainty. In the vast majority of cases a compensatory order will most likely be in the form of a monetary payment and must correspond to injury suffered by the third party. However given the breadth of factual situations that could arise in a contract conferring rights or benefits upon a third party, such flexibility is appropriate.</p>
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Clause 10 Protection of promisor from double liability

Draft Bill	Comment
<p><i>(1) If a third party has a right under section 4 [the main subsection authorising third parties to enforce a contractual term] to enforce a term of a contract, and the promisor has performed the promisor’s obligations to the third party under the term in whole or in part, the promisor is, to the extent of that performance, discharged from the same obligations owed by the promisor to the promisee.</i></p>	<p>Comment 1: This sub-clause may be redundant as it seems to state the obvious.</p> <p>This sub-clause clarifies the extent of the promisor’s liability towards the promisee in the event that the promisor has performed part or whole of his obligations to the third party.</p> <p>Two situations may arise in this context:</p> <p>The first possible situation is where the contract provides for parallel and concurrent obligations of the promisor towards the promisee and the third party. In this situation, performance by the promisor of the obligations owed to the third party should not extinguish the promisor’s liability towards the promisee. The result of applying this sub-clause would run contrary to the parties’ intention for the promisor to owe obligations to both the promisee and the third party.</p> <p>The second possible situation is where the contract provides for one set of obligations of the promisor towards either the promisee or the third party. In this situation, it will be obvious that performance of whole or part of the obligations will extinguish the promisor’s liability to the extent that the obligations have been performed, and there is no need for this to be explicitly spelt out in the Draft Bill.</p> <p>Accordingly it is submitted that this sub-clause may be dispensed with. It is noted that the relevant</p>

<p><i>(2) If a third party has a right under section 4 to enforce a term of a contract, and the promisee has recovered from the promisor a sum... then... the court or arbitral tribunal before which the proceedings are brought must reduce any award to the third party to the extent that it thinks appropriate to take account of the sum.</i></p>	<p>section in the UK Act does not contain provisions equivalent to sub-clause (1).</p> <p>Comment 2 : The Third Party's recovery should be made a defence</p> <p>Clause 10(2) provides that where a promisee has already made a recovery from the promisor in respect of the third parties' loss this can be used as a defence to the extent of such payment. A potential problem arises where payment is made to another third party either under Sub-clause 4 of the proposed Ordinance 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. Clause 10(2) could be amended to specifically take account of these payments also.</p>
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Clause 11 Arbitration clause and exclusive jurisdiction clause

Draft Bill	Comment
<p><i>(1) If a third party has a right under section 4 to enforce a term of a contract, and the contract contains an arbitration clause or exclusive jurisdiction clause, the third party is to be bound by the clause as regards a dispute between the third party and the promisor relating to the enforcement of the term by the third party.</i></p>	<p>If a third party's right to enforce a term of contract is conditional upon the third party enforcing that term by <u>mediation</u>, then the third party is bound to enforce the term by mediation.</p> <p>The rationale applicable to the requirement on the part of the third party on enforcement by arbitration should also apply to mediation, that is, if the contract also requires the third party to go through mediation before commencing arbitration, there is no reason why the third party should not be so bound to go through mediation before commencing arbitration.</p>

**The Law Society of Hong Kong
11 December 2012**