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CHAPTER 1

INTRODUCTION

A. THE ISSUE

The doctrine of privity states that only persons who are parties to a contract may sue or be sued on it. The corollary to that principle is that a third party or stranger to the contract derives neither rights nor obligations from the contract. There is no significant dissatisfaction with that part of the doctrine which prevents burdens and liabilities from being cast on those who have not willingly assumed them.[1] Consequently, this Report does not examine nor does it make recommendations on that issue. It is the principle that denies the enforceability of a promise to confer a benefit on a third party to the contract which invites assessment and reform. The failure of the law to provide a third party beneficiary with an enforceable right may defeat both the common intention of the parties and the reasonable expectations of the third party.[2] This Report will consider the development of the rule that third party beneficiaries have no enforceable rights. It will explore possible justifications for the existing rule. It will outline and discuss the plethora of exceptions, modifications and limitations which have been placed on the rule. It will consider the experience of those jurisdictions that have abolished the rule. It will consider the New Brunswick Law Reform Bill and the recent recommendations of the Ontario Law Reform Commission and the English Law Commission. Finally, it will make proposals for reform of the law of Manitoba to permit third parties to enforce contractual provisions made in their favour and for their benefit.

B. ACKNOWLEDGMENTS

The Commission has long considered the law of privity as one in need of review and possible reform. Due to our small legal research staff, it was decided that we should seek the services of an outside consultant. The Commission engaged the services of Professor Philip H. Osborne of the Faculty of Law, University of Manitoba, as our consultant and to prepare this Report.

The Commission wishes to thank Prof. Osborne for his valuable assistance in this project, as well as his legal research assistant, Mr. Rod Crook, and the Legal Research Institute of the Faculty of Law, University of Manitoba.

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[1] There are some exceptions to this branch of the rule. The most important is that involving restrictive convenants in respect of land. Where A sells land to B with certain restrictions relating to use, those restrictions may bind successive purchasers who take the land with knowledge of the restriction: *Tulk* v. *Moxhay* (1848), 2 Ph. 774, 41 E.R. 1143.

[2] In a recent treatise on privity, V.V. Palmer underlines this point. He states: "The refusal to admit the beneficiary action often frustrates the expectations of the parties, penalizes reasonable reliance, and rewards the bad faith of the promisor.": V.V. Palmer, *The Paths to Privity* (1992) 4.

CHAPTER 2

THE ESTABLISHMENT OF THE DOCTRINE OF PRIVITY OF CONTRACT

In the early development of contract law, the boundaries of agreement were not drawn narrowly. Courts were generally sympathetic to the third party beneficiary and he or she was often allowed to enforce a contractual provision made for his or her benefit. Flannigan[1] has analyzed the early cases from *Provencher* v. *Wood*[2] in 1630 to *Carnegie* v. *Waugh*[3] in 1823. He concluded:

> To this point in time the historical case for the privity doctrine is extremely modest. The assertions of the judges in the few cases claiming a doctrine of privity were unsupported and were made in ignorance of an established line of authority. Support for a third party right of action, in comparison, is both voluminous and continuous.[4]

However, the mid-19th century witnessed a hardening of judicial attitudes and a desire to circumscribe contractual relationships by strict application of the doctrine of consideration. The doctrine of consideration defines a contractual relationship as a "bargain" where each contracting party has, by giving a promise or act of value, bought the reciprocal obligation of the other party. In simple terms, a promise is not enforceable at common law unless the promisee has paid the price requested by the promisor. This is, of course, a hostile doctrine to any concept of third party beneficiary rights. In the typical case of a contract between A (promisor) and B (promisee) under which A promises to pay C (beneficiary) a sum of money, there is no consideration requested of or supplied by C. Consequently, C is not a party to the contract and has no enforceable rights. This position was firmly established in two leading 19th century cases: *Price* v. *Easton*[5] and *Tweddle* v. *Atkinson*.[6] *Price* v. *Easton* dealt with the paradigm of the third party beneficiary contract. A promised B that, if B worked for him, he would pay C a sum of money. The Court, without substantial discussion, refused to permit an action by C to enforce the promise. Denman C.J. explained why the claim could not succeed. He stated: ". . . [there was no] consideration for the promise moving from the plaintiff to the defendant".[7] *Tweddle* v. *Atkinson* is the more well known of the two cases. In that case the fathers of a bride and groom exchanged mutual promises that each would pay a sum of money to the married couple. There was clearly sufficient consideration to support the contract between the fathers. But could the groom enforce the promise made by his father-in-law? The Court unanimously decided that the plaintiff had no cause of action. He had given no consideration and was not, therefore, a party to the contract.

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[1]R. Flannigan, "Privity - The End of an Era (Error)" (1987), 103 L.Q.R. 564.

[2]*Provencher* v. *Wood* (1630), Het 30, 124 E.R. 318 (C.P.).

[3]*Carnegie* v. *Waugh* (1823), 1 L.J. 89 (K.B.).

[4]Flannigan, *supra* n. 1, at 567.

[5]*Price* v. *Easton* (1833), 4 B & Ad 433, 110 E.R. 518 (K.B.).

[6]*Tweddle* v. *Atkinson* (1861), 1 B & S 393, 121 E.R. 762 (K.B.).

[7]*Price* v. *Easton*, *supra* n. 5, at 519.

The doctrine of privity received authoritative approval from the House of Lords in 1915 in *Dunlop Pneumatic Tyre Co. Ltd.* v. *Selfridge*.[8] The case dealt with a price maintenance arrangement between the manufacturer (Dunlop), a wholesaler (Dew) and a retailer (Selfridge). In the contract between Dew and Selfridge, Selfridge promised that it would not sell tires below a certain list price. Under the agreement, Selfridge was to pay Dunlop $5 for each tire sold in breach of the pricing arrangement. The House of Lords refused to allow Dunlop to enforce the agreement. Dunlop was not a party to the contract between Dew and Selfridge. Viscount Haldane, in a frequently cited passage, sought to elevate the privity rule into a cardinal principle of contract law. He stated:

> My Lords, in the law of England certain principles are fundamental. One is that only a party to the contract can sue on it. Our law knows nothing of a jus quaesitum tertio arising by way of contract. Such a right may be conferred by way of property, as, for example, under a trust, but it cannot be conferred on a stranger to a contract as a right to enforce the contract in personam. A second principle is that if a person with whom a contract not under seal has been made is to be able to enforce it consideration must have been given by him to the promisor or to some other person at the promisor's request. These two principles are not recognised in the same fashion by the jurisprudence of certain Continental countries or of Scotland, but here they are well established.[9]

This passage has fuelled a debate in the law as to whether the doctrine of privity and the rule that consideration must be provided by the promisee are, in fact, two different rules. There are situations where one can frame a distinction. A person may be a signatory to a contractual document and, therefore, in one sense of the word be a "party to the contract" but he or she may not have provided consideration. Consequently, it may be said that he or she is privy to the agreement but has not satisfied the consideration rule. However, the better view is that one is not a 'party' to a contract, technically speaking in Canadian law, unless one has provided consideration. The rules are therefore different ways of describing the same legal phenomenon.

In any event, the words of Viscount Haldane had a powerful effect and the doctrine of privity was entrenched into contract law. It has been fully adopted and applied in Canadian law[10] and, as recently as 1980, the landmark English cases were approved and applied by the Supreme Court of Canada in *Greenwood Shopping Plaza* v. *Beattie*.[11] The limitations and exceptions of the privity principle will be discussed shortly, but it is still fair to say that, in Canadian law, a third party beneficiary to a contract has no enforceable rights.

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[8] *Dunlop Pneumatic Tyre Co. Ltd.* v. *Selfridge*, [1915] A.C. 847 (H.L.).

[9] *Id.*, at 853.

[10] *Mulholland* v. *Merriam* (1872), 19 Gr. 288 affm'd (1873), 20 Gr. 152 (Ch., *en banc*); *Smith* v. *Rae* (1919), 46 O.L.R. 518 (S.C., App. Div.); *Great Northern Railway* v. *Cole Agencies Ltd.* (1964), 49 W.W.R. 153 (Sask. Q.B.); *Sears* v. *Tanenbaum* (1968), 70 D.L.R. (2d) 126 (Ont. H.C.), varied (1969), 9 D.L.R. (3d) 425 (C.A.), rev'd (1971), 18 D.L.R. (3d) 709 (S.C.C.).

[11] *Greenwood Shopping Plaza Ltd.* v. *Beattie* (1980), 111 D.L.R. (3d) 257. See also *London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.* (1992), 97 D.L.R. (4th) 261 (S.C.C.).

CHAPTER 3

AVOIDANCE EXCEPTIONS AND LIMITATIONS OF PRIVITY OF CONTRACT

This Report places a great deal of emphasis on the judicial and legislative erosion of the doctrine of privity. Not every departure from the privity rule is canvassed but a significant range of situations is described. There are a number of reasons for this preoccupation. First, it will give a sense of the significant erosion of privity by a wide range of legal devices. Secondly, it will illustrate the commercial inconvenience and individual injustice that can be caused by strict application of the rule. Thirdly, it will provide some understanding of the commercial and non-commercial arrangements which give rise to 'third party' problems. Fourthly, it will provide some appreciation of the way in which the judiciary and the Legislature have sought to resolve those problems. Fifthly, it will identify issues and circumstances which must be addressed and resolved in crafting an appropriate reform of the privity rule. Finally, it will illustrate the immense capacity of the common law to accommodate bad rules and avoid bad results in the majority of cases. Indeed, the law relating to privity has been referred to as an "obstinent and persistent battle between practice and theory".[1] Substantially more is to be learned from the practice than the theory.

The exceptions and evasions of privity will be described in no particular order.

A. ENFORCEMENT BY THE PROMISEE

While the third party beneficiary cannot sue in his or her own name, there is no doubt that the promisee, being a party to the contract, can sue the promisor for failure to perform his or her promise. This is how a just result was crafted in the leading House of Lords decision in *Beswick* v. *Beswick*.[2] In that case a contract was entered into between an uncle and his nephew whereby a small coal retailing business was sold to the nephew. The price paid was a lifelong periodic payment, first to the seller for his life, and, upon his death, in a reduced amount to his widow. It was a fair and reasonable arrangement. The nephew was provided with the necessary credit to buy the business and the uncle and aunt were provided with the security of a small pension for the rest of their lives. After the uncle's death, the nephew refused to make payment to the widow. To have refused a remedy would have been most unjust. It would have subverted the clear intentions of the parties, upset their reasonable expectations and sanctioned the unjust enrichment of the nephew who would avoid paying the full price for the business. Nevertheless, the House of Lords upheld the basic rule that the widow, *in her personal capacity* as a third party beneficiary, had no enforceable right to her pension. A remedy had to be found by a much more circuitous route.

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[1] S. Williston, "Contracts for the Benefit of a Third Party" (1902), 15 Harv. L. Rev. 767 at 767 translating and citing Busch, "Doktrin und Praxis über die Gültigkeit von Verträgen zu Gunsten Dritter" (Heidelberg 1860).

[2] *Beswick* v. *Beswick*, [1968] A.C. 58 (H.L.).

The House of Lords accepted that the widow could sue in another capacity, that of administratrix of the deceased's estate. On death, the deceased's contractual rights were assigned by operation of law to his estate. Consequently, an action by the estate was the equivalent of an action by the *promisee* to enforce a contractual provision in favour of a third party. However, under such an action, damages are not an effective remedy. The failure to pay the widow in her personal capacity was not a loss to the estate. Damages would, therefore, be nominal. The solution was found in an order of specific performance. At the suit of the promisee, the promisor was ordered to pay the pension to the beneficiary. In this way, a just result was achieved.

Specific performance at the suit of the promisee is a powerful and effective remedy, but it is not a full solution to the problem of third party rights. First, it depends upon the willingness of the promisee to incur the time and expense of litigation to protect the third party. In many situations the close relationship between promisee and third party that was a feature of *Beswick* v. *Beswick*[3] will not be present.[4] Secondly, specific performance is a discretionary remedy not normally given to secure the payment of money. There are no guarantees that other courts, in less sympathetic situations, will order specific performance.

A final comment should be made on the issue of damages in an action by a promisee. Damages will not always be nominal. If the promisee was seeking to discharge an existing debt to the beneficiary by means of a contractual promise, damages may be substantial. It has also been suggested that the House of Lords would not have held so strongly to the view that damages are only nominal in *Beswick* v. *Beswick*[5] if specific performance was unavailable.[6] Some support that this view may be open to reconsideration in some cases is found in cases dealing with vacation contracts. In one case where a family had a disappointing and frustrating holiday, the father, who was the only party to the vacation contract, was permitted to recover substantial damages on behalf of other family members.[7] Clearly, action by the promisee is a useful protection of third party rights, but it is not a panacea.

B. JOINT PROMISEES

Sometimes the courts are faced with contracts made between one individual (A) and a number of others (B, C and D). They may all be signatories to the contract and therefore they may all appear to be parties to the contract. Close examination of the situation, however, may reveal that only A and B provided consideration. It can therefore be argued that C and D are not really parties to the contract in a technical sense and cannot sue on the contract. The courts have not, however, always wished to be drawn to this conclusion. One way of avoiding it is to construe B, C and D as joint promisees. As long as one joint promisee supplies consideration, all may sue on the contract.[8] Windeyer J. in the High Court of Australia in *Coutts* v. *Bagot's Executor and Trustee Co. Ltd.* expressed the position well. He said:

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[3] *Id.*

[4] A third party may be able to secure the co-operation of the promisee by some arrangement which would protect the promisee against the costs of litigation.

[5] P.S. Atiyah, *Introduction to the Law of Contract* (3d ed., 1981) 377.

[6] *Beswick* v. *Beswick*, *supra* n. 2.

[7] *Jackson* v. *Horizon Holidays Ltd.*, [1975] 1 W.L.R. 1468 (C.A.), approved in *Woodar Investment Development Ltd.* v. *Wimpey Construction (U.K.) Ltd.*, [1980] 1 W.L.R. 277 (H.L.).

[8] *McEvoy* v. *Belfast Banking Co. Ltd.*, [1935] A.C. 24 (H.L.); *Selby* v. *Selby* (1956), 3 D.L.R. (2d) 275 (N.B.C.A.); *Waugh* v. *Slavik* (1975), 62 D.L.R. (3d) 577 (B.C.S.C.). Other cases are discussed in B. Coote, "Consideration and the Joint Promisee" (1978), 37 Camb. L.J. 301.

> The promise is made to them collectively. It must, of course, be supported by consideration, but that does not mean by considerations furnished by them separately. It means a consideration given on behalf of them all, and, therefore, moving from all of them. In such a case the promise of the promisor is not gratuitous; and, as between him and the joint promisees, it matters not how they were able to provide the price of his promise to them.[9]

There is, of course, a fine line between joint promisees and a single promisee and a third party beneficiary, particularly when the third party knows that a contract which contains a promise in his or her favour is being made. Much will depend on the circumstances and the equities of the particular case.

C. TRUSTS

For some years it was thought that the equitable concept of a trust held the solution to problems caused by the doctrine of privity. Where A and B make a trust in favour of C, C may enforce that trust. The doctrine of privity has no applicability to trust law. It is not surprising, therefore, that it has been argued that when A and B make a contract for the benefit of C they are, in fact, creating a *trust* under which B holds contractual rights *in trust* for C. C can then take the advantages of trust law and secure the benefit of the promise as a beneficiary of a trust. Of course, this arrangement often involves something of a fiction. The parties are not normally setting up a trust at all. They are making a *contract* which is being called a trust for the purpose of securing third party beneficiary rights. However, there is a strong tradition in the common law of using fictions to overcome troublesome legal doctrines and, as long as close attention is not given to the reality of the situation, the trust has considerable potential to circumvent privity rules. Ultimately, however, the use of trust as an avoidance technique has proved disappointing. A brief summary of the use of trust law will trace its fortunes and identify the problems that led to its demise as a means of avoiding the privity rule.

There is strong early authority supporting the use of a trust to provide enforceable rights to third parties. In 1753, in *Tomlinson* v. *Gill*,[10] Lord Hardwick was willing, in a case where A promised B to pay money to C, to regard B as a trustee for C. This position was reiterated sixty years later in *Gregory and Parker* v. *Williams*.[11] However, these cases were decided well before the mid-19th century when attitudes about privity began to harden.

Nevertheless, by the end of the 19th century renewed interest in the trust is apparent. In 1883, in *Re Flavell, Murray* v. *Flavell*,[12] there was an agreement between a retiring partner and continuing partners that the latter would, on the retiring partner's death, pay an annuity to his widow. The Court of Appeal found a trust in favour of the widow. Further support was given to the use of the trust in 1919 by the House of Lords. In *Les Affréteurs Réunis Société Anonyme* v. *L. Walford Ltd.*,[13] a broker had negotiated a charter-party between the owner of a ship and a charterer. A clause in the charter-party called on the owner to pay a commission to the broker. Lord Birkenhead cited the early cases and commented that "in such cases charterers can sue as

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[9] *Coutts* v. *Bagot's Executor and Trustee Co. Ltd.* (1967), 40 A.L.J.R. 471 at 483.

[10] *Tomlinson* v. *Gill* (1756), Amb. 330, 27 E.R. 221 (Ch.).

[11] *Gregory and Parker* v. *Williams* (1817), 3 Merc. 582, 36 E.R. 224 (Rolls).

[12] *Re Flavell, Murray* v. *Flavell* (1883), 25 Ch. D. 89 (C.A.).

[13] *Les Affréteurs Réunis Société Anonyme* v. *L. Walford Ltd.*, [1919] A.C. 801 (H.L.).

trustees on behalf of the broker."[14] Canadian cases also utilized the trust to provide relief.[15] It appeared that the stage was set for a robust use of trust to evade privity rules.

However, by 1933, the tide was beginning to turn again. The Privy Council decision in *Vandepitte* v. *Preferred Accident Insurance Corporation*[16] signalled a change of heart. The case involved a policy of automobile liability insurance. The insured was the owner of the automobile and it was argued that, since the policy was clearly intended to cover not only the liability of the insured but also those driving his car with his consent, the owner was a trustee of contractual rights for those third parties. The Privy Council decided that in the absence of clear evidence of an intention to create a trust, a trust could not be found. It could not be inferred from general words in the policy. This case was followed by the leading English decision of the period, *In re Schebsman.*[17] In that case, a contract of employment called for the employer to pay a sum of money in certain eventualities to an employee's widow and daughter. It was held that the contract did not create a trust in favour of the widow and daughter. Three years later, in *In re Miller's Agreement*,[18] the position solidified further. In that case, annuities charged on partnership assets in favour of the daughter of a deceased partner were held not enforceable by way of trust. Since that time, the trust has not been seen as an effective method to avoid privity rules.

The failure of the trust device was due in large part to the fact that several propositions of trust law are incompatible with contractual concepts. This made the trust device so awkward and implausible that there was an unwillingness to maintain the fiction in the face of strong formalistic argument. There were two key problems. First, to create a trust there must be clear evidence of an intention to do so. The fact is that contracting parties rarely have such an intention. Secondly, trusts are irrevocable without the consent of the beneficiary. Contracts are open to variation or termination by the parties at any time. Even in contracts for the benefit of third parties, the contracting parties rarely intend to forgo that power. The consequence is that today both English and Canadian courts are unwilling to infer a trust on the basis that a third party was intended to receive a contractual benefit.[19]

Recently, the Supreme Court[20] confirmed that trust is a recognized exception to privity rules but noted that clear evidence must be presented that a trust was intended and that the contracting parties intended to relinquish their right to terminate or vary without the beneficiary's consent. It is not clear what evidence will be sufficient on these points. Clearly the express use of the word 'trust' is sufficient, but beyond that uncertainty governs. What is clear is that the trust can no longer be seen as a general means of escape from the privity rules.

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[14]*Id.*, at 807.

[15]*Mulholland* v. *Merrian* (1872), 19 Gr. 288 affm'd (1873) 20 Gr. 152 cited in S.M. Waddams, *The Law of Contracts* (2d ed., 1984) 202.

[16]*Vandepitte* v. *Preferred Accident Insurance Corporation*, [1933] A.C. 70 (P.C.).

[17]*In re Schebsman*, [1944] Ch. 83 (C.A.).

[18]*In re Miller's Agreement*, [1947] Ch. 615.

[19]*Tobin Tractor (1957) Ltd.* v. *Western Surety Co.* (1963), 40 D.L.R. (2d) 231 (Sask. Q.B.); *Fournier Van and Storage Co.* v. *Fournier*, [1973] 3 O.R. 741 (Ont. H.C.).

[20]*Greenwood Shopping Plaza Ltd.* v. *Beattie* (1980), 111 D.L.R. (3d) 257. See also *London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.* (1992), 97 D.L.R. (4th) 261 (S.C.C.).

D. AGENCY

Agency is often seen as an exception to the privity rule. An agency relationship is formed when one person, the principal, gives to another, the agent, the power or authority to enter contracts on his or her behalf with others (third parties). Where an agent acts within his or her scope of actual authority, a valid and enforceable contract is made between the principal and the third party. The agent has brought the two parties together in a direct contractual relationship. In this typical situation, the exception to the privity rule is more theoretical than real. The principal is known to be the contracting party. The agent has declared his or her status as one who is acting for the principal. Both contracting parties intended to contract with each other. However, three situations illustrate the breadth of the common law concept of agency and its disregard for the strictures of privity.

The first two are situations where the principal is held bound to a contract that he or she had no intention to enter at the time when it was formed. The first of these is the situation of *apparent authority*. Apparent authority arises where an agent has acted without actual authority. The principal will, nevertheless, be bound if he or she has, by words or conduct, led the third party reasonably to believe that his or her agent has authority to bind him or her to a contract of the kind that has been entered into. The doctrine is designed to protect the reasonable reliance of the third party. Of course, the principal may sue the agent for breach of his or her duty to follow instructions but that does not diminish the fact that a contract is formed between the principal, who did not intend to enter a contract of this kind, and the third party. The other situation is the *doctrine of ratification*. It arises where an agent has acted without actual or apparent authority. *Prima facie*, the principal is not bound in such circumstances and the third party must content himself or herself with an action against the agent for breach of warranty of authority. However, a principal may decide, on reflection, that the contract is beneficial and may wish to adopt it. This may be achieved by the doctrine of ratification. If, within a reasonable time, a principal approves the agent's actions, a retroactive ratification occurs and the agent is deemed to have had actual authority when the contract was formed.

However, it is the third situation which most vividly illustrates the robust nature of agency and its indifference to privity rules. It is the law relating to *undisclosed principals*. In this situation, an agent with actual authority contracts with a third party without disclosing that he or she is acting as an agent. The third party reasonably believes that he or she has contracted with the agent as principal. Nevertheless, at common law, the undisclosed principal can step out of the shadows and take the benefit of the contract. The third party has a contractual link with someone with whom he or she never intended to contract. There are some limitations to this doctrine. The agent must have actual authority to make the contract. Ratification is not permitted. The third party does have the option to sue the agent and the principal cannot take over a contract of a personal nature. Nevertheless, as Waddams points out:

> The effect from the point of view of the person dealing with the agent is equivalent to an assignment of the benefit of the contract to the undisclosed principal or to a contract made by two persons for the benefit of a third, though the existence of the third party beneficiary (the undisclosed principal) is unknown to the obligor at the time of contracting.[21]

Finally, it should be noted that agency has proved to be a very flexible and useful device to draw third parties into the contractual nexus. It is of particular importance in the area of exemption clauses which will be discussed in some detail later.

[21] Waddams, *supra* n. 15, at 189.

E. ASSIGNMENT

The rules of privity can be overcome with relative ease in many cases by a simple assignment of contractual rights. A simple contractual promise to confer a benefit on a third party may not be enforceable. But, where under a contract between A and B, A is obliged to pay a sum of money to B, B may immediately assign the right of payment to C. The assignee may then enforce that right directly against A. Thus the law of assignment allows one to do indirectly what the law of contract will not permit directly. Assignment is an essential tool in the commercial market place and it mitigates the inconvenience of the privity rules substantially. There are two kinds of assignment, voluntary assignment of the kind just described and involuntary assignment which arises on death and bankruptcy. Each will be described.

1. Voluntary Assignment

The common law refused to enforce the assignment of contractual rights. There were a number of reasons for this. First, a contract was seen as a personal bond which could not be transferred. Secondly, assignment was perceived as a purchase of a right of action and was therefore thought to offend against the rules about maintenance.[22] Thirdly, penalties for debt were so severe, it was important to choose one's creditors wisely and, consequently, the substitution of an unknown person as the creditor of rights was unreasonable.[23] Finally, there were conceptual problems about the transfer of intangible 'rights' which in the law are known as *choses in action*.

In due course, however, assignments were enforced by the Courts of Equity. Equity recognized both the assignment of *legal choses in action* such as contractual rights and *equitable choses in action* such as rights arising from a trust. However, different rules apply to an equitable assignment of a legal chose in action and an equitable assignment of an equitable chose in action. In respect of the former, the assignor must be joined in the litigation. Joinder is not necessary in the enforcement of an equitable assignment of an equitable chose in action. Consequently, the equitable assignment of contractual rights has the added complication of joinder. Other aspects of equitable assignment are uniformly applicable whether or not the subject matter is a legal or equitable chose in action. No particular form is necessary for an equitable assignment so long as the intention to transfer the chose in action is clear. Only the assignment of future choses in action requires consideration. Notice to the debtor is not necessary to perfect an equitable assignment but the failure to give notice can have serious consequences. Prior to notice, a debt may be extinguished by payment to the *assignor*. Furthermore, only notice gives the assignee priority over subsequent assignments of the same rights. All assignees take the chose in action *subject to equities*. This means that any defence or set-off that the debtor has against the assignor are equally applicable against the assignee. Finally, if the assignment is conditional rather than absolute, the assignor must be joined whether or not the assignment is of a legal or equitable chose in action.

Clearly, the incidents and procedures of equitable assignment could be rationalized and improved. That this did not occur is explained by the introduction of a form of *statutory assignment* which simplified the procedure for making assignments and avoided some of the difficulties and limitations of equitable assignment. Statutory assignment was first introduced in

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[22]Maintenance involves assisting a person to bring litigation without the party assisting having any legitimate interest in the proceedings.

[23]Waddams, *supra* n. 15 at 193, points out that when a creditor could throw a defaulting debtor in prison, the debtor had good reason to choose his own creditors.

England in 1873[24] and since then, most common law jurisdictions have passed similar provisions. All of the common law provinces in Canada have introduced a statutory form of assignment.[25] In Manitoba, section 31 of *The Law of Property Act*[26] sets out the requirements for a statutory assignment. The important parts of the section are reproduced here:

> 31(1) Every debt and any chose in action is assignable at law by any form of writing that contains apt words in that behalf, but subject to such conditions or restrictions in respect of the right of transfer as may appertain to the original debt or as may be connected with or be contained in the original contract; and the assignee thereof may bring an action thereon in his own name, as the party might to whom the debt was originally owing, or in whom the right of action originally arose; or he may proceed in respect thereof as though this Act had not been passed.
>
> 31(2) Every assignment of a debt or chose in action arising out of contract, and not assignable by delivery, is subject to any defence or set-off, in respect of the whole or any part of the debt or chose in action, existing at the time of the notice of assignment to the debtor or person sought to be made liable, in the same manner and to the same extent as the defence or set-off would be effectual in case there had been no assignment thereof; and every such defence or set-off applies as between the debtor and any assignee of the debt or chose in action.
>
> 31(3) Where an assignment is made in conformity with the provisions hereof, and notice thereof is given to the debtor or person liable in respect of the subject of the assignment, the assignee shall have, hold, and enjoy it, free from any claims, defences or equities, that may have arisen subsequent to the notice by any act of the assignor or otherwise.

A number of aspects of this section warrant comment. First, the section provides for the assignment of all choses in action both legal and equitable. Secondly, the section covers both absolute and conditional assignments. Thirdly, there is no necessity of joinder of the assignor in the enforcement of assigned rights. Fourthly, no consideration is needed for any assignment of a chose in action. To this extent, the statutory form of assignment has clear advantages. While notice is not essential to perfect an assignment, subsection (3) indicates the continuing practical importance of it. After notice, the assignee holds the assigned rights free of later claims and defences[27] and the debt cannot be extinguished by payment to the assignor.

Section 31 does not invalidate equitable assignments. It may have been hoped that the superior statutory form of assignment would replace equitable assignments. However, if an assignment fails as a statutory assignment (for example, oral assignment), it can still be enforced if it meets the requirements of an equitable assignment. Consequently, equitable assignment still has an important, though diminished, role in the law.

Assignment does have some limitations as a device to avoid privity rules. Not all contractual rights are assignable. Contractual rights involving personal skills and personal relationships are not assignable. Some are not assignable on the grounds of public policy.[28] Some contracts contain provisions preventing assignment. Nevertheless, the availability of assignment is an important vehicle for avoiding the privity rule. Both Atiyah and Waddams have commented on the inherent inconsistency of a legal system which permits the free assignment of rights and denies a remedy to a third party beneficiary. Atiyah has written:

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[24]*Supreme Court of Judicature Act 1873*, 36 & 37 Vict. c. 66, s. 25(6), now contained in s. 136 of *Law of Property Act 1925*, 15 Geo. V, c. 20 (U.K.).

[25]Alberta, British Columbia, New Brunswick, Newfoundland, Nova Scotia, Ontario and Prince Edward Island adopted the English Act verbatim.

[26]*The Law of Property Act*, C.C.S.M. c. L90, s. 31. The Manitoba Act is broader than the English Act and that of most other Canadian provinces. The Manitoba Act gives effect to all written assignments, whether absolute or conditional. The English Act only applies to absolute assignments. Saskatchewan and the Northwest Territories mirror the Manitoba statute on this point.

[27]See *Harding Carpets Ltd.* v. *Royal Bank of Canada*, [1980] 4 W.W.R. 149 (Man. Q.B.).

[28]Eg., contracts under which pensions and salaries are payable out of national funds to a public officer and contracts in which maintenance is paid to a wife.

The fact that the law is thus prepared in principle to accept the simple assignability of contractual rights makes the doctrine of privity particularly anomalous, and hard to justify on rational grounds. Since the law is perfectly prepared to allow a contracting party to transfer his rights, once created, to a third party, there can hardly be any valid objection to his creating the rights for the benefit of the third party in the first instance.[29]

Waddams echoes that sentiment:

Once the principle of assignment is accepted, what possible objection can there be to A and B doing the two things in one step, that is, conferring an enforceable right in C against A? It is pure formalism unworthy of a mature legal system to permit A and B to achieve this result indirectly (by assignment) but to deny effect to a direct attempt to do the same thing.[30]

A final point should be made about the rule that an assignee takes the contractual rights 'subject to equities'. This presents some impediment to the free assignment of debts in the market place because a cautious assignee will wish to inquire if the debt is really owing. This problem has been overcome by the concept of *negotiability*. Where an obligor creates a negotiable instrument such as a bill of exchange or a promissory note, he or she will be liable to a good faith assignee (holder in due course) even though he or she may have had a good defence in respect of the original payee.[31] This issue of available defences is an important one in respect of the reform of privity rules. In due course, we will address the question whether a third party beneficiary must take subject to equities.

2. Involuntary Assignment

Involuntary assignment, which is sometimes called assignment by operation of law, arises on death and bankruptcy. Upon death all contractual rights and liabilities of the deceased pass to his or her estate. The rule of common law is confirmed by *The Trustee Act*.[32] Similarly, under the *Bankruptcy Act*[33] rights of action for breach of contract may vest, on bankruptcy, in the trustee in bankruptcy.

F. NOVATION AND ATTORNMENT

Novation and attornment are two early common law concepts which, in certain circumstances, can perform a function similar to assignment and thereby evade privity rules. They are sufficiently important to warrant coverage. Novation allows third parties to be incorporated into the contractual arrangements of others. Technically, novation occurs when a contract is terminated with consent of all parties and a similar, and sometimes identical, contract is entered into with the addition of new contracting parties. In this way, contractual rights and obligations are transferred from the membership of an existing contract to the changed membership of the new contract. This device is particularly useful in changing the membership of a partnership, when members retire or new members are admitted. There must be consideration for a novation.

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[29]Atiyah, *supra* n. 5, at 271.

[30]Waddams, *supra* n. 15, at 201.

[31]Other marks of negotiability are that consideration is presumed where the transferee is a holder in due course, nothing other than delivery of the negotiable instrument is necessary to effect negotiation, no notice to the original debtor is necessary and delivery of the instrument is absolute. See G.H.L. Fridman, *Law of Contract* (2nd) 622.

[32]*The Trustee Act*, C.C.S.M. c. T160.

[33]*Bankruptcy Act*, R.S.C. 1985, c. B-3, s. 67.

Attornment is a very old concept whereby a person willing to give up contractual rights to another may appoint the recipient as his or her attorney for the purpose of suing in court. The litigation is brought in the name of the donor as if the rights had not been given up at all. It is understood that if the suit is successful the attorney will take the benefit and will not be required to turn it over to the donor. This procedure has, however, been largely replaced by assignment.

G. INSURANCE LAW AND THIRD PARTIES

There are few areas of the law where the doctrine of privity is less compatible with commercial practice and the reasonable expectations of contracting parties than insurance law. Both the Legislature and the common law have created exceptions to and limitations of the doctrine of privity to fulfil the common intention of insureds and insurers. Some of these modifications will be described.

1. Third Party Beneficiaries

Insurance arrangements are often made by the insurer and insured for the benefit of a third party. In such circumstances, the doctrine of privity has the capacity to cause grave difficulties and injustice. The leading example of such a situation is *Vandepitte* v. *Preferred Accident Insurance Corporation*.[34] The case involved a policy of liability insurance between an insurer and the owner of an automobile. The policy purported to indemnify the owner against third party risks and to extend that protection to anyone driving the automobile with the owner's permission. The owner's daughter sought the protection of the policy after being found liable for injuries caused to a third party while she was driving the automobile with her father's permission. An action brought to enforce the policy in favour of the daughter failed. The Privy Council took the view that, since she was a third party beneficiary, she was not privy to the contract of insurance and could not sue on it. Few cases so vividly illustrate the injustice of the privity rule as *Vandepitte*.

Not surprisingly, the law has been changed to facilitate and promote claims by third party insureds. Those changes will be examined in relation to life insurance policies, automobile liability policies and other liability policies.

(a) Life insurance

The contract of life insurance is a paradigm of a contract for the benefit of a third party. The whole aim and object is to provide security for the family and other dependents of the insured. If the third party had no enforceable rights, there would be a clear risk of an unjust enrichment being secured by the insurer. However, section 172 of Part V (Life Insurance) of *The Insurance Act*[35] permits the beneficiary of a life insurance policy to enforce for his or her own benefit the payment of insurance moneys payable to him or her under the policy. The right to enforce the policy is subject to any defence that the insurer could have set up against the insured.

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[34]*Vandepitte* v. *Preferred Accident Insurance Corporation*, *supra* n. 16.

[35]*The Insurance Act*, C.C.S.M. c. I40.

(b) Automobile liability insurance

The Legislature has also stepped in to resolve the kind of difficulties brought to light in *Vandepitte*.[36] There are now a series of provisions in *The Insurance Act* which change the privity rules to facilitate automobile insurance.

Under section 258(1) of Part VII (Automobile Insurance, Motor Vehicle Liability Policies) of *The Insurance Act*,[37] a person who has a claim against an insured for which indemnity is provided by a motor vehicle liability policy, may, upon recovering judgment against the insured, maintain an action directly against the insurer albeit that he or she is not a party to the contract. Section 258(4) goes even further in protecting the interests of the judgment creditor and declares that his or her claim under section 258(1) is not subject to the act or default of the insured in contravention of *The Insurance Act* or the terms of the policy. Nor is it subject to any change in the contract of insurance made by the insured and insurer after the event giving rise to the claim.

Section 243 reverses the *Vandepitte* decision. It reads:

> Any person insured by but not named in a contract to which section 239 or 240 applies may recover *indemnity* in the same manner and to the same extent as if named therein as the insured, and for that purpose shall be deemed to be a party to the contract and to have given consideration therefor. [emphasis added]

Virtually the same wording is found in section 267(1) of the Act. Section 267(1) applies the same rules to uninsured motorist coverage, medical expenses and accident benefits. It reads:

> Any person insured by but not named in a contract to which section 263, 264 or 265 applies may recover *under the contract* in the same manner and to the same extent as if named therein as the insured, and for that purpose shall be deemed to be a party to the contract and to have given consideration therefor. [emphasis added]

These provisions are mirrored in *The Manitoba Public Insurance Act*.[38] Under section 40(1), a person having a claim against an insured for which indemnity is provided may, after recovering a judgment against the insured, maintain an action directly against the insurer (Autopac) for the insurance money. Section 40(4) declares that the person having a claim under section 40(1) is not subject to default of the insured or changes in the policy after the event giving rise to a claim. Section 42 of *The Manitoba Public Insurance Act* states that a person insured by, but not named, may recover an indemnity as if a named insured and shall exercise the same rights and be subject to the same obligations as the named insured. These sections would appear to resolve most of the privity problems in respect of automobile insurance.

(c) Non-automobile liability insurance

Section 127(1) Part III (Insurance Contracts in Manitoba - Loss under Policy) of *The Insurance Act*[39] allows for a direct action by the judgment creditor of an insured against the insurer. This applies in respect of liability for personal or property damage other than that relating to motor vehicles. The claim of the judgment creditor is limited to the amount of the policy and is subject to defences that the insurer could raise against the insured. There is, however, no similar provision to that in relation to motor vehicle insurance to permit a *third party* insured to recover against the insurer. Section 127(1) is virtually identical to the provision

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[36]*Vandepitte* v. *Preferred Accident Corporation*, *supra* n. 16.

[37]*The Insurance Act*, C.C.S.M. c. I40.

[38]*The Manitoba Public Insurance Act*, C.C.S.M. c. P215.

[39]*The Insurance Act*, C.C.S.M. I40.

considered in *Vandepitte* where recovery of the third party insured was not permitted. This situation arose recently before the High Court of Australia in *Trident General Insurance Co. Ltd.* v. *McNiece Bros.*[40] In that case a liability policy provided for an indemnity to the insured and "its contractors". A contractor who was not a party to the contract of insurance sought to enforce the indemnity. The insurance company argued that, in the absence of legislation, the rules of privity dictated that the third party had no claim. However, in a 4-3 decision, it was held that the rules of privity do not apply to a contract of liability insurance and the third party was entitled to sue on the contract.

This situation is now governed in Australia by section 48 of *The Insurance Contract Act* 1984. The dispute in *Trident* arose before the Act came into operation. Nevertheless, the decision is an important one. It indicates that the rules of privity are not immutable and the courts continue to exercise an inherent power to modify and create exceptions to them when commercial practice, common sense and the intention of the parties dictate.

2. A Note on Subrogation

Subrogation is a concept of insurance law which affects privity rules. It arises where an insurer has made payment to an insured to cover a loss that was caused by the wrongful act of a third party. Under subrogation, the insured is deemed to have assigned his or her right of action against the wrongdoer to the insurer. The insurer sues in the name of the insured to recoup the money paid out under the policy. Often it is a tort action which is subrogated to the insurer but it may be a contractual claim. In these circumstances, the privity rule is evaded because a third party is able to enforce rights arising from a contract to which he or she is not a party.

3. Standard Mortgage Clauses and Loss Payee Clauses

(a) Standard mortgage clause

It is a condition of most real estate mortgages that the mortgagor insures the property and that the insurance policy contains a standard mortgage clause. The standard mortgage clause obliges the insurer, in the case of loss, to pay the mortgagee to the extent of the mortgagor's indebtedness. In this way, both the mortgagor's and the mortgagee's interests are protected. This, of course, has every appearance of a contract (insurance policy) for the benefit of a third person (mortgagee). Not surprisingly, however, the courts have avoided the consequences dictated by the privity doctrine and have recognized the right of the mortgagee to enforce the mortgage clause.

In fact, beginning with *London and Midland Gen. Ins.* v. *Bonser*,[41] the courts have construed the standard mortgage clause as a distinct and separate contract between the insurer and the mortgagee to insure the mortgagee's interest in the mortgaged property. This policy is 'engrafted' on to the policy between the mortgagor and the insurer. This two contract analysis was applied in Manitoba[42] and British Columbia[43] and has been analyzed closely by the Alberta Court of Appeal in *National Bank of Canada* v. *Co-Operative Fire & Casualty Co.*[44] The Court

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[40] *Trident General Insurance Co. Ltd.* v. *McNiece Bros.* (1988), 165 C.L.R. 107 (H.C. of Aust.)

[41] *London and Midland Gen. Ins.* v. *Bonser* [1973] S.C.R. 10.

[42] *Royal Bank of Canada* v. *Red River Valley Mutual Insurance Co.* (1986), 42 Man. R. (2d) 124 (C.A.).

[43] *Canadian Imperial Bank of Commerce* v. *Insurance Corporation of Ireland Ltd.* (1990), 51 B.C.L.R. (2d) 341 (C.A.).

[44] *National Bank of Canada* v. *Co-Operative Fire & Casualty Co.* (1988), 53 D.L.R. (4th) 519 (Alta. C.A.).

sought to justify the separate contract analysis on the basis of an agency on the part of the mortgagor. Consideration could be found in the promise to advance the loan, in the promise not to call it or in the mutual covenants given by the insurer and mortgagee. However, once again, the universality of the practice, particularly in fire insurance policies, the economy and rationality in the use of one policy rather than two and commercial expedience dictate the enforceability of the clause. Recently, the two contract theory has been confirmed by the Supreme Court in *Caisse populaire de Deux Rives* v. *Société mutuelle d'assurance contre l'incendie de la Vallée du Richelieu*[45] and *National Bank of Greece (Canada)* v. *Katsikonouris*.[46] In the *Katsikonouris* case, the Court made it clear that the contract of insurance between the insurer and mortgagee was completely *independent* and therefore its validity was unaffected by misrepresentation, or breach of policy conditions committed by the mortgagor.

(b) Loss payee clause

A weaker version of the standard mortgage clause is the 'loss payee' clause. It is also designed to protect a lender by declaring that money payable on loss shall be paid to a creditor. However, this clause does not create a privity of contract between insurer and lender, and consequently the designated payee's rights depend upon the validity of the policy between borrower and insurer. Nevertheless the payee does have an enforceable right. This was recognized most recently in respect of a chattel mortgage on an automobile in *Trans Canada Credit Corp. Ltd.* v. *Royal Insurance Co. of Canada*.[47] The Court enforced the loss payee clause at the suit of the mortgagee on the grounds that the mortgagee was an appointee entitled as such to receive the benefit of the policy.

It is clear that many of the privity problems in the area of insurance law have been overcome by legislative or judicial action. Some may remain. There does not appear to be a legislative provision dealing with the situation that arose in *Trident General Insurance Co. Ltd.* v. *McNiece Bros*.[48] Some difficulties may arise in respect of first party property insurance. One example is a loss of chattels by fire or theft when the chattels are owned by members of a household who are within the definition of insured under the home-owner's or tenant's policy but are not named insureds in that policy. Strictly speaking, such persons are third parties to the contract of insurance and have no common law or statutory right to enforce the policy. There seems little doubt however that when these issues are resolved authoritatively, commercial practice and the reasonable expectations of the reasonable persons will be more persuasive than the formal privity doctrine.

II. RETAIL SALES OF GOODS AND SERVICES

The doctrine of privity has created some difficulties for the purchasers of retail goods and services. Some of these difficulties have, however, been overcome by judicial action and more recently by legislation.

The distribution of goods is achieved by a chain of contracts of sale which move the goods from manufacturer through wholesalers and distributors to retailers and finally to purchasers and other users of the product. Each sale is an independent transaction, the boundaries of which are drawn by the doctrine of privity. In each contract of sale, in the absence of an effective

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[45]*Caisse populaire de Deux Rives* v. *Société mutuelle d'assurance contre l'incendie de la Vallée du Richelieu* (1990), 74 D.L.R. (4th) 161 (S.C.C.).

[46]*National Bank of Greece (Canada)* v. *Katsikonouris* (1990), 74 D.L.R. (4th) 197 (S.C.C.).

[47]*Trans Canada Credit Corp. Ltd.* v. *Royal Insurance Co. of Canada* (1983), 149 D.L.R. (3d) 280 (N.S.S.C., App. Div.).

[48]*Trident General Insurance Co. Ltd.* v. *McNiece Bros*., *supra* n. 40.

exemption clause, the seller owes strict obligations in respect of the quality and safety of the goods. The problems arise in two ways. First, the modern consumer tends to rely less on promises and guarantees of the retailer and more on those of the manufacturer or distributor. A great deal of print and television advertising is provided by the manufacturer. Normally, however, the purchaser has no *contractual* claim against the manufacturer. A tort claim may be brought where negligence is the cause of a defect causing injury but there is no strict contractual liability. This is the problem of *vertical privity*. Secondly, the person who suffers loss as a result of defective or shoddy products may not be the purchaser. It may be a member of the purchaser's family or merely a user of the goods. Since he or she is not a party to the contract, he or she has no right to sue unless he or she can prove the negligence of one or more of the actors in the chain of distribution. This is the problem of *horizontal privity*.

The law has had more success in overcoming vertical privity than horizontal privity. This is not surprising since express promises and representations are being made and there is an expectation that they will influence people to buy the product. At common law, the courts have been receptive to arguments of collateral contracts, particularly in relation to consumer transactions. In *Murray* v. *Sperry Rand Corp.*,[49] the Court concluded that statements made by the manufacturer and the distributor in respect of a harvester were promissory in nature and created collateral contracts between both the manufacturer and the buyer, and the distributor and the buyer. Similarly, in *Hallmark Pool Corp.* v. *Storey*,[50] the manufacturer's guarantee of a swimming pool was construed as a collateral contract in spite of the fact that the defects were caused by improper installation by an authorized dealer. The device is a limited one requiring promissory intent and clear reliance by the purchaser but nevertheless gives some latitude to judges to ensure accountability for promotional statements by non-sellers. The device is not, however, likely to be as effective in respect of commercial relationships.[51]

Of much greater significance, however, is *The Business Practices Act* 1991[52] which, through a mélange of criminal sanctions, administrative controls and civil remedies, seeks to abate unfair business practices. Among the unfair business practices prohibited are misrepresentations made by *suppliers*. The Act contains a broad range of civil remedies including damages, rescission and price abatement to a consumer who is a party to a consumer transaction. These remedies are not available solely against a *seller*, however. The action may be brought against *suppliers* which include manufacturers, producers and distributors. This significantly diminishes vertical privity in consumer transactions. Lest there be any doubt on this point, section 4 states:

> Any of the unfair business practices described in sections 2 and 3 is an unfair business practice for the purposes of this Act, notwithstanding
>
> (a) that the unfair business practice is not directed at a specific consumer and does not occur in the course of or for the purposes of a specific consumer transaction but is directed to the public at large; and
>
> (b) that there is no privity of contract between the supplier and any specific consumer affected by the unfair business practice.

The Act does not address horizontal privity. The remedies are only available to a consumer who is a party to a consumer transaction, that is, a buyer.

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[49]*Murray* v. *Sperry Rand Corp.* (1979), 96 D.L.R. (3d) 113 (Ont. H.C.J.).

[50]*Hallmark Pool Corp.* v. *Storey* (1983), 144 D.L.R. (3d) 56 (N.B.C.A.).

[51]*Lambert* v. *Lewis (sub nom. Lexmead (Basingstoke) Ltd.* v. *Lewis*, [1982] A.C. 225 (H.L.).

[52]*The Business Practices Act*, C.C.S.M. c. B120.

I. INTERNATIONAL SALES OF GOODS: COMMERCIAL LETTERS OF CREDIT AND BILLS OF LADING

Two important exceptions to the doctrine of privity have been created to facilitate the international sale of goods. The first relates to the commercial letter of credit. It is a mechanism designed to assure an international seller that the price will be paid. It is a three party arrangement in which the buyer of goods instructs his or her bank to issue an irrevocable letter of credit in favour of the seller which guarantees payment when certain conditions, such as the delivery of goods, are satisfied. Comforted by this security, the seller ships the goods. The main difficulty in this arrangement relates to the seller's right to enforce the letter of credit against the bank. The consideration provided by the bank is not immediately apparent.

However, again commercial necessity has triumphed over formal rules and the courts have held that commercial letters of credit are, in the absence of fraud, enforceable against the bank.[53] Waddams has pointed out that a theoretical justification for this result can be found. He writes:

> . . . a court could find a collateral contract between the seller and the bank, for the seller's act (shipping the goods to the buyer in reliance on the bank's promise) could be said to benefit the bank indirectly, for its international credit business depends on maintaining its reputation and acceptability to sellers.[54]

However, such theoretical arguments are probably unnecessary in the face of the exigencies of international trade and commerce.

The second exception to privity relates to the operation of a bill of lading. It facilitates the international carriage of goods. It is both evidence of the contract of carriage (normally by sea) and a document of title to the goods. The bill of lading is initially between the seller of the goods (consignor) and the carrier. The third party to this arrangement is the consignee (the buyer). It is clearly convenient that the consignee be a party to the bill of lading when the bill of lading is endorsed to him or her. This is achieved in Canada by section 2 of the *Bills of Lading Act*. It states:

> Every consignee of goods named in a bill of lading, and every endorsee of a bill of lading to whom the property in the goods therein mentioned passes on or by reason of the consignment or endorsement, has and is vested with all rights of action and is subject to all liabilities in respect of those goods as if the contract contained in the bill of lading had been made with himself.[55]

This Act does not, however, extend to a *pledgee* of a bill of lading. However, when the pledgee takes delivery of the goods and pays any carriage charges, an implied contract arises between the pledgee and the carrier on the terms of the bill of lading. Such a contract was recognized in *Brandt* v. *Liverpool, Brazil & River Plate Steam Navigation Co. Ltd.*[56]

J. EXEMPTION CLAUSES AND THIRD PARTIES

A great deal of modern litigation has revolved around exemption clauses and whether such clauses protect third parties who, while not technically parties to the contract, are involved in the

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[53]*United City Merchants (Investments) Ltd.* v. *Royal Bank of Canada*, [1983] 1 A.C. 168 (H.L.); *W.J. Alan & Co. Ltd.* v. *El Nasr Export and Import Co.*, [1972] 2 Q.B. 189 (C.A.); *C.D.W. Research and Development Ltd.* v. *Bank of Nova Scotia* (1982), 136 D.L.R. (3d) 656 (Ont. H.C., Div. Ct.).

[54]Waddams, *supra* n. 15, at 212.

[55]*Bills of Lading Act*, R.S.C. 1985, c. B-5, s. 2.

[56]*Brandt* v. *Liverpool, Brazil & River Plate Steam Navigation Co. Ltd.*, [1924] 1 K.B. 575 (C.A.).

performance of it on behalf of a contracting party. The situation can arise when a person contracts with a company for certain services. The contract may contain a wide exemption clause protecting the company against any damage or loss howsoever caused. The service will no doubt be performed by employees, agents or independent contractors who may, through their negligence, cause loss or injury. In such circumstances, the plaintiff will not sue the company on the contract because, in light of the exemption clause, the claim will fail. A better course of action is to sue the employee, agent or independent contractor in *tort*. Of course, the servant will seek to shelter behind the exemption clause but strict application of the privity rules will deny that protection. He or she is a third party seeking to take advantage from a contractual relationship between the company and the plaintiff. The position is the same whether or not there are words in the exemption clause extending the protection to the employee or independent contractor.

However, increasingly courts are finding such results distasteful and are seeking to escape this conclusion. More and more judges are crafting exceptions to the privity rule to bring employees and independent contractors within the protection of the exemption clauses. However, the response of the courts continues to be very uneven and there are few reliable guidelines as to when the privity rules will be applied and when they will be evaded. Much of this unevenness is a consequence of contradictory policies within the law of contract. On the one hand, there is a strong policy in contract law against exemption clauses, particularly in relation to negligent conduct. Courts often seek to construe exemption clauses narrowly and minimize the protection given by them. This policy is strengthened by strict application of privity rules so that negligent people are held accountable for their conduct. On the other hand, exemption clauses in modern commercial relationships are often less about deterring negligence and more about the allocation of inevitable risks for the purposes of insurance. In such circumstances, there is a strong policy in favour of allowing the exemption clause a wide application and the development of some sort of principle of vicarious immunity. On another level, it may seem unfair that an employee can incur a liability which he or she has plainly not willingly assumed when his or her employer, who benefits from the profit making enterprise, enjoys an immunity from suit.

It is not surprising, therefore, to find some inconsistency in the cases on exemption clauses as various policies are pursued by different judges. The extent of the inroads into the privity principle will be described in relation to different categories of cases.

1. Bills of Lading and Negligent Stevedores

The issue of exemption clauses and third parties has arisen most often in recent years in respect of contracts for the carriage of goods by sea (bills of lading). This is perhaps not surprising because it presents a very strong argument for the avoidance of privity rules. Normally, in a bill of lading between the owner of goods (the consignor) and the carrier, there will be an exemption clause restricting the liability of the carrier for damage caused to the goods.[57] The limitation often reflects international rules for carriage of goods by sea (The Hague Rules) which limit a carrier's liability to $500 per package unless a greater value is declared. It is not uncommon for goods which have not been declared to have a greater value to be damaged in the process of unloading by the stevedores. In these circumstances, the owner (usually, at this time, it is the consignee of the goods) seeks to avoid the limitations in the bill of lading and sue the stevedores in negligence. The stevedores will claim the protection of the bill of lading. Two of the conflicting policies mentioned earlier are at play in these cases. To protect the stevedores by creating an exception to privity forgives their poor conduct and fails to deter future conduct of a similar nature. On the other hand, to leave them exposed to liability upsets the allocation of risk under the bill of lading which dictates the pattern of insurance for goods in transit. Since

[57]This exemption will also bind the consignee of the goods.

double insurance is needlessly expensive and because the owner is the best person to know the value of the goods, the contract of carriage leaves the primary responsibility for insurance with the owner unless he or she declares a greater value. If a declaration is made, the carrier, for a suitable fee, insures the goods. If this insurance pattern can be ripped open by tort action, the stevedores must secure liability insurance, the costs of which will eventually be reflected in increased transport costs.

In the first of a long line of cases on this issue, the House of Lords in *Midland Silicones Ltd.* v. *Scruttons Ltd.*[58] upheld the rules of privity and imposed liability on the stevedores. The Supreme Court took the same position in *Canadian General Electric Co. Ltd.* v. *Pickford & Black Ltd.*.[59]

However, in the mid-seventies, the Privy Council, in a majority judgment delivered by Lord Wilberforce, exploited an *obiter* statement of Lord Reid in *Midland Silicones*. The statement suggested that an exception to the privity rule might be crafted with the help of agency theory where the exemption clause expressly sought to protect stevedores (the Himalaya clause). The case was *New Zealand Shipping Co. Ltd.* v. *A.M. Satterthwaite & Co.*[60] The facts were strong. The clause expressly sought to protect stevedores and there was an existing agency relationship between carrier and stevedore. In essence, the argument adopted by Lord Wilberforce was that the bill of lading by the use of clear words contained an offer of immunity. The offer was made by the owner to the stevedore through the *agency* of the carrier. The stevedore accepted the offer by unloading the goods, thereby supplying the necessary consideration. This created a collateral unilateral contract with the stevedore and overcame privity problems.[61] This analysis, while admirable in its legal ingenuity, is very artificial and has the potential for uneven application because of differences in the language of bills of lading and the different relationships between carriers and stevedores. A period of inconsistency[62] ended with another Privy Council judgment in *Port Jackson Stevedoring Pty Ltd.* v. *Salmond & Spraggon Aust. Pty Ltd.*[63] In that case, Lord Wilberforce discouraged the search for "fine distinctions" which would "diminish the general applicability, in the light of established commercial practice, of the decision."[64] The Supreme Court has recently adopted that approach in *ITO - International Terminal Operators Ltd.* v. *Miida Electronics Inc.*[65] The Court stressed that commercial reality was more important than contractual theory and that commercial circles clearly favoured protection being extended to the stevedores. It is now clear that a fairly generous exception has been carved in the privity rules in respect of Himalaya clauses in

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[58]*Midland Silicones Ltd.* v. *Scruttons Ltd.*, [1962] A.C. 446 (H.L.).

[59]*Canadian General Electric Co. Ltd.* v. *Pickford & Black Ltd.* (1971), 14 D.L.R. (3d) 372 (S.C.C.).

[60]*New Zealand Shipping Co. Ltd.* v. *A.M. Satterthwaite & Co.*, [1975] A.C. 154 (P.C.)

[61]For a discussion of the case see F. Dawson, "Himalaya Clauses, Consideration Privity of Contract" (1974), 6 N.Z. U.L.R. 161; F.D. Rose, "Return to Elder Dempster" (1975), 4 Anglo-Am. L. Rev. 7; W. Tetley, The Himalaya Clause - Heresy or Genius? (1977-78), 9 J. Maritime L. & Com. 111; S.M. Waddams, "Contracts - Carriage of Goods - Exemptions for the Benefit of Third Parties" (1977), 55 Can. Bar Rev. 327.

[62]See *Calkins & Burke Ltd.* v. *Far Eastern Steamship Co.* (1976), 72 D.L.R. (3d) 625 (B.C.S.C.); *Eisen & Metall A.G.* v. *Ceres Stevedoring Co. Ltd. & Canadian Overseas Shipping Ltd.* [1977] 1 Ll L.R. 665 (Que. C.A.); *Marubeni America Corp.* v. *Mitsui OSK Lines Ltd.* (1979), 96 D.L.R. (3d) 518 (Fed. Ct., Trial Div.); *Herrick* v. *Leonard & Dingley Ltd.*, [1975] 2 N.Z.L.R. 567. See also P.H. Clarke, "The Reception of the Eurymedon Decision in Australia, Canada and New Zealand" (1980), 29 Int. Comp. L.Q. 132; J.L.R. Davis, "Midland Silicones Refulgent" (1977) 40 Mod. L.R. 709; G. Battersby, "Exemption Clauses and Third Parties - Recent Decisions" (1978), 28, U.T.L.J. 75.

[63]*Port Jackson Stevedoring Pty Ltd.* v. *Salmond & Spraggon Aust. Pty Ltd.*, [1981] 1 W.L.R. 138 (P.C.).

[64]*Id.*. at 144. For a discussion of the case see F.M.B. Reynolds "Again the Negligent Stevedore" (1979), 95 L.Q.R. 183; F.D. Rose "Return to the Antipodes" (1981), 44 Mod. L.R. 336; M. Tedeschi, "Consideration, Privity and Exemption Clauses"; *Port Jackson Stevedoring Pty. Ltd.* v. *Salmond & Spraggon (Australia) Pty. Ltd.* (1981), 55 Aust. L.J. 876.

[65]*ITO - International Terminal Operators Ltd.* v. *Miida Electronics Inc.* (1986), 28 D.L.R. (4th) 641 (S.C.C.).

contracts for the carriage of goods by sea. There seems to be no reason why this will not be extended to other contracts of carriage.

2. Personal Injuries and Waiver Clauses

Similar problems arise when the negligence of a servant or independent contractor causes personal injury through negligence in the performance of their employer's contract. There is good reason in this situation for applying privity rules strictly. First party insurance for personal injury is uncommon, expensive and possibly unavailable. There is, therefore, sympathy for an innocent victim against a negligent person and a desire to find some compensation for the injuries suffered. The employee may have liability insurance or the employee may pay the judgment. These policies seem to have been influential in the early cases. The most famous of these is *Adler* v. *Dickson*.[66] Mrs. Adler purchased a ticket for passage on the ship 'The Himalaya'. The ticket contained a non-responsibility clause in favour of the shipping company. She was injured when a gangway fell and she was thrown 16 feet onto the wharf. She successfully avoided the contractual exemption by suing the captain of the ship in negligence. The same result was reached in respect of a contract of carriage of a person in *Gore* v. *Van der Lann*.[67] However, both these cases were decided before *New Zealand Shipping Co.* v. *A.M. Satterthwaite & Co.*.[68] The most important case to be decided since that time is the Manitoba case of *Dyck* v. *Manitoba Snowmobile Association*.[69] In that case Dyck contracted with the Manitoba Snowmobile Association to participate in a snowmobile race. The contract contained a wide waiver clause which sought to exempt the Association and its servants and agents from liability in negligence. Dyck was seriously injured by the negligence of a servant of the Association and he sued the servant in tort. Perhaps surprisingly, the Manitoba Court of Appeal held that the servant was covered by the clause. The Court of Appeal applied the agency reasoning from *Satterthwaite*. The clause expressly extended its protection to the servant and could therefore be construed as an offer of immunity from the plaintiff to the servant. The Association was the agent of the servant and the latter supplied consideration by performing his duties. An appeal to the Supreme Court was dismissed without extensive discussion of the point.[70] The case has been subjected to severe criticism[71] for its apparently unreflective application of the reasoning in the bills of lading cases without consideration of the different context, patterns of insurance and nature of the loss. Nevertheless, the case indicates further expansion of the inroads to the privity doctrine sparked by *Satterthwaite*.

3. Insurance Arrangements and Employees

A vivid example of the unfortunate consequences of the strict application of the privity rule is provided by the Supreme Court decision in *Greenwood Shopping Plaza Ltd.* v. *Beattie*.[72] In that case, the lessor of business premises promised the tenant that it would insure the premises against fire and that it would arrange that the insurer would have no rights of subrogation against

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[66] *Adler* v. *Dickson*, [1955] 1 Q.B. 158 (C.A.).

[67] *Gore* v. *Van der Lann*, [1967] 2 Q.B. 31 (C.A.).

[68] *New Zealand Shipping Co.* v. *A.M. Satterthwaite & Co.*, *supra* n. 60.

[69] *Dyck* v. *Manitoba Snowmobile Association* (1982), 136 D.L.R. (3d) 11 (Man. C.A.) affm'd (1985), 18 D.L.R. (4th) 635 (S.C.C.).

[70] *Id.*

[71] D. Vaver, "Developments in Contract Law, The 1984-85 Term" (1986), 8 S.C.L.R. 109 at 124.

[72] *Greenwood Shopping Plaza Ltd.* v. *Beattie*, *supra* n. 20.

the tenant. A loss by fire occurred as a result of the negligence of two employees of the tenant. The key issue was whether the provisions of the tenancy protected the *employees* from liability. Technically speaking, they were not parties to the lease and were not therefore protected. The Nova Scotia Court of Appeal[73] took the position that the employees were protected by the terms of the tenancy. McKeighan C.J.N.S. stated that to hold otherwise was to ". . . fly in the face of common sense, modern commercial practice and labour relations."[74]

In the Court's view, the tenancy impliedly promised the employees the same protection as that given to the tenant and that, for the purposes of liability, the employees must be *identified* with their employers. However, the Supreme Court in a very formalistic judgment asserted strict privity rules. The Court stated:

> There have been many attempts to break out of the rigid mould imposed by the concept of privity and some statutory relief has been provided in special cases *but the concept remains one of general application.*[75]

The employees were not parties to the lease and, unless they could bring themselves within one of the recognized exceptions of trust or agency, they were liable for the consequences of their negligence. The Court held that there was insufficient evidence of an intention to create a trust and there was no indication that the lessor and tenant had abandoned their contractual power to vary their lease without the consent of the employees; both crucial elements of a trust. Similarly, there was insufficient evidence to support the agency theory used in *Satterthwaite*. The problems were the lack of a distinct promise in favour of the employees and the failure to prove an agency between employer and employees. The case is a hard one and is incompatible with the tone and approach of *ITO - International Terminal Operators Ltd.* v. *Miida Electronics Inc.*[76] where the Court took the view that commercial reality and pragmatism were more important than formalistic reasoning.

It is not surprising therefore that some subsequent courts have been reluctant to follow the decision. A good example is *L. & B. Construction Ltd.* v. *Northern Canada Power Commission.*[77] In that case a contract was entered into between the owner of a transformer and L. & B. Construction. The contract called for the transformer to be lifted from a barge to a trailer and then from the trailer to its final resting place. It was understood that cranes would be supplied by a third company. During the contractual negotiations, it was made quite clear that the owner would insure the transformer against loss and damage. The transformer was damaged as a result of negligence and the question arose as to the liability of the employees of L. & B. Construction, the crane company and its employees, all technically third parties to the main contract. In this case, Marshall J. found that the agency exception utilized by Lord Wilberforce in *Satterthwaite* was established. The contract made it clear that all those involved in lifting the crane were to be protected by the insurance provisions of the contract. L. & B. Construction acted as agent for the others involved and had authority to act for them. In performing their appointed tasks, consideration was provided. His Lordship was also willing to support this result on the basis that the owner had assumed the risk of damage to the transformer and that his tort claim was defeated by the defence of *volenti non fit injuria*. The result appears to be fair. All parties assumed that the transformer was at the owner's risk. Furthermore, single insurance is economical and that will be reflected in a reduced cost of the service.

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[73] *Greenwood Shopping Plaza Ltd.* v. *Neil J. Buchanan Ltd.* (1979), 99 D.L.R. (3d) 289 (N.S.S.C., App. Div.).

[74] *Id.*

[75] *Greenwood Shopping Plaza Ltd.* v. *Beattie*, *supra* n. 20, at 263 [emphasis added].

[76] *ITO - International Terminal Operators Ltd.* v. *Miida Electronics Inc.*, *supra* n. 65.

[77] *L. & B. Construction Ltd.* v. *Northen Canada Power Commission*, [1984] 6 W.W.R. 598 (N.W.T.S.C.).

A similar result to *L. & B. Construction* has been achieved in England by different reasoning in *Norwich City Council* v. *Harvey*.[78] In that case the plaintiff employed the main contractor to make extensions to his swimming pool complex. The contract placed the risk of fire loss on the plaintiff who undertook to place appropriate insurance. Roofing work was subcontracted to the second defendants on the same terms and conditions as those in the main contract. An employee of the subcontractor (the first defendant) negligently caused a fire which damaged the existing complex and the extension. The defendants were held not liable. The decision was based however on a finding that the defendants did not owe the plaintiff a duty of care - an essential component of the tort action of negligence. This finding is, of course, only explicable on the basis of the main contract and the arrangements about risk and insurance in that contract. The effect of the use of tort concepts is to avoid the privity rules. Indirectly, the provision of a contract has protected a third party from liability.

4. Professional Employees

A similar issue came before the Manitoba Court of Appeal recently in relation to a professional employee. The case is *Moss* v. *Richardson Greenshields of Canada Ltd.*[79] The contract was between an experienced investor and a brokerage firm. It anticipated the trading of option contracts on the Chicago Board of Options Exchange. The contract contained an exemption clause protecting the firm from all liability unless gross negligence was proved. One of the issues dealt with by the Court was whether or not the employee broker who dealt with the plaintiff was protected by the clause. The Court of Appeal held that the broker was not liable on the grounds that he owed no duty of care to the plaintiff. The Court accepted that the employee was not a party to the contract. Nevertheless, because the contract was with the firm and the essence of the plaintiff's complaint was a breach of that contract, there was no "independent cause of action" against the employee. The Court distinguished *Scruttons* v. *Midland Silicones Ltd.*[80] and *Greenwood Shopping Plaza Ltd.* v. *Beattie*[81] on the grounds that the contractors and employees in those cases owed a general duty to take care in their activities "independent from the contract". Huband J.A. for the majority stated:

> In this case [the employee's] acts or omissions related solely to the work he was doing as an employee . . . no one else was or could be affected. The contract . . . became the foundation of the working relationship under which [the employee] performed his function. When [the plaintiff and firm] framed a contractual relationship it must have been in contemplation of [the employee] performing the activities called for under the agreement. The duty of care which [the plaintiff] contends was breached was [the employee's] duty in performance of the contract and not some more general duty existing beyond the contract.[82]

5. Storage of Goods and Employees

Canadian courts have recently been confronted with cases involving the liability of third parties in relation to contracts between owners and warehousemen for the storage of goods. These contracts normally contain wide exemption clauses allocating most of the risk of loss or

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[78]*Norwich City Council* v. *Harvey*, [1989] 1 W.L.R. 828 (C.A.). For a similar case with similar reasoning see *Southern Water Authority* v. *Carey*, [1985] 2 All E.R. 1077 (Q.B.D.).

[79]*Moss* v. *Richardson Greenshields of Canada Ltd.*, *supra* n. 58.

[80]*Midland Silicones Ltd.* v. *Scruttons Ltd.*, *supra* n. 58.

[81]*Greenwood Shopping Plaza Ltd.* v. *Beattie*, *supra* n. 20.

[82]*Moss* v. *Richardson Greenshields of Canada Ltd.*, *supra* n. 79, at 57.

damage to the owner of the goods. This arrangement anticipates that the owner of the goods will maintain insurance and the expense of double insurance will be avoided. If, for some reason, the owner is not insured, he or she may request the warehouseman to secure it for him or her at additional cost. In lieu of such an arrangement, the risk is predominantly on the owner. When goods are damaged by the employees, the issue of third party liability in tort again arises. This was the situation in the leading case of *London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.*[83] The plaintiff delivered a transformer for storage. The contract for storage limited the liability of Kuehne and Nagel to $40. The plaintiff was told of the limitation and informed that insurance through Kuehne & Nagel was available. The plaintiff, however, preferred to rely on his own insurance. In due course, the transformer suffered almost $34,000 in damage because of the negligence of employees. Clearly the case raises similar policy considerations to the stevedoring cases. However, there were impediments to the application of the agency theory utilized in *Satterthwaite*. There was no express provision in the contract that employees were to receive the protection of the exemption clause and the contract did not describe the employer as an agent for the employees.

Nevertheless, a majority of the British Columbia Court of Appeal held that the employees were protected by the terms of the exemption clause and that their liability was limited to $40. In spite of impediments already mentioned, Lambert J.A. applied an agency theory. It was his view that the clause *impliedly* extended protection to the employees and an agency relationship could be *inferred* from the surrounding circumstances. The three other judges in the majority relied on tort principles. McEachern C.J. and Wallace J.A. held that only a limited duty of care was owed and that tort liability was restricted to $40. Hinkson J.A. held that no duty of care was owed.[84] While the reasoning of the judges is diverse, it does not conceal a desire to uphold a sensible allocation of risk made by the contract. In their view, it would be unreasonable to impose an extensive liability on employees when the owner has fully accepted the risk of loss over $40 and has given a generous exemption to the employer.

The plaintiff appealed unsuccessfully to the Supreme Court.[85] The majority judgment was delivered by Iacobucci J. His Lordship preferred to decide the case on contractual principles. He supported an 'incremental relaxation' of the privity rule to extend the protection of the contractual exemption to the third party employees. His Lordship pointed to the 'identity of interest' between the employer and employees when, to the knowledge of the contracting parties, employees perform the contractual obligations of their employer. There was, in his opinion, no valid reason to allow the plaintiff to evade the contractual limitation by suing the employees in tort. Such a result would defeat the allocation of risk deliberately made by the contracting parties and would defeat the reasonable expectations of all involved. In particular, his Lordship held that employees are entitled to the benefit of a limitation of liability clause in a contract between the employer and the plaintiff if two conditions are met:

(1) the clause must either expressly or impliedly extend its benefit to the employee or employees seeking to rely on it; and

(2) the employee or employees seeking the benefit of the clause must have been acting in the course of their employment and have been performing the very services provided for in the contract when the loss occurred.

Only the first requirement gave his Lordship pause. The contract gave protection to the warehouseman which could be taken as a reference to Kuehne and Nagel alone. However, in his

[83] *London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.* (1990), 70 D.L.R. (4th) 51 (B.C.C.A.).

[84] *Id.*, Southin J.A. dissenting.

[85] *London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.*, *supra* n. 20.

Lordship's view, in the light of all the circumstances, including the nature of the employment relationship, the identity of interest in respect to the contractual obligation, the knowledge of the plaintiff that employees would perform the contractual obligations and the absence of a clear indication to the contrary, 'warehouseman' must be interpreted as including the employees as unexpressed or implicit third party beneficiaries. The two conditions being met, the new exception to the doctrine of privity was satisfied.

Two other judgments were delivered in favour of the respondent employees. Both approach the question on tort principles. McLachlin J. took the position that the negligence claim failed because the plaintiff had consented to the risk of damage in excess of $40. La Forest J. held that the employees owed the plaintiff no duty of care. The Court was unanimous in the result.

It is clear from the case that there is a great deal of dissatisfaction with the privity doctrine in relation to exemption clauses and the liability of those actually performing the contract on behalf of the contracting party. The weight of authority is in favour of extending the protection the contracting party enjoys to independent contractors, agents and employees. This result has been achieved in a variety of ways. The agency theory has been used where the exemption clause expressly provides that third parties are to be protected. More difficulty and greater inconsistency of analysis has occurred when the clause does not expressly extend its protection to third parties. Various techniques have been used including "no duty of care", a 'limited' duty of care, the *volenti* argument and the doctrine of "identification". The recent Supreme Court decision in *London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.*[86] signals a greater willingness to openly craft limited exceptions to privity rules where commercial expedience, the intention of the parties and common sense dictate. This willingness to extend protection in situations where no express provision is made for employees and others involved in performance of the contract is an important one because it may indicate a gradual emergence of a doctrine of vicarious immunity similar to that expressed by Scrutton L.J. in *Mersey Shipping and Transport Co. Ltd.* v. *Rea Ltd.* who said: "Where there is a contract which contains an exemption clause the servants or agents who act under that contract have the benefit of the exemption clause."[87] In many circumstances, this is a fair and reasonable view.

K. BAILMENT

There is an important principle of bailment which is an exception to privity of contract. It was established in the case of *Morris* v. *C.W. Martin & Sons Ltd.*[88] In that case the owner of a fur stole (the bailor) sent it to a furrier (the bailee) to be cleaned. The furrier was not equipped to clean furs so he sought and received the bailor's permission to send it to the defendant (sub-bailee) for cleaning. One of the issues was whether or not words of exemption in the contract between the bailee and the sub-bailee protected the latter in respect of a claim by the owner for loss of the fur. Denning M.R. concluded that the sub-bailee was protected. He stated:

> Now comes the question: can the defendants rely, as against the plaintiff, on the exempting conditions although there was no contract directly between them and her? There is much to be said on each side. On the one hand, it is hard on the plaintiff if her just claim is defeated by exempting conditions of which she knew nothing and to which she was not a party. On the other hand, it is hard on the defendants if they are held liable to a greater responsibility than they agreed to undertake. . . . The answer to the problem lies, I think, in this: the owner is bound by the conditions

[86] *London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.*, *supra* n. 20.

[87] *Mersey Shipping and Transport Co. Ltd.* v. *Rea Ktd*, (1925), 21 L.L.L.R. 375 at 378 (Div. Ct., K.B.). See also *London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.*, *supra* n. 20, per La Forest J.

[88] *Morris* v. *C.W. Martin & Sons Ltd.*, [1966] 1 Q.B. 716 (C.A.).

> if he has expressly or impliedly consented to the bailee making a sub-bailment containing those conditions but not otherwise.[89]

In the case, it was held that the bailor did consent to the bailee making a contract to have it cleaned on the usual terms of the defendant.[90]

It is debatable whether this case represents a departure from the rule preventing third parties from enforcing contracts made for their benefit. From one point of view, the bailor is *burdened* by the exemption clause in the contract of sub-bailment. From another point of view, the sub-bailee is benefiting from the contract between bailor and bailee. From any point of view, however, commercial expedience is clearly more influential than formal rules.

L. TORT LAW

It is a feature of the common law that some of the rigid positions adopted by contract law have been ameliorated by a more flexible law of tort. This has been so in respect of the privity rules and the tort of negligence. This century has witnessed an enormous expansion in the range of the duty of care in negligence. This expansion has indirectly broken down privity rules because the courts have been willing to hold that duties of care arising in a contractual relationship may be owed to third parties. The obligation is one of reasonable care but, nevertheless, the erosion of privity of contract has been substantial. The full story cannot be told here but the significant steps in the development are described.

1. *Donoghue* v. *Stevenson*[91]

The development began with the erosion of privity rules in respect of the distribution of manufactured goods. In the 19th century, the manufacturer (or repairer) of goods owed contractual obligations relating to the safety and quality of goods to the purchaser but that liability was circumscribed by the rules of privity. There was no liability to third parties injured by the use of a carelessly manufactured chattel. All this changed in 1932 with the decision of the House of Lords in *Donoghue* v. *Stevenson*.[92]» In that case the manufacturer of a defective product was held to owe a duty of care to a non-purchasing user of the product. This duty, anchored in tort law and based on the notion of foreseeability of harm, is unrestrained by the discrete contractual links separating the manufacturer and purchaser. The duty expanded quickly to all manner of defendants providing products and services within the community without reference to individualized contractual arrangements. The duty was, until 1965, largely restricted to the avoidance of personal injury and property damage.

[89] *Id.*, at 729.

[90] See also, *Johnson Matthey Ltd.* v. *Constantine Terminals*, [1976] 2 Lloyd's Rep. 215 (Q.B.). where Donaldson J. extended the principle by holding that the bailor is bound by any terms which constitute the consideration upon which the sub-bailee accepted the goods irrespective of the bailor's consent. In *Singer Co. U.K. Ltd.* v. *Tees and Hartlepool Port Authority*, [1988] 2 Lloyd's Rep. 164 (Q.B.), Steyn J. endorsed Denning M.R.'s view.

[91] *Donoghue* v. *Stevenson*, [1932] A.C. 562 (H.L.).

[92] *Id.*

2. *Hedley Byrne & Co.* v. *Heller & Partners*[93]

In 1965, the House of Lords in *Hedley Byrne & Co.* v. *Heller & Partners*[94]» extended the duty of care to some circumstances in which representations caused economic loss. Liability may be imposed when a defendant with special skill and knowledge negligently provides erroneous information or advice to a person who relies on that information to his or her financial detriment. Financial losses had hitherto been the exclusive preserve of contract law and further intrusion into privity rules was inevitable. Information and advice that is provided by A to B under a contract may be passed on and relied on by C. The extension of duty in *Hedley Byrne* encouraged C to sue A in tort. This situation arose in the Supreme Court in *Haig* v. *Bamford*.[95] An accounting firm provided audited financial reports to its corporate client. The client showed the reports to a private investor to secure equity investment. The reports were prepared negligently and consequently portrayed a false picture of the economic viability of the company. The Court held that a duty is owed to a known, ascertainable and limited class of person if the speaker knows that the information will be relied on for a particular purpose. Since the defendant knew that the report would be relied on by a 'private investor' for the purpose of equity investment, liability was imposed. In these circumstances, the plaintiff is, in essence, a third party beneficiary to the contract of accounting services.

3. Negligent Performance of a Contract for Services

Hedley Byrne & Co. v. *Heller & Partners*[96] encouraged and supported a series of subsequent decisions which recognized that, in certain circumstances, economic loss caused by *negligent actions* is recoverable. This created a potential of liability to third parties where a contract of services is performed negligently. A useful illustration of this development is found in the 'negligently prepared wills' cases. Actions have been brought by disappointed beneficiaries[97] against solicitors for loss caused when a will fails because of the solicitor's negligence. In these circumstances, the disappointed beneficiary is clearly a third party beneficiary to the contract between testator and solicitor. His or her claim would not be enforceable in contract law.

4. Product Quality Claims

There is, of course, no impediment to a tort claim against the producer of a chattel or building where negligent construction has caused personal injury or property damage external to the building or chattel itself. This is a straightforward claim within *Donoghue* v. *Stevenson*.[98] Much greater difficulty arises where the complaint of a second purchaser (who has no contract with the builder or manufacturer) is that negligence has produced an inferior or shoddy product which has caused economic loss such as the cost of repairs or the diminution in value of the product. The plaintiff is, in essence, trying to establish a transmissible warranty of quality under the guise of tort liability. The recognition of these claims would be a major breach of privity rules.

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[93] *Hedley Byrne & Co.* v. *Heller & Partners*, [1964] A.C. 465 (H.L.).

[94] *Id.*

[95] *Haig* v. *Bamford* (1976), 72 D.L.R. (3d) 68 (S.C.C.). See also *Caparo Industries Plc* v. *Dickman*, [1990] 1 All E.R. 568 (H.L.).

[96] *Hedley Byrne & Co.* v. *Heller & Partners*, *supra* n. 93.

[97] *Whittingham* v. *Crease & Co.* (1978), 88 D.L.R. (3d) 353 (B.C.S.C.); *Ross* v. *Caunters* [1979] 3 All E.R. 580 (Ch. Div.).

[98] *Donoghue* v. *Stevenson*, *supra* n. 91.

The response of Canadian courts has been quite consistent in respect of chattels. They have refused to recognize product quality claims in tort. The remedy for the plaintiff is to sue the seller in contract, not the manufacturer in tort.[99]

The situation in respect of poorly constructed buildings is less clear. Initially, courts were receptive to these claims, at least where the repairs were undertaken to remove danger and the threat of injury. Such a claim was indirectly recognized in *Anns* v. *Merton London Borough Council*.[100] The House of Lords went even further in *Junior Books Ltd.* v. *Veitchi Ltd.*[101] The owner employed the main contractor to build a factory. The main contractor hired a sub-contractor to lay the floor. The floor proved defective and it had to be replaced. The floor was not dangerous, it was just substandard. The House of Lords allowed the owner to sue the sub-contractor in tort. This permits a third party beneficiary (the owner) to sue on a contract to which he or she is not a party (the sub-contract). However, recently the English House of Lords[102] has repudiated these views and refused *all* product quality claims, even those where the claim is for repairs necessitated to abate danger. The position in Canada is unclear. There has been some sympathy for the position taken in *Anns* and the courts have allowed plaintiffs to recover the cost of repairs from municipalities where, through negligence, the municipality has failed to prevent substandard and *dangerous* construction to take place.[103] If one permits a claim against the municipality, it is difficult to deny the accountability of the builder who is the primary cause of the defective premises. Consequently, a product quality claim by a second purchaser against the builder of dangerous premises for the cost of necessary repairs to abate the danger may well be recognized by the Supreme Court. However, the most recent decision on this issue is not encouraging. In *Winnipeg Condominium Corporation No. 36* v. *Bird Construction Co. Ltd.*,[104] the Manitoba Court of Appeal held that the general contractor of a condominium building did not owe a duty of care to the second owner in respect of the cost of repairs necessitated by a dangerous latent defect in the building.

This summary of exceptions to the doctrine of privity indicates that, in the battle between theory and practice, practice has, to a large extent, been the victor. The erosion of the rule of privity has been substantial and many of the less fortunate consequences of the rule have been overcome by judicial and legislative activity.

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[99] *Rivtow Marine Ltd.* v. *Washington Iron Works*, [1973] 6 W.W.R. 692 (S.C.C.).

[100] *Anns* v. *Merton London Borough Council*, [1978] A.C. 728 (H.L.). It was directly recognized in *Dutton* v. *Bognor Regis United Building Co.*, [1972] 1 All E.R. 462 (C.A.) and *Bowen* v. *Paramount Builders*, [1977] 1 N.Z.L.R. 394 (C.A.).

[101] *Junior Books Ltd.* v. *Veitchi Ltd.*, [1983] 1 A.C. 520 (H.L.).

[102] *Murphy* v. *Brentwood District Council*, [1990] 2 All E.R. 908 (H.L.). See also *D & F Estates* v. *Church Commissioners of England*, [1988] 2 All E.R. 992 (H.L.).

[103] *Kamloops* v. *Nielsen*, [1984] 2 S.C.R. 2 and *Manolakos* v. *Gohman* (1990), 1 C.C.L.T. (2d) 233 (S.C.C.).

[104] *Winnipeg Condominium Corporation No. 36* v. *Bird Construction Co. Ltd.* (1993), 15 C.C.L.T. (2d) 1 (Man. C.A.).

CHAPTER 4

THE NEED FOR REFORM

It is the view of the Commission that the rule of contract law preventing third party beneficiaries from enforcing the contract is no longer appropriate in Manitoba. We recognize that much of the injustice flowing from the privity rule has been overcome by legislative and judicial activity. Nevertheless, it is time to simplify and rationalize the law to permit just solutions to be achieved by simpler and more direct means. There are strong reasons in favour of such a step. The enforcement of third party beneficiary rights will protect and enhance the integrity of contract as a legal and social phenomenon. It will implement the will of the contracting parties. It will protect and fulfil the reasonable expectations of the promisee and the third party. It will prevent the unjust enrichment of a promisor who takes the benefit of a contract but refuses to honour his or her promise in favour of the beneficiary. Furthermore, direct enforcement of third party rights will avoid a great deal of legal and commercial inconvenience, uncertainty, complexity and unpredictability which is unavoidable when the exceptions seem greater in aggregate than the privity rule.

The Commission does, however, recognize that there are arguments in favour of the status quo. No rule that has stood for well over one hundred years is bereft of reason. There are three reasons which are worthy of serious consideration. The first argument is based on the fact that the third party beneficiary is the recipient of a gratuitous promise on which he or she may not have placed any reliance. It is said that the enforceability of such a promise would be incompatible with a law of contract which, because of the doctrine of consideration, only enforces bought promises (bargains). If the third party is given a contractual right to enforce a gratuitous promise, how can that right be denied other gratuitous promisees who are not in a tripartite arrangement? In essence there is no good reason to give third party beneficiaries preferential treatment in the context of contract law. One rejoinder to this point is that a promise to a third party beneficiary can only be seen as gratuitous if one divorces it from its context and source. Clearly, value has been given for the promise - albeit by the contracting party. Enforcement would recognize this reality and that both the promisee and the third party have a legitimate interest in the performance of the promise. Secondly, there is support for the current rule on the basis of certainty and predictability. It is argued, in particular, that there is no appropriate substitute for privity rules which would contain contractual liability within appropriate and certain boundaries. Special concern is expressed in respect of potential liability to those who expect to secure incidental or collateral benefits from the performance of a contract between others. A common example is a homeowner whose property is likely to increase in value from the construction of a very expensive home on adjoining land. There is no doubt that substitute control devices must be developed to prevent the homeowner from suing the builder in respect of non-performance of the construction contract. However, we are not convinced that these problems cannot be resolved fairly. Consequently, they do not provide a cogent excuse to maintain the privity rule. Thirdly, it is argued that third party rights ought not to be recognized because such a step would be inconsistent with the basic principle that a contract may be varied or terminated at the will of the contracting parties. Clearly, meaningful protection of third party rights necessitates some restriction on the power of contracting parties to alter their contract. However, a reasonable balancing of interests between those of the contracting parties and that of

the third party is not beyond reach, and certainly does not raise such intractable problems as to justify the retention of an unjust rule. Our conclusion is that while these arguments raise valid concerns which must be addressed, they are insufficient singly and collectively to justify the privity rule.

Our view that the time is ripe for legislative reform of the doctrine of privity receives considerable support from the Supreme Court in its recent decision in *London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.*[1] The Supreme Court canvassed the criticism that has been levelled at the privity rule, acknowledged the calls for reform made by other law reform agencies and surveyed reforms in other jurisdictions. The Court spoke sympathetically of the need for reform. Indeed, La Forest J. went so far as to describe the doctrine of privity as 'pestilential'.[2] Nonetheless, the Court made it clear that, despite strong reservations about the current law, it was not appropriate for the courts to embark on major reform or abolition of the privity rule. The Court recognized an obligation to ameliorate injustice by the incremental relaxation of privity rules in particular cases but major revision of the law must be left to the Legislature. Indeed, New Brunswick has already commenced that process with the first reading of the *Law Reform Act*.

Consequently, we turn to a consideration of the law in those jurisdictions which have instituted reform of the privity rule in order to identify issues which must be addressed and the shape of possible solutions.

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[1]*London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.* (1992), 97 D.L.R. (4th) 261 (S.C.C.), per Iacobbuci J.

[2]*Id.*, per La Forest J., at 266.

CHAPTER 5

RECOGNITION OF THIRD PARTY RIGHTS IN OTHER JURISDICTIONS

Our examination of the law of those jurisdictions that have recognized third party rights will focus on the three key issues that must be addressed in any reform. The first is the definition of the scope of the legislation by describing the circumstances in which third party rights will be recognized. The second is the extent to which the contracting parties ought to retain control of the contract and have power to vary or terminate the third party's benefit. The third is the extent to which a promisor may assert defences to a claim by a third party. Each issue raises difficult questions to which different answers have been given.

A. AUSTRALIA

Two states in Australia, Western Australia and Queensland, have given statutory recognition to third party beneficiary rights. Both states were heavily influenced by the English Law Revision Committee *Sixth Interim Report (Statute of Frauds and Doctrine of Consideration)* 1937. The Committee recommended:

> Where a contract by its express terms purports to confer a benefit directly on a third party, it shall be enforceable by the third party in his own name subject to any defences that would have been valid between the contracting parties. Unless the contract otherwise provides, it may be cancelled by the mutual consent of the contracting parties at any time before the third party has adopted it expressly or by conduct.

It will be noted that the three key issues are addressed. Enforceable rights are restricted to those on whom a benefit is directly conferred by the express terms of the contract; those rights are indefeasible without the beneficiary's consent after *adoption* of the contract by the third party; and the third party's rights are subject to equities. To a large extent these views are mirrored in the Australian legislation.

1. Western Australia

Western Australia was the first common law jurisdiction to legislatively reform the law of privity.[1] The reform is found in section 11 of *The Property Law Act 1969*.[2] It states:

> 11(1) A person may take an immediate or other interest in land or other property or the benefit of any condition, right of entry, covenant or agreement over or respecting land or other property, although he is not named as a party to the conveyance or other instrument that relates to the land or property.

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[1]For a useful article calling for reform see G. Samuels, "Contracts of the Benefit of Third Parties" (1967), 8 U.W.A.L.R. 378.

[2]Western Australian Statutes 1969 No. 32. For a useful discussion of the Act see A.J. Rogers, "Contract and Third Parties" in *Essays on Contract* ed. P.D. Finn. (1987) 92.

11(2) Except in the case of a conveyance or other instrument to which subsection 1 of this section applies, where a contract expressly in its terms purports to confer a benefit directly on a person who is not named as a party to the contract, the contract is, subject to subsection 3 of this section, enforceable by that person in his own name but -

(a) all defences that would have been available to the defendant in an action or proceeding in a court of competent jurisdiction to enforce the contract had the plaintiff in an action or proceeding been named as a party to the contract shall be so available;

(b) each party who is named to the contract shall be joined as a party to the action or proceeding; and

(c) such defendant in the action or proceeding shall be entitled to enforce as against such plaintiff all the obligations that in the terms of the contract are imposed on the plaintiff for the benefit of the defendant.

11(3) Unless the contract referred to in subsection 2 of this section otherwise provides, the contract may be cancelled or modified by the mutual consent of the persons named as parties thereto at any time before the person referred to in that subsection has adopted it expressly or by conduct.

The Western Australian legislation is very cautious and conservative and imposes quite strict requirements before recognition of third party rights. Some aspects of the Act will be considered.

(a) Scope of the legislation

Section 11(2) follows the recommendations of the English Law Review Committee and recognizes a third party beneficiary right where "a contract expressly in its terms purports to confer a benefit *directly* on a person who is not named as a party". A number of points arise from this section. First, the use of the word 'expressly' seems to exclude implied promises in favour of a third party. This would appear to be unduly restrictive and contrary to the general view in contract law that what may be done expressly may also be done by implication. The Act clearly and reasonably desires to avoid claims from incidental beneficiaries such as those who will, in an indirect way, stand to benefit by the performance of a contract between others. Nevertheless, the language appears to be very restrictive and an over-reaction to a valid concern.

Secondly, the words do not appear to permit enforcement by those who are unascertained at the time of the making of the contract such as a general class or description of third parties (for example, employees, agents)[3] or those who are non-existent at the time the contract is made such as unborn children and yet to be incorporated businesses.

Thirdly, the use of the words 'not named as a party to the contract' may indicate that the third party at least must be *named* in some capacity. Again, this seems unnecessarily restrictive.

Fourthly, the legislation does not specifically require proof of an intention to give the third party an enforceable right. A direct and express stipulation is sufficient.

(b) Variation and termination

Under section 11(3) the normal right of contracting parties to vary or discharge their contractual relationship by agreement is maintained until the third party has adopted the contract. After adoption, the third party beneficiary's rights are vested and indefeasible. Presumably,

[3] Concern has been expressed as to whether the Western Australian Act is worded sufficiently widely to cover the situation that arose in *New Zealand Shipping Co.* v. *A.M. Satterthwaite & Co.* [1975] A.C. 154 (P.C.). See J. Longo, "Privity and The Property Law Act: *Westralian Farmers Co-op Ltd.* v. *Southern Meat Packers*" (1983), 15 U.W.A.L.R. 411, 416. Rogers, *supra* n. 2 at 96, has little doubt that the Act would apply to protect the stevedores.

variation or termination of the right remains possible if *all* parties agree. Clearly some restriction of the contracting parties' right to withdraw or vary the third party benefit is necessary to give meaningful protection to the third party. This solution is sometimes referred to as the "trust option". That is, the third party's right is irrevocable (similar to a trust) as soon as the beneficiary has indicated acceptance, consent or adoption of the contract. Other than immediate irrevocability once the contract is made, this is the solution most advantageous to the third party and clearly favours the interests of the third party over those of the contracting parties.

(c) Defences

Under section 11(2)(a) the promisor may raise any defences or set-offs that would be available if he or she had been sued by the contracting party. The third party beneficiary's rights are in essence subject to equities. A technical argument was made in *Westralian Farmers Co-op Ltd.* v. *Southern Meat Packers Ltd.*[4] that, while the legislation removed the privity rule, section 11(2)(a) still permitted the defence that consideration must move from the promisee. The Western Australian Court of Appeal rejected the argument on the grounds that such an interpretation would subvert the intention of the Legislature.

(d) Procedure

Section 11(2)(b) has been strongly criticized for its requirement that all parties named in the contract be joined as a party to the action. The New Zealand Report by the Contracts and Commercial Law Reform Committee on *Privity of Contract* 1981 felt that such a requirement "could lead to unnecessary expense and possible problems as to service of the proceedings".[5]

(e) Miscellaneous provisions

Section 11(2)(c) enables a defendant in an action by a beneficiary of a promise to enforce against the plaintiff all obligations imposed by the contract on the plaintiff for the benefit of the defendant.

2. Queensland

In 1974, the Queensland state Legislature passed section 55 of *The Property Law Act*.[6] In its general approach, it is similar to the Western Australian reform but, in its detail, there are significant differences. The section states:

> 55(1) A promisor who, for a valuable consideration moving from the promisee, promises to do or to refrain from doing an act or acts for the benefit of a beneficiary shall, upon acceptance by the beneficiary, be subject to a duty enforceable by the beneficiary to perform that promise.
>
> (2) Prior to acceptance the promisor and promisee may without consent of the beneficiary vary or discharge the terms of the promise and any duty arising therefrom.
>
> (3) Upon acceptance -
>
> (a) the beneficiary shall be entitled in his own name to such remedies and relief as may be just and convenient for the enforcement of the duty of the promisor; and relief by way of specific performance, injunction or otherwise shall not be refused solely on the ground that, as against the promisor, the beneficiary may be a volunteer.

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[4]*Westralian Farmers Co-op Ltd.* v. *Southern Meat Packers Ltd.*, [1981] W.A.R. 241 (W.A.C.A.).

[5]The New Zealand Contracts and Commercial Law Reform Committee, *Privity of Contract* (Report, 1981) 49.

[6]*The Property Law Act*, Queensland statute No. 76 1974. A useful discussion of this Act is found in Rogers, *supra* n. 2, at 96.

(b) the beneficiary shall be bound by the promise and subject to a duty enforceable against him in his own name to do or refrain from doing such act or acts (if any) as may by the terms of the promise be required of him.

(c) the promisor shall be entitled to such remedies and relief as may be just and convenient for the enforcement of the duty of the beneficiary.

(d) the terms of the promise and the duty of the promisor or the beneficiary may be varied or discharged with the consent of the promisor and the beneficiary.

(4) Subject to subsection (1), any matter which would in proceedings not brought in reliance on this section render a promise void, voidable or unenforceable, whether wholly or in part, or which in proceedings (not brought in reliance on this section) to enforce a promissory duty arising from a promise is available by way of defence shall, in like manner and to the like extent, render void, voidable or unenforceable or be available by way of defence in proceedings for the enforcement of a duty to which this section gives effect.

(5) In so far as a duty to which this section gives effect may be capable of creating and creates an interest in land, such interest shall, subject to section 12, be capable of being created and of subsisting in land under the provisions of any Act but subject to the provisions of that Act.

(6) In this section -

(a) "acceptance" means an assent by words or conduct communicated by or on behalf of the beneficiary to the promisor, or to some person authorized on his behalf, in the manner (if any), and within the time, specified in the promise or, if no time is specified, within a reasonable time of the promise coming to the notice of the beneficiary;

(b) "beneficiary" means a person other than the promisor or promisee, and includes a person who, at the time of acceptance is identified and in existence, although that person may not have been identified or in existence at the time when the promise was given;

(c) "promise" means a promise -

(i) which is or appears to be intended to be legally binding; and

(ii) which creates or appears to be intended to create a duty enforceable by a beneficiary,

and includes a promise whether made by deed, or in writing, or, subject to this Act, orally, or partly in writing and partly orally;

(d) "promisee" means a person to whom a promise is made or given;

(e) "promisor" means a person by whom a promise is made or given.

(7) Nothing in this section affects any right or remedy which exists or is available apart from this section.

(a) Scope of the legislation

Section 55 does not require that the words of the contract expressly confer a benefit on a third party. There is room for implied promises. This allows for a broader scope than the Western Australian legislation. However, section 55(6)(c)(ii) does introduce the requirement that the promise must be intended to create an enforceable duty. The burden of proof appears to be on the beneficiary. This ensures that incidental beneficiaries will not have an enforceable right. Furthermore, the beneficiary does not acquire an enforceable right until he or she has accepted the promise and that acceptance has been communicated. Formation of contract principles are used to tie the third party into the agreement by the expression and communication of consent. It has been suggested that the failure to satisfy these formalities may defeat otherwise meritorious claims. The beneficiary must be in existence at the time of acceptance though not at the time of the contract. Overall, this aspect of the Act is less restrictive than that of Western Australia.

(b) Variation and termination

Acceptance not only defines the creation of an enforceable right, it also forecloses the power of the contracting party to vary or terminate the promise in favour of the third party. Prior to acceptance, the promisor and promisee may vary or terminate the terms of the promise to the third party (section 55(2)). After acceptance, that can only be achieved with the consent of all three parties (section 55(3)(d)). This approach follows the 'trust' model and reflects the Western Australian Act.

(c) Defences

Section 55(4) allows the promisor to raise all defences that would be available if an action was brought by the promisee. This provision is similar to that in Western Australia. Section 55(3) makes it clear that the defence that no consideration has moved from the promisee cannot be asserted. This was designed to remove all doubt that both privity and consideration rules are no defence. This is to foreclose any argument similar to that made in *Westralian Farmers Co-op Ltd.* v. *Southern Meat Packers Ltd.*[7]

(d) Procedure

The Act does not require the promisee to be joined to any litigation. Section 55(3)(a) states that the action may be brought in the third party's own name and all remedies are available for the enforcement of the duty.

(e) Miscellaneous

If a third party does accept the benefit, he or she must accept all conditions and obligations imposed by the contract in favour of the promisor. Section 55(1) may be unduly restrictive in its demand that consideration move from the *promisee* since that may exclude the enforceability of third party rights under a deed. In light of section 55(6)(c), it seems that such a consequence was not intended but the wording of section 55(1) is strong.

B. QUÉBEC

Like most civil law jurisdictions,[8] Québec recognized the enforceability of contracts for the benefit of a third party at a very early point. Article 1029 of the *Civil Code* 1866 stated:

> A party in like manner may stipulate for the benefit of a third person when such is the condition of the contract which he makes for himself, or of a gift which he makes to another and he who makes the stipulation cannot revoke it if the third person have [sic] signified his consent to it.

The drafting style is typical of that found in civilian Codes, and precision and detail was provided by judicial interpretation.[9] Much of the surrounding jurisprudence has been incorporated in the more detailed provisions of the *Civil Code* of 1991. The provisions relating to third parties are found in Articles 1444-1450. They are set out below.

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[7]*Westralian Farmers Co-op Ltd.* v. *Southern Meat Packers Ltd., supra* n. 4.

[8]A useful discussion can be found on the civil law approach to the problem of third party rights in M.A. Millner, "Ius Quaesitum Tertio: Comparison and Synthesis" (1967), 16 Int. & Comp. L.Q. 446.

[9]A useful discussion of the interpretation of Article 1029 is found in C.K. Irving: "Article 1029 C.C.: Stipulation for a Third Party: Notes on the Jurisprudence of Québec" (1963), 9 McGill L.J. 337.

1444 A person may make a stipulation in a contract for the benefit of a third person.

The stipulation gives the third person beneficiary the right to exact performance of the promised obligation directly from the promisor.

1445 A third person beneficiary need not exist nor be determinate when the stipulation is made; he need only be determinable at that time and exist when the promisor is to perform the obligation for his benefit.

1446 The stipulation may be revoked as long as the third person beneficiary has not advised the stipulator or the promisor of his will to accept it.

1447 Only the stipulator may revoke a stipulation; neither his heirs nor his creditors may do so.

If the promisor has an interest in maintaining the stipulation, however, the stipulator may not revoke it without his consent.

1448 Revocation of the stipulation has effect as soon as it is made known to the promisor; if it is made by will, however, it has effect upon the opening of the succession.

Where a new beneficiary is not designated, revocation benefits the stipulator or his heirs.

1449 A third person beneficiary or his heirs may validly accept the stipulation, even after the death of the stipulator or promisor.

1450 A promisor may set up against the third person beneficiary such defences as he could have set up against the stipulator.

1. Scope of the Legislation

The legislation does not specifically address the issue of express, implied and incidental beneficiaries. However, it is clear that the beneficiary need not be in existence or determined at the time when the stipulation is made. He or she must, however, be in existence and determinable when a promisor is due to perform the obligation. There would seem to be some scope for implied beneficiaries.

2. Variation and Termination

A number of the provisions deal with issues of revocation. Like most civilian jurisdictions, a 'trust model' is adopted. Article 1446 lays down the general rule that the promise in favour of the third party may not be revoked after the beneficiary has accepted the promise. Interestingly, the right to revoke is seen primarily as a personal right of the stipulator (promisee) rather than a right of the contracting parties determined by mutual agreement. Article 1447 does, however, qualify the stipulator's right to revoke where "the promisor has an interest in maintaining the stipulation". It might be noted that revocation of the promise cannot be made by the heirs or creditors of the stipulator and generally revocation will benefit the stipulator. Consequently, the benefit must be given by the promisor to the stipulator if the benefit to the third party is revoked.

3. Defences

Article 1449 makes the beneficiary's right subject to equities by allowing the promisor to set up all defences that he or she could have relied on in an action brought by the stipulator.

4. Procedure

The third party beneficiary has a direct right against the promisor (Article 1444).

C. UNITED STATES OF AMERICA

There is a long history of disaffection with the privity rule in American law. The precise response to that disaffection varies from state to state. However, the American Law Institute *Restatement (Second) of Contracts* 1981[10] articulates the general principles followed by most states and it provides a reliable guide to the current American law. Our examination of the Restatement has also been broken down into paragraphs corresponding with the key issues.

1. Scope of Protection

There has been a significant evolution in American thinking on the scope of recognition of third party rights in contract. The *First Restatement of the Law of Contract* in 1932 restricted third party rights to those who fell into one of two categories: donee beneficiaries and creditor beneficiaries. The donee beneficiary is one on whom the contract confers a gift. A good example is found in a life insurance policy taken out in favour of a spouse or child. A creditor beneficiary is one to whom the promisee owes an existing debt. The contractual promise secured from the promisor in favour of the beneficiary is designed to discharge that debt. However, courts found these categories to be overly restrictive and preferred the more general "intention to benefit" test. This intention to benefit test was adopted in the Second Restatement and it is set out in the paragraphs below.

> §302(1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either
>
> (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or
>
> (b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.
>
> (2) An incidental beneficiary is a beneficiary who is not an intended beneficiary.
>
> §304 A promise in a contract creates a duty in the promisor to any intended beneficiary to perform the promise, and the intended beneficiary may enforce the duty.
>
> §308 It is not essential to the creation of a right in an intended beneficiary that he be identified when the contract containing the promise is made.
>
> §315 An incidental beneficiary acquires by virtue of the promise no right against the promisor or the promisee.

[10] *Restatement (Second) of Contracts*, Vol. 2, 439*ff.* (1981).

It will be noted that paragraph 302 has not fully escaped the influence of the First Restatement. Subsection 302(1)(a) and (b) clearly describe the donee beneficiary and creditor beneficiary situations, and no doubt these will continue to be the paradigm of third party beneficiary cases. However, paragraph 302 pushes beyond these categories by recognizing that a promise will be enforced if it is "appropriate to effectuate the intention of the parties". In a comment on paragraph 302, the intention test is defined. Part of Comment (d) reads:

> If the beneficiary would be reasonable in relying on the promise as manifesting an intention to confer a right on him, he is an intended beneficiary. Where there is doubt whether such reliance would be reasonable, considerations of procedural convenience and other factors not strictly dependent on the manifested intention of the parties may affect the question whether under subsection (1) recognition of a right in the beneficiary is appropriate.

Some further assistance is provided by examples given in the Restatement.[11]

> A, the operator of a chicken processing and fertilizer plant, contracts with B, a municipality to use B's sewage system. With the purpose of preventing harm to landowners downstream . . . B obtains from A a promise to remove specified types of waste from its deposits into the system. C, a downstream landowner is an intended beneficiary. . . .
>
> A, a labour union, enters into a collective bargaining agreement with B, an employer, in which B promises not to discriminate against any employee because of his membership in A. All B's employees who are members of A are intended beneficiaries. . . .
>
> A, a corporation, contracts with B, an insurance company, that B shall pay to any future buyer of a car from A the loss he may suffer by the burning or theft of the car within one year after sale. Later A sells a car to C, telling C about the insurance. C is an intended beneficiary.

The intended beneficiary is to be contrasted with the incidental beneficiary who, under paragraph 315, received no enforceable right. This concept is designed to exclude third parties who stand to gain in some more unrelated or collateral way from the performance of a contract between other parties. Three illustrations drawn from the Restatement are set out here.[12]

> B contracts with A to erect an expensive building on A's land. C's adjoining land would be enhanced in value by the performance of the contract. C is an incidental beneficiary.
>
> B contracts with A to buy a new car manufactured by C. C is an incidental beneficiary, even though the promise can only be performed if money is paid to C.
>
> A contracts to erect a building for C. B then contracts with A to supply lumber needed for the building. C is an incidental beneficiary of B's promise to pay A for the building.

An intention to benefit will clearly not be found purely on the basis that some collateral gain was expected from the performance of a contract. Nevertheless, the line between intended and incidental beneficiaries is not a sharp one and there is a good deal of room for judicial discretion. While there are examples of the intention to benefit test being interpreted very broadly, a recent analysis of cases led one writer to conclude that:

> It would seem that more, and more the Courts are insisting on proof of the contracting parties' intention to confer a benefit *directly* upon the non-party claiming.[13]

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[11]*Restatement (Second) of Contracts*, Vol. 2, 442-443 (1981).

[12]*Restatement (Second) of Contracts*, Vol. 2, 443-444 (1981).

[13]S.P. De Cruz, "Privity in America: A Study in Judicial and Statutory Innovation" (1985), 14 Anglo-Am. L.R. 265 at 275.

Paragraph 313 of the Restatement also stipulates some restrictions on consequential damages in respect of governmental contracts which benefit members of the public.[14]

Nevertheless, the intent to benefit test has a degree of inherent uncertainty and it is not easy to apply it in marginal circumstances. A useful example is *Alva* v. *Cloninger*.[15] In that case, a purchaser of a home brought an action against a valuer who, in performance of a contract for valuation with a mortgage company, failed to detect a significant structural defect. Since the valuer had not been instructed to give a copy of the valuation report to the purchaser, the Court held that there was insufficient evidence of an intention to confer a benefit on the third party purchaser. Of course, jurisdictions which adhere to a privity rule do not escape such difficult cases. In England, there have been a number of such cases. They are, however, argued and analyzed on the basis of tort principles with results that ironically seem more generous to the purchaser.[16]

2. Variation and Termination

The power of the contracting parties to vary or terminate the promised benefit is contained within paragraph 311:

> (1) Discharge or modification of a duty to an intended beneficiary by conduct of the promisee or by a subsequent agreement between promisor and promisee is ineffective if a term of the promise creating the duty so provides.
>
> (2) In the absence of such a term, the promisor and promisee retain power to discharge or modify the duty by subsequent agreement.
>
> (3) Such a power terminates when the beneficiary, before he receives notification of the discharge or modification, materially changes his position in justifiable reliance on the promise or brings suit on it or manifests assent to it at the request of the promisor or promisee.
>
> (4) If the promisee receives consideration for an attempted discharge or modification of the promisor's duty which is ineffective against the beneficiary, the beneficiary can assert a right to the consideration so received. The promisor's duty is discharged to the extent of the amount received by the beneficiary.

Unless there is agreement to the contrary, this paragraph reserves the power of the contracting parties to vary or terminate the promise to the third party. This power is lost only after the commencement of an action, detrimental reliance or the manifestation of consent at the request of the promisor or promisee. This may be contrasted with the view taken by the Australian and Québec legislation. It will be remembered that those jurisdictions adopted a "trust" solution. As soon as the third party accepted or adopted the promise, the power to vary or discharge was lost. This rule is favourable to the third party. A remnant of this view is found in

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[14]§313(1) The rules stated in this chapter apply to contracts with a government or governmental agency except to the extent that application would contravene the policy of the law authorizing the contract or prescribing remedies for its breach.

§313(2) In particular, a promisor who contracts with a government or governmental agency to do an act for or render a service to the public is not subject to contractual liability; to a member of the public for consequential damages resulting from performance or failure to perform unless

(a) the terms of the promise provide for such liability or
(b) the promisee is subject to liability to the member of the public for the damages and a direct action against the promisor is consistent with the terms of the contract and with the policy of the law authorizing the contract and prescribing remedies for its breach.

[15]*Alva* v. *Cloninger* (1981), N.C. App. 602 cited in De Cruz, *supra* n. 13, at 275.

[16]*Smith* v. *Eric S. Bush; Harris* v. *Wyre Forest D.C.*, [1989] 2 All E.R. 514 (H.L.); *Yianni* v. *Edwin and Sons*, [1981] 3 All E.R. 592 (Q.B.D.).

paragraph 311(3) insofar as assent *at the request of the promisor or promisee* forecloses the power to alter the benefit. However, the requirement that it must be at the request of one of the contracting parties probably narrows its application. The central concept is detrimental reliance, particularly if the commencement of proceedings is a form of reliance. This has been referred to as a "contract model" because it maximizes the freedom of the contracting parties to control their contract. It is only lost when significant unfairness would be caused by revocation or variation of the promise. Clearly, the third party's position is less well protected.

3. Defences

Paragraph 309 deals with the defences that may be asserted by the promisor in a claim by the beneficiary:

> (1) A promise creates no duty to a beneficiary unless a contract is formed between the promisor and the promisee; and if a contract is voidable or unenforceable at the time of its formation, the right of any beneficiary is subject to the infirmity.
>
> (2) If a contract ceases to be binding in whole or in part because of impracticability, public policy, non-occurrence of a condition, or present or prospective failure of performance, the right of any beneficiary is to that extent discharged or modified.
>
> (3) Except as stated in subsections (1) and (2) and in para. 311 or as provided by the contract, the right of any beneficiary against the promisor is not subject to the promisor's claims or defences against the promisee or the promisee's claims or defences against the beneficiary.
>
> (4) A beneficiary's right against the promisor is subject to any claim or defence arising from his own conduct or agreement.

This paragraph deals with the defences in a very deliberate and specific manner. Subsections (1) and (2) specifically permit the defence that the contract is "void or unenforceable, ceasing to be binding . . . because of impracticability, public policy, non-occurrence of a condition or present or prospective failure of performance. . . ." This makes the validity of the contract a condition of the third party's rights. Subsection (3) provides that defences that are personal as between the promisor and the promisee cannot be raised against the beneficiary. Subsection (4) is an interesting provision. It provides that the conduct of the beneficiary may give rise to claims and defences which may be asserted against him or her by the promisor.

4. Procedure

There are a number of other provisions that deal with procedural matters. Paragraph 304 establishes that the beneficiary's right is personally enforceable. Paragraph 305 recognizes that the promisor's duty is owed both to the *promisee* and the beneficiary. It also states that performance in favour of the beneficiary discharges the obligation to the promisee. Paragraph 307 makes the remedy of specific enforcement available to both the promisee and the beneficiary.

Paragraph 310 applies particularly to creditor beneficiaries. Subsection (1) states that the claim of the beneficiary against the promisee is not discharged by the contractual arrangement requiring the promisor to pay the beneficiary. In essence, the promisee remains liable as a surety for the promisor's obligations. The creditor (beneficiary) can enforce the claim against the promisor or the promisee and does not necessarily have to sue the promisor first. Subsection (2) allows a promisee who pays the beneficiary to claim reimbursement from the promisor. Since that right only arises after payment, there will be no competition for the assets of the promisor between the promisee and beneficiary.

5. Miscellaneous

Under paragraph 306, a beneficiary may disclaim a benefit before assent. Apparently this is not possible after assent.

D. NEW ZEALAND

The New Zealand *Contracts (Privity) Act* 1982 was passed to reform the law of privity.[17] It is a very detailed piece of legislation which attempts to set out clearly the rights and obligations of the promisor, promisee and third party beneficiary.[18] The Act has been broken down into sections dealing with the key issues. A full text is found in Appendix B.

1. Scope of the Legislation

The scope of the legislation is discovered in the Interpretation section and in section 4. Section 8 is also included. It expressly removes both privity and "no consideration" defences. Some comment will be made on these provisions which are set out below.

> 2. In this Act, unless the context otherwise requires, -
> "Benefit" includes
>
> (a) Any advantage; and
> (b) Any immunity; and
> (c) Any limitation or other qualification of -
> (i) An obligation to which a person (other than a party to the deed or contract) is or may be subject; or
> (ii) A right to which a person (other than a party to the deed or contract) is or may be entitled; and
> (d) Any extension or other improvement of a right or rights to which a person (other than a party to the deed or contract) is or may be entitled:. . . .
>
> "Contract" includes a contract by deed or in writing, or orally, or partly in writing and partly orally or implied by law: . . . .
>
> 4. Where a promise contained in a deed or contract confers, or purports to confer, a benefit on a person, designated by name, description, or reference to a class, who is not a party to the deed or contract (whether or not the person is in existence at the time when the deed or contract is made), the promisor shall be under an obligation, enforceable at the suit of that person, to perform that promise:
>
> Provided that this section shall not apply to a promise which, on the proper construction of the deed or contract, is not intended to create, in respect of the benefit, an obligation enforceable at the suit of that person.
>
> 8. The obligation imposed on a promisor by section 4 of this Act may be enforced at the suit of the beneficiary as if he were a party to the deed or contract, and relief in respect of the promise, including relief by way of damages, specific performance, or injunction, shall not be refused on the ground that the beneficiary is not a party to the deed or contract in which the promise is contained and that, as against the promisor, the beneficiary is a volunteer.

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[17]The Act, in large measure, follows the recommendations of the New Zealand Contracts and Commercial Law Reform Committee, *supra* n. 5.

[18]For helpful commentary and discussion of the Act, see B. Coote, "The Contracts (Privity) Act 1982" (1984) 10 Recent Law (N.S.). 107; F. Dawson, "The New Zealand Privity of Contract Bill" (1982), 2 Oxford Jo. of Leg. Studies 448; G.D. Pearson, "Privity of Contract: Proposed Reform in New Zealand" (1983), 5 Otago L.R. 316; Rogers, *supra* n. 2; R.H. Newman, "The Doctrine of Privity of Contract: The Common Law and the *Contracts (Privity Act* 1982" (1983), 4 Auck. U.L.R. 339; J. Finn, "Reform of Privity" (1981), 1 Cant. L.R. 292; J. Vroegop, "The New Zealand *Contracts (Privity) Act*" (1984), 58 Aust. L.J. 5.

The first matter of note is the broad definition of benefit in the interpretation section. The notion of benefit by way of "immunity" or "limitation" is designed to cover the exemption clause cases such as the *New Zealand Shipping Co.* v. *A.M. Satterthwaite & Co.*[19] Employees, agents and independent contractors will receive the protection of appropriately worded exemption clauses. Most of these clauses can be construed as a promise of immunity or limitation. It has been pointed out that section 4 is slightly awkward in its application to the issue of third parties and exemption clauses.[20] The words at issue are "where a promise . . . confers . . . a benefit . . . , the promisor shall be under an obligation, enforceable *at the suit* of that person, to perform that promise". The emphasized words are not entirely compatible with raising a defence by way of an exemption clause. It would seem to suggest that the defendant must bring a counterclaim. Pearson has suggested that the language could be improved to read "enforceable by that person by way of suit or as a defence to any legal proceedings brought by the promisor."[21] Some adjustment would also be necessary to the proviso to section 4. Mention should also be made of section 2(c)(ii) which defines a benefit as any limitation or other qualification of a *right* to which a person (other than a party to the deed or contract) is or may be entitled. It is difficult to see how a *limitation* of a *right* can be a benefit.

Section 4 is, of course, the pivotal section. It seeks to define those third parties who will have enforceable rights under the legislation. To a large extent, section 4 reflects the recommendations of the New Zealand Contracts and Commercial Law Reform Committee in its Report on *Privity of Contract*. It stated:[22]

> The reform we propose is the enactment of legislation to enable a third party to enforce a term of a contract intended by the contracting parties to benefit him, or to give to him the benefit of any immunity or limitation of liability which the contracting parties intended to apply to him, in cases where it appears, as a matter of construction of the contract that the contracting parties also intended that the beneficiary would have right of enforcement of that term.

The Committee attached to its Report a Draft Bill and a section of the Bill reads:[23]

> Where a promise contained in a deed or contract confers, or purports to confer a benefit on a person who is not a party to the deed or contract (whether or not the person is identified or in existence at the time when the deed or contract is made) the promisor shall be under an obligation at the suit of that person to perform that promise.
>
> Provided that this section shall not apply to a promise which on the proper construction of the deed or contract, is not intended to create an obligation enforceable at the suit of that person.

This section of the Bill clearly implements the desire of the Committee to base the third party's claim on basic contract principles: an express or implied promise to benefit the third party and an intention to create an enforceable right. It also reflects the Committee's belief that placing the burden of proof on the beneficiary would be unduly restrictive. Consequently, by use of a proviso, the burden of proof is switched to the promisor. The beneficiary must prove the express or implied promise to his or her benefit and then the defendant, to escape liability, must show that there was no intention to create an enforceable right.

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[19] *New Zealand Shipping Co. Ltd.* v. *A.M. Satterthwaite & Co.*, *supra* n. 3.

[20] Pearson, *supra* n. 18, at 332.

[21] Pearson, *supra* n. 18, at 332.

[22] New Zealand Contracts and Commercial Law Reform Committee, *supra* n. 5, para. 8.2.1 at 53.

[23] New Zealand Contracts and Commercial Law Reform Committee, *supra* n. 5, at 71.

Section 4 of the *Contracts (Privity) Act 1982* mirrors these requirements. However, before the Bill was passed, an additional control device was introduced. The following emphasized words were added to section 4.

> Where a promise . . . purports to confer a benefit on a person *designated by name, description or reference to a class.*

This change resulted in part from concerns that the wording of the Bill was insufficient to guard against enforcement by incidental beneficiaries. An academic article cited a number of American decisions where the 'intent to benefit' test had been applied very liberally as evidence of a potential problem.[24] One rejoinder to this concern is that the test under section 4 (requiring intent to benefit *and* an intention to create an enforceable right) is inherently narrower than the American test. Moreover, it is clear that the Contracts and Commercial Law Reform Committee was initially of the opinion that section 4 of their Draft Bill was sufficiently restrictive to avoid inappropriate results. Their Report indicates that they were alive to the issue of incidental beneficiaries.[25] Nevertheless, out of an abundance of caution, the words of designation were added to the Act. Coote has explained that the words were added "to require . . . that the parties should have had it in mind to benefit particular persons or classes of persons".[26] He does, however, recognize that "the presence or absence of a 'designation' may in many instances turn out to be more a matter of accident than of design."[27]

The three-fold New Zealand test of 'intent to benefit', 'intent to create an enforceable right' and words of 'designation' would certainly seem to be sufficient to allay fears that incidental beneficiaries will recover under the Act. Indeed, in some respects, the New Zealand position may be perceived as too restrictive. Some examples are provided of situations where there may be some concern about the limited scope of section 4.

We have already discussed the situation which arose in the heavily criticized case of *Greenwood Shopping Plaza Ltd.* v. *Beattie*.[28] Many believe that the employee defendants in that case ought to have received the protections contained in the lease. However, the contract of lease did not designate the employees by name, description or reference to a class as beneficiaries of the insurance arrangements embodied in the lease. There may also be doubt about whether the parties to the lease intended to benefit the employees and, if so, whether it was intended that they should have enforceable rights. There is also doubt about whether or not the language of section 5 would cover the situations which arose in *London Drugs Ltd.* v. *Kuehne & Nagel Ltd.*,[29] *L. & B. Construction Ltd.* v. *Northern Canada Power Commission*[30] and *Moss* v. *Richardson Greenshields of Canada Ltd.*[31] In these cases it may be possible to show an implied promise to create an enforceable benefit but the employees were not designated in the contract by name, description or reference to a class. The designation requirement would appear to inhibit any evolving doctrine of vicarious immunity.

A problem has also arisen in New Zealand about the legal implications of contracts for the sale of land to "X or *his nominee*". Prior to the *Contracts (Privity) Act 1982*, it had been held

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[24]Dawson, *supra* n. n. 18.

[25]New Zealand Contracts and Commercial Law Reform Committee, *supra* n. 5, para. 8.2 at 53-55.

[26]Coote, *supra* n. 18 at 116.

[27]Coote, *supra* n. 18, at 116.

[28]*Greenwood Shopping Plaza Ltd.* v. *Beattie* (1980), 111 D.L.R. (3d) 257 (S.C.C.).

[29]*London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.*, (1992) 97 D.L.R. (4th) 261 (S.C.C.).

[30]*L. & B. Construction Ltd.* v. *Northern Canada Power Commission*, [1984] 6 W.W.R. 598 (N.W.T.S.C.).

[31]*Moss* v. *Richardson Greenshields of Canada Ltd.*, [1989] 3 W.W.R. 50 (Man. C.A.).

that the words 'or his nominee' did no more than reflect the undoubted common law right of a purchaser to nominate the person into whose name he or she wishes title to be placed.[32] It did not create privity of contract between the seller or the nominee.[33] The issue which has arisen in New Zealand since the Act came into force is whether or not the nominee, once nominated, has an enforceable right under the *Contracts (Privity) Act* as a third party beneficiary. The authorities on this point are conflicting but the clear majority view is that a bare nominee does not have enforceable rights.[34] It has been pointed out that the parties may not intend the nominee to have enforceable rights but the most compelling argument is that a bare nominee is not designated by name, description or reference to a class. A bare nominee is designated solely by the will of the purchaser. Consequently, the Act does not appear to change the position at common law.

Problems may also arise in respect of express warranties given to the purchasers of goods and services. Even if the warrantor impliedly intends to give enforceable benefits to sub-purchasers and users, those 'beneficiaries' will rarely be designated by name, description or reference to a class.

A final illustration is provided by the New Zealand Court of Appeal decision in *Gartside* v. *Sheffield, Young and Ellis*.[35] In that case, a solicitor negligently failed to carry out a testator's instructions with due diligence. As a result of this, the testator's will was not changed in favour of the plaintiff before the testator's death. The Court of Appeal held that the "disappointed beneficiary" could not rely on the *Contracts (Privity) Act 1982*. The *contract* between the testator and the solicitor was not intended to confer a benefit on the plaintiff. Only the will was intended to confer the benefit. Nevertheless, the plaintiff succeeded in the tort of negligence. This case illustrates the importance of section 14 of the Act (to be discussed) which preserves other legal mechanisms (tort, agency, trust, etc.) which recognize third party rights.

Of course, no test of enforceable rights can succeed in including all deserving claims and excluding all undeserving claims. Some of the preceding illustrations do, however, question the advisability of including the words of designation. Sufficient protection from inappropriate claims may well be provided by the original section 4 of the Draft Bill.

A final aspect of section 4 deserves brief comment. It is clear that the third party does not have to be in existence at the time the contract is entered into. This introduces useful flexibility and allows for provision to be made for unborn children and yet to be incorporated companies.

In New Zealand there has been some confusion about the relationship between section 4 of the *Contracts (Privity) Act* and section 42A of the *Companies Act* in respect of unincorporated companies.[36] However, each legislative provision has its own sphere of operation and they are

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[32]*Lambly* v. *Silk Pemberton Ltd.*, [1976] 2 N.Z.L.R. 427 (C.A.).

[33]In Manitoba the position is a little more complicated. In *Westward Farms Ltd. and Deniau* v. *Cadieux*, [1982] 5 W.W.R. 1 (Man. C.A.), the Manitoba Court of Appeal held that a description of the purchaser as "X or nominee" rendered the contract void for uncertainty on the grounds that the purchaser could be one of any number of persons. In Manitoba, prudence dictates that the contract make it clear that the *purchaser* is the named individual and that title may be taken in the name of the designated purchaser or the name of the nominee. In that situation, the Manitoba position is no different from the New Zealand situation at common law. See also, A.B. Bass, "The Westward Farms Case" (1983), 13 Man. L.J. 143.

[34]See *McElwee* v. *Beer*, unreported, High Court, Auckland, 19 February 1987 A-445/1262-85; *Field* v. *Fitton*, [1988] 1 N.Z.L.R. 482 (C.A.); *Karangahape Road International Village Ltd.* v. *Holloway*, [1989] 1 N.Z.L.R. 83; *Brown* v. *Healy*, unreported, High Court, Auckland, 25 July 1988 A147/84. Contra *Coldicutt* v. *Webb and Keeys*, unreported, High Court, Whangerei, 1 June 1983 A50/84, cited in S. Todd, "The Contracts (Privity Act 1982", a Research Paper commissioned by the New Zealand Law Commission, 5-7. This paper is incorporated in Law Commission (England), *Contract Statutes Review* (Report, 1993).

[35]*Gartside* v. *Sheffield, Young and Ellis*, [1983] N.Z.L.R. 37 (C.A.).

[36]See *Palmer* v. *Bellamy*, unreported, High Court, Christchurch, 1 November 1982, A303/83; *Speedy* v. *Nylex New Zealand Ltd.* (unreported, High Court, Auckland, 3 February 1989, CL 29/87); *Cross* v. *Aurora Group Ltd.* (1989) 4 N.Z.C.L.C. 64, 909. These cases are discussed in Todd, *supra* n. 34, at 3-5.

entirely compatible. Section 42A reverses the common law rule in *Kelner* v. *Baxter*.[37] In that case, it was held that an unincorporated company could not be bound by a contract made on its behalf; nor could it ratify such a contract. Agency principles could not apply if the principal was non-existent at the time the contract was made. This inconvenient rule was reversed by section 42A of the *Companies Act*. The section allows the company to ratify a contract made in its name or on its behalf within a reasonable time (or a time specified in the contract) of its incorporation. The section allows the company to become a full contracting party. The rule in *Kelner* v. *Baxter* has been similarly reformed in Canada. Section 4 of the *Contracts (Privity) Act* applies in circumstances where two contracting parties seek to confer a benefit on an unincorporated company. Under the Act, the beneficiary does not have to be in existence at the time the contract is made so there is no objection to the company being unincorporated at that time. The point has been summarized well by Todd. He states:

> Section 4 applies where A and B intend to bind themselves by contract and some benefit under the contract is to go to C. Section 42A applies where A contracts with B as agent for C, a company to be formed. The intention is that the contract should be with C, on C being incorporated. The commom law was unable to deal with this case and s. 42A fills the gap. A contract for the benefit of C is not the same thing as a contract on behalf of C.[38]

2. Variation and Termination

The Act devotes a great deal of attention to the issue of variation and termination and the appropriate balance between the interests of the contracting parties to retain the power to alter their contract and the interests of the third party beneficiary in entrenching his or her rights. The Act seems to complete an evolution in thinking on this issue from the 'trust' model of the Australian and civilian legislation, through the American hybrid to a 'contract model' which favours the contracting parties' capacity to alter the contract so long as it is consistent with notions of fairness and justice to the beneficiary. The diminution in the protection given to the beneficiary was thought to be more consistent with his or her position as the donee of an executory gratuitous promise.[39]

Section 5 sets out the general rules:

> 5. (1) Subject to sections 6 and 7 of this Act, where, in respect of a promise to which section 4 of this Act applies, -
> (a) The position of a beneficiary has been materially altered by the reliance of that beneficiary or any other person on the promise (whether or not that beneficiary or that other person has knowledge of the precise terms of the promise); or
> (b) A beneficiary has obtained against the promisor judgment upon the promise; or
> (c) A beneficiary has obtained against the promisor the award of an arbitrator upon a submission relating to the promise, -
>
> the promise and the obligation imposed by that section may not be varied or discharged without the consent of that beneficiary.
>
> (2) For the purposes of paragraph (b) or paragraph (c) of subsection (1) of this section, -
> (a) An award of an arbitrator or a judgment shall be deemed to be obtained when it is pronounced notwithstanding that some act, matter, or thing needs to be done to record or perfect it or that, on application to a Court or on appeal, it is varied:
> (b) An award of an arbitrator or a judgment set aside on application to a Court or on appeal shall be deemed never to have been obtained.

[37] *Kelner* v. *Baxter* (1866), L.R. 2 C.P. 174.

[38] Todd, *supra* n. 34, at 5.

[39] New Zealand Contracts and Commercial Law Reform Committee, *supra* n. n. 5, para. 8.3.2 at 59.

Section 5 provides for full control over the contract by the parties unless the beneficiary has obtained judgment or an arbitration award or the position of the beneficiary has been altered materially by reliance of the beneficiary or *any other person*. Indeed, it may be argued that reliance is the sole criterion since obtaining a judgment[40] would qualify under that criterion. Litigation with its attendant costs and inconvenience would seem almost always to amount to a material alteration of position.

> 6. Nothing in this Act prevents a promise to which section 4 of this Act applies or any obligation imposed by that section from being varied or discharged at any time -
> (a) By agreement between the parties to the deed or contract and the beneficiary; or
> (b) By any party or parties to the deed or contract if -
> (i) The deed or contract contained, when the promise was made, an express provision to that effect; and
> (ii) The provision is known to the beneficiary (whether or not the beneficiary has knowledge of the precise terms of the provision); and
> (iii) The beneficiary had not materially altered his position in reliance on the promise before the provision became known to him; and
> (iv) The variation or discharge is in accordance with the provision.

Section 6(a) allows for alteration to be made with the consent of all parties. Section 6(b), consistent with a contract model, allows one or both parties by express provision to alter the contract, even in the face of reliance, if four conditions (section 6(b)(i)-(iv)) are met. Again notions of fairness control the exercise of express powers of alteration. It has been suggested that the requirement of knowledge of the provision is too generous to the beneficiary and that there ought to be some burden on the beneficiary to make enquiries. The requirement, as it stands, may harshly penalize a promisor who has reserved a unilateral right of termination.[41]

Of greatest interest is section 7 which allows for variation or termination with the consent of the court in some circumstances where it would otherwise not be permitted. It reads:

> 7. (1) Where, in the case of a promise to which section 4 of this Act applies or of an obligation imposed by that section, -
>
> (a) The variation or discharge of that promise or obligation is precluded by section 5(1)(a) of this Act; or
> (b) It is uncertain whether the variation or discharge of that promise is so precluded, -
> a Court, on application by the promisor or promisee, may, if it is just and practicable to do so, make an order authorising the variation or discharge of the promise or obligation or both on such terms and conditions as the Court thinks fit.
>
> (2) If a Court -
> (a) Makes an order under subsection (1) of this section; and
> (b) Is satisfied that the beneficiary has been injuriously affected by the reliance of the beneficiary or any other person on the promise or obligation, -
> the Court shall make it a condition of the variation or discharge that the promisor pay to the beneficiary, by way of compensation, such sum as the Court thinks just.

This discretionary power cannot be exercised in all circumstances where the normal power to terminate a contract has been lost. It does not apply where a judgment has been given or the award of an arbitrator has been made. And it appears not to apply where the exercise of an express power of alteration has been lost because the conditions in section 6(b) have not been met. It does apply where there is no express reservation of a power of alteration in the contract and there has been reliance or there is uncertainty about reliance by the beneficiary. Broad notions of fairness control the exercise of the court's discretion. An order may be made only where it is just and practicable to do so and under section 7(2) the court shall order the promisor

[40] The date of judgment is defined broadly in s. 5(2) to ensure that the promisor does not buy off the promisee in the interim between pronouncement and formalization.

[41] Pearson, *supra* n. 18, at 334.

to make compensation to the beneficiary if the beneficiary has been injuriously affected by his or her own reliance or that of another person. The measure of compensation was left deliberately vague and in the discretion of the court. However, it is clear that compensation will normally be made on a reliance measure. There would be little value in having such a section if an expectation measure was used. Consequently, the aim of the compensation will be to place the beneficiary in the position he or she would have been in if the reliance had not occurred. Nevertheless, the wording of section 7(2) is sufficiently wide to allow an expectation measure to be used where it is no longer possible to restore the beneficiary to his or her former position. Coote[42] gives an example of where this would be an appropriate solution. Imagine a contract between an employer and employee which provides pension and health insurance benefits to the employee's wife on his death. In reliance on these promises, the wife cancels her own private life endowment and health insurance policies. In due course, at the promisor's request, a court terminates the 'widow's benefit' as part of an overall restructuring of employees' benefits. It would clearly be necessary to pay some compensation to the wife. If she was still in a position to secure private insurance of the kind she used to have, the increased cost of the insurance would be the appropriate measure. However, if, because of age, health or market conditions, such insurance was unobtainable, an expectation measure securing the pension and health care benefits would be in order.

A very significant effort has been made to balance the competing interests of contracting parties and beneficiaries. However, the difficulty of drafting for a diversity of situations has been pointed out by Dawson[43] in relation to commercial letters of credit. Commercial practice and authority suggest that the bank's promise to pay the seller is irrevocable as soon as it is communicated to the seller, not when the seller has materially altered his or her position. However, this is not likely to create a major problem because the seller will normally ship the goods soon after receiving the communication.

3. Defences

Defences available to the promisor are set out in section 9 below:

9. (1) This section applies only where, in proceedings brought in a Court or an arbitration, a claim is made in reliance on this Act by a beneficiary against a promisor.

(2) Subject to subsections (3) and (4) of this section, the promisor shall have available to him, by way of defence, counterclaim, set-off, or otherwise, any matter which would have been available to him -

(a) If the beneficiary had been a party to the deed or contract in which the promise is contained; or

(b) If -

(i) The beneficiary were the promisee; and

(ii) The promise to which the proceedings relate had been made for the benefit of the promisee; and

(iii) The proceedings had been brought by the promisee.

(3) The promisor may, in the case of a set-off or counterclaim arising by virtue of subsection (2) of this section against the promisee, avail himself of that set-off or counterclaim against the beneficiary only if the subject-matter of that set-off or counterclaim arises out of or in connection with the deed or contract in which the promise is contained.

(4) Notwithstanding subsections (2) and (3) of this section, in the case of a counterclaim brought under either of those subsections against a beneficiary, -

(a) The beneficiary shall not be liable on the counterclaim, unless the beneficiary elects, with full knowledge of the counterclaim, to proceed with his claim against the promisor; and

[42]Coote, *supra* n. 18, at 114.

[43]Dawson, *supra* n. 18, at 453.

(b) If the beneficiary so elects to proceed, his liability on the counterclaim shall not in any event exceed the value of the benefit conferred on him by the promise.

Subsections (1) and (2) are unremarkable in establishing the right of the promisor to raise defences, set-offs and counterclaims against the beneficiary that would have been available in an action brought by the promisee. Subsection 3 limits counterclaims and set-offs to those arising out of the contract. The Contracts and Commercial Law Reform Committee did not have strong reasons for this limitation and at least one commentator[44] has suggested that a third party beneficiary should not have greater rights of enforcement against the promisor than the promisee. Section 4 adds further protection for the beneficiary in respect of counterclaims. The beneficiary cannot be liable unless, with full knowledge of the counterclaim, he or she elects to continue the claim and, in a provision not included in the draft Bill, the liability of the beneficiary cannot exceed the value for the benefit received. This may favour the beneficiary unduly.[45]

4. Procedure

Section 8 makes it clear that the third party can sue in his or her own right and there is no need for joinder of the promisee. The section also permits relief by way of damages, specific performance and injunction. It is not clear why some contractual remedies such as a declaratory judgment or an order under section 7 of the *Contractual Remedies Act, 1979* were omitted.[46] General words permitting all available contractual relief would have been better. Enforcement by the promisee would still seem to be an option.

5. Miscellaneous

Section 14 is a very important section. The drafters of the Act were conscious of the fact that any statutory implement can never cover all deserving situations and cannot anticipate all future legal and societal changes. The Act was designed to bring certainty and stability to a wide range of third party situations. It was not designed as an exhaustive code and an exclusive repository of recognized third party beneficiary rights. Consequently, section 14 saves other legal vehicles which recognize third party rights and which may involve more generous protection of such rights outside of the Act. Section 14 reads:

14. (1) Subject to section 13 of this Act, nothing in this Act limits or affects -

(a) Any right or remedy which exists or is available apart from this Act; or
(b) The Contracts Enforcement Act 1956 or any other enactment that requires any contract to be in writing or to be evidenced by writing; or
(c) Section 49a of the Property Law Act 1952; or
(d) The law of agency; or
(e) The law of trusts.

(2) Notwithstanding the repeal effected by section 13 of this Act, section 7 of the Property Law Act 1952 shall continue to apply in respect of any deed made before the commencement of this Act.

Of particular note and importance is the applicability of trust law. If the parties desire to create a trust of contractual rights in favour of a third party, they may do so. The saving of all rights and remedies available apart from the Act permits tort remedies to evolve. This is

[44]Dawson, *supra* n. 18, at 452.

[45]Rogers, *supra* n. 2, at 102.

[46]Pearson, *supra* n. 18, at 332.

illustrated by *Gartside* v. *Sheffield Young and Ellis*[47] where a tort remedy was available in the absence of liability under the Act. Given the extraordinary difficulty of drafting an Act appropriate to all occasions, present and future, the section is a valuable one.

6. Contract Statutes Review

In May 1993, the New Zealand Law Commission issued its 25th Report entitled *Contract Statutes Review*.[48] The Report canvasses the broad range of New Zealand contract legislation including the *Contracts (Privity) Act 1982*.[49] The Law Commission concluded that the Act was satisfactory and recommended only one minor amendment to it.[50] It recognized that there continued to be some uncertainties about the scope and interpretation of the Act but concluded that these were no more than might be expected and that they can be resolved by judicial interpretation. In the *Review*, it was noted that some had expressed reservations about the detailed nature of the New Zealand Act and its attempt to cover all possibilities. However, the Commission found that no serious problem had been created by the 'terms of the Act'.[51]

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[47] *Gartside* v. *Sheffield Young and Ellis*, *supra* n. 35.

[48] Law Commission (New Zealand), *Contract Statutes Review* (Report, 1993).

[49] The *Contract Statutes Review* is made up of six research papers covering the various contract statutes. They were written by leading experts in the field of contract law. The Commission then considered the papers and it formally adopted recommendations for amendment to the Act (*where it considered it appropriate*). The paper on the *Privity (Contracts) Act 1982* was written by Associate Professor S. Todd.

[50] The Commission recommended a change in the wording of s. 6(b)(iii). It deals with the situation where the beneficiary knows of the contract but is not informed of the provision permitting variation of the contract until some later time. Section 6(b)(iii) states that the contract cannot be varied if the beneficiary has altered his or her position in reliance on the contract benefit. However, unlike s. 6(1)(a) and s. 7(1)(b), the section says nothing about alteration of position by third persons to the detriment of the beneficiary. The Commission recommended that s. 6(b)(iii) be amended to include reference to alteration of position by third parties detrimentally affecting the beneficiary.

[51] Law Commission (New Zealand), *supra* n. 48, at 228.

CHAPTER 6

PROPOSALS FOR REFORM IN OTHER JURISDICTIONS

A. ONTARIO LAW REFORM COMMISSION

In 1987, the Ontario Law Reform Commission reviewed and made recommendations for reform of the general law of contract.[1] One of the issues dealt with was the doctrine of privity. The Commission had no reservations about its assessment of the rule. It declared:

> We believe that the time has come for Ontario to recognize that the doctrine of privity of contract is no longer appropriate as a general principle of contract law.
>
> It is the firmly held view of the Commission that the privity of contract rule should be abolished.[2]

However, the Commission did not offer any legislative model of the kind that has been described and discussed earlier in this Report. The Commission recommended a general enabling provision permitting the courts to enforce third party rights where they think it appropriate. The Commission recommended:

> There should be enacted a legislative provision to the effect that contracts for the benefit of third parties should not be unenforceable for lack of consideration or want of privity.[3]

The Commission rejected the use of a detailed legislative model setting out rights and obligations of promisors, promisees and beneficiaries on the ground that the issue of third party rights arises in such a diversity of commercial and private settings that any one solution will prove inadequate to the task. In essence, drafting an adequate statutory instrument is not possible. This is not the first time such a view has been put forward. Myers A.J. has written,

> What distinguishes those in which it is desirable that the [third party] right should exist from those in which it is not, is the circumstances of the particular cases and is therefore something incapable of definition or general explanation.[4]

In support of this position, the Commission pointed to the two issues which, in their view, defied normative solution. The first is the issue of an appropriate definition or description of the class of beneficiary entitled to sue. The second is the issue of variation and termination.

The Commission correctly identified the first issue as involving the development of a control device to prevent every indirect beneficiary of a contract from suing. It gave two

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[1]Ontario Law Reform Commission, *Report on Amendment to the Law of Contract* (Report, 1987).

[2]*Id.* at 68.

[3]Ontario Law Reform Commission, *supra* n. 1, at 71.

[4]G.F. Myers, "Third Party Contracts" (1954), 27 A.L.J. 175 at 179.

examples of the kind of incidental beneficiaries which ought to be excluded. The first is a contract between a landowner and a builder for development of land which, if completed,. would benefit a neighbour's business. The second is the homeowner who stands to benefit from the performance of a contract between a municipality and a contractor for the improvement of a municipal street. Against these hypothetical situations, the Commission canvassed the available norms. Confining the action to creditor and donee beneficiaries, as was done in the First Restatement, was dismissed as too restrictive. Manifestation of an 'intention to benefit' the third party was rejected on the grounds that it would include the incidental beneficiaries in the two hypotheticals, assuming that intent was defined as knowing with certainty that a benefit would be conferred on a third party. A test based on expectation of benefit would not exclude the disappointed neighbour in the first hypothetical. Intention to create enforceable legal rights was dismissed as too restrictive. The test in the Second Restatement, which gives a right of action where it is "appropriate to effectuate the intention of the parties", was viewed as too vague[5] given that a purpose of specific legislation is certainty.

The Commission was equally pessimistic about finding an appropriate norm for controlling the right to vary and terminate the promised benefit. No one event or concept could prove adequate in all situations. In particular, there did not seem to be any rationale for the rule that assent or adoption should foreclose the right to vary. As far as reliance was concerned, it was suggested that any loss suffered by the beneficiary should be restricted to the reliance interest. There was no reason why reliance should vest an expectation interest.

Thus, the solution of the Commission was to free the judiciary from the constraints of privity and allow it to furnish appropriate solutions in individual cases. In due course, a pattern of enforceability will become apparent and certainty will be achieved. Such a process does, however, have its disadvantages. It gives to the judiciary very broad powers of discretion in respect of establishing a regime for the recognition of third party rights. It anticipates a long period of uncertainty and unpredictability. Certainty can only be restored in respect of the rights of third parties by a significant amount of very expensive litigation. The lack of any guidelines invites litigation in the most difficult area of incidental beneficiaries. When these cases reach appellate levels, the judiciary will be forced to find the appropriate control devices that the Legislature has declined to provide. If the problem is truly intractable, it seems unfair to pass them off on the judiciary. No guidance is provided on a number of issues that are capable of resolution such as the availability of defences, procedures, nature of benefit, etc. There seems to be no reason to force expensive litigation to define such matters. Indeed, the Commission appears to minimize the role of law as a planning device which can be relied on to craft reliable commercial and private relationships.

Finally, it is likely that the Commission has over-estimated the difficulties in finding a legislative model that will do justice to the great majority of situations that are likely to arise. Certainly the experience of other jurisdictions does not suggest that a reasonably workable reform is unattainable.

[5]No comment was made in respect of such a test where the onus of proof is reversed as in section 4 of the *Contracts (Privity) Act* 1982 (N.Z.).

B. THE LAW COMMISSION (ENGLAND)

1. Introduction

In 1991, the English Law Commission released a consultation paper on privity entitled *Privity of Contract: Contracts for the Benefit of Third Parties*.[6] The Commission reviewed the current state of the law and provisionally concluded that there should be reform of the third party rule. The Commission also discussed at some length the main issues that need to be addressed in formulating the nature of the reform. Unfortunately, the Law Commission did not uniformly reach provisional recommendations on all of the issues involved. Nevertheless, some tentative proposals were made and an overall approach to the kind of reform it envisages is evident.

The Commission canvassed four broad approaches to reform: the creation of further and discrete exceptions to the current privity rule, abolition of the rule preventing the promisee from recovering the third party beneficiary's loss, passage of a legislative enabling provision declaring that no third party should be denied enforcement of a promise made for his or her benefit on the grounds of lack of privity (the Ontario Law Reform Commission model) and a detailed legislative scheme spelling out the rights and obligations of promisor, promisee and beneficiary (the New Zealand model).

The creation of further exceptions was rejected on the grounds that the third party rule is generally flawed and that this would increase the complexity of the law and forestall possible judicial reform. Enabling the promisee to recover the third party's loss was dismissed on the grounds that the promisee may not always be willing or able to sue. The approach of the Ontario Law Reform Commission was also rejected. The English Commission declared:[7]

> It would not be right to undertake . . . reform without, at the same time making clear through legislation the full implications for those issues of the method of reform that is selected. For that reason, and also because we consider the issues to be too significant to be left to the accident of resolution by the courts, we do not, as at present advised, support a reform that did no more than simply to allow third parties a right of suit.

Later in its Paper, the Commission commented further on this approach.[8]

> [The Ontario Law Reform Commission] method of reform has the attraction of making the change of principle a legislative matter while leaving subsequent development to the courts. However, it is our provisional view that the problems involved are too complex and numerous to lend themselves to such a generalised approach . . . . To leave these issues to the courts with no legislative guidance could be said to be an abdication of responsibility when we are aware that they involve questions of principle which will at some stage have to be faced, if not by the legislature by the courts. The general approach also achieves flexibility at the expense of clarity and certainty.

Consequently, the Commission provisionally recommended a detailed legislative scheme similar to the New Zealand model. This would, in the Commission's view, have the advantage of certainty and clarity. It also, of course, demands a resolution to the number of difficult issues inherent in crafting such a legislative regime. The Commission discussed the issues and tentatively resolved some of them.

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[6] The Law Commission (England), *Privity of Contract: Contracts for the Benefit of Third Parties* (Consultation Paper #121, 1991). For a discussion of the Paper and issues relating to the law of privity, see, J. Beatson, "Reforming the Law of Contracts for the Benefit of Third Parties: A Second Bite at the Cherry" (1992), 45 Current Legal Problems 1.

[7] The Law Commission (England), *supra* n. 6, at 5-6.

[8] The Law Commission (England), *supra* n. 6, at 100.

2. Scope of the Legislation

The Commission provisionally recommended that a third party be permitted to enforce a promise made in his or her favour if the parties intend that he or she should take the benefit of the promised performance and also intend to create a legal obligation enforceable by him or her. The burden of proof would appear to be on the beneficiary and intention would be judged in light of all the surrounding circumstances when the contract was made. In the Commission's view, this was the best compromise between options which could lead to an unacceptably wide class of third party beneficiaries (intent to benefit, factual benefit, reliance) and overly restrictive tests (express promise to a named beneficiary).

The Commission reached no conclusion on whether or not there ought to be some further designation of the third party. Designation by name was tentatively rejected as unduly restrictive but the Commission invited comment on the desirability of a more general requirement similar to the New Zealand rule that the third party be designated by "name, description, or reference to a class."

The Commission did, however, reach a provisional conclusion that the third party need not be ascertained or in existence at the time the contract was made.

Finally, it is worth noting that the Commission preferred a general definition of benefit to cover both a promised performance and protections given by exemption clauses.

3. Variation and Termination

The Law Commission identified the issue of variation and termination of the third party's rights as central to any proposed reform. It canvassed all options including the 'trust model' (barring variation after adoption or consent) and the contract model (allowing variation until injurious reliance by the third party). The Commission did not, however, make any provisional recommendation. This indicates just how difficult an issue variation of the third party's rights is.

The Commission did, however, recommend provisionally that the courts should have no residual power to order or prohibit variation or discharge for reasons of justice. In particular, the Commission was not inclined to adopt any provision similar to section 7 of the New Zealand Act. Its preference appears to be for a choice of one or other of the 'trust' or 'contract' models and consequent avoidance of the complications and uncertainties of an overriding judicial discretion. However, the position of the Commission on variation and termination has yet to be fully worked through.

4. Defences

The Law Commission provisionally recommended that the third party beneficiaries be subject to the defences, set-offs and counterclaims that the promisor would be able to raise in an action by the promisee. The Commission invited views on whether, as is the case in the New Zealand Act, counterclaims and set-offs may only be raised if they arise from the contract in which the promise is contained or whether a set-off and counterclaim that arises from other relations between promisor and promisee may be raised.

5. Procedure

The Law Commission invited views on whether or not the promisee must be joined in an action brought by a third party against the promisor. The objections to joinder expressed by the

New Zealand Contracts and Commercial Law Committee's Report on *Privity of Contract* (problems of expense and service) were noted.

The Commission appears to have been influenced by the American *Restatement (Second) of Contracts*[9] in deciding that the nature of the promisee's rights be addressed by reform legislation. It provisionally decided that the promisor's duty is owed both to the promisee and the beneficiary. However, insofar as performance has been made to or released by the beneficiary, all remedies inure to the beneficiary alone. The Commission also raised for consideration the situation where the promisor has made performance to the promisee and the third party seeks performance of the promise.

The Commission, again influenced by the American *Restatement (Second) of Contracts*,[10] also made a recommendation in respect of creditor beneficiaries. In such a case, the third party would be permitted to sue either the promisor or the promisee but the reception of benefit from the promisor would discharge the promisee to the extent that such an obligation is thereby fulfilled.

6. Miscellaneous

The Commission recommended that existing legislative and common law exceptions to privity rules be preserved.

C. NEW BRUNSWICK LAW REFORM BILL

1. Introduction

In May 1993, the *Law Reform Act* was introduced into the New Brunswick Legislature as Bill 60. It is an omnibus Bill covering a wide range of amendments to the common law of tort and contract. It includes a provision designed to reform the rules of privity. The Bill is accompanied by an explanatory commentary describing the proposed reforms. The first reading of this Bill was designed to institute a consultative process and invite scrutiny and comment by interested parties during the summer of 1993. The eventual disposition of the Bill will depend upon the general response to its provisions.

The government's proposals on privity are designed to displace the law of privity to a limited extent and address the most glaring deficiencies of the existing law. Section 4 of the *Law Reform Act* contains the proposed reform.

> 4(1) A person who is not a party to a contract but who is identified by or under the contract as being intended to receive some performance or forbearance under it may enforce that performance or forbearance by a claim for damages or otherwise.
>
> 4(2) In proceedings under subsection (1) against a party to a contract, any defence may be raised that could have been raised in proceedings between the parties.
>
> 4(3) The parties to a contract to which subsection (1) applies may amend or terminate the contract at any time, but where, by doing so, they cause loss to a person described in subsection (1) who has incurred expense or undertaken an obligation in the expectation that the contract would be performed, that person may recover the loss from any party to the contract who knew or ought to have known that the expense would be or had been incurred or that the obligation would be or had been undertaken.

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[9] *Restatement (Second) of Contracts*, Vol. 2, §305(1) (1981).

[10] *Restatement (Second) of Contracts*, Vol. 2, §310 (1981).

> 4(4) This section applies to contracts entered into before or after the commencement of this section, except that subsection (3) does not permit the recovery of loss arising in relation to an expense incurred or an obligation undertaken before the commencement of this section.

It would appear that the section steers a middle course between the more detailed legislative framework of the New Zealand reform and the general enabling provision favoured by the Ontario Law Reform Commission. It is, in its generality and brevity, similar to the Australian legislation that was prompted by the English Law Revision Committee *Sixth Interim Report 1937*.

2. Scope of the Legislation

The scope of third party rights protected by the legislation appears to be quite narrow. It is designed to protect those who are *identified* under the Act as being intended to receive some benefit. There are two criteria to this description - identification and intention. The concept of identification may suggest that the beneficiary must be named in order to secure a right to the benefit. If this is the case, the scope of protection would be very narrow and would exclude implied beneficiaries and those who are described by class or group such as employees, agents and independent contractors. It may be sufficient that the beneficiary is identified by words of description but this is not clear. There may also be some difficulty in including beneficiaries not yet in existence such as unknown children and future employees. Clearly the judicial interpretation of identification will be very important. The second criterion is 'intention to benefit'. It is not clear if this means a factual intent to benefit or whether it is necessary also to prove that the contracting parties intended that the beneficiary have a legal right to enforce the promise. The commentary accompanying the Act suggested the narrower meaning is intended. It states:

> S. 4(1) would, essentially, reverse this [privity] rule in cases in which the *obligation* and the intended beneficiary of it were readily identifiable.[11]

The emphasized words suggest that the parties must intend a legal obligation enforceable by the beneficiary. The burden of proof would appear to be on the beneficiary. The provision reflects the general concern about the necessity to exclude incidental beneficiaries from the scope of the reform but the boundaries may have been drawn too narrowly.

It should be noted that *benefit* covers both performance in favour of the third party and forbearance. It therefore covers both the reception of a benefit and protection from a liability such as provided by an exemption clause.

3. Variation and Termination

The most novel aspect of the proposed New Brunswick reform is section 4(3) which deals with the power of the contracting parties to vary or terminate the contract and, thereby, defeat the beneficiary's expectations. We have noted the drift of sentiment from a 'trust model' strongly favouring the protection of the beneficiary towards a 'contract model' favouring the right of contracting parties to vary and terminate unless the beneficiary has relied on the promise. Section 4(3) extends even greater protection to the contracting parties than the 'contract model'. It permits the parties to vary or terminate the contract 'at any time'. These strong words are qualified only by the requirement to pay compensation where the beneficiary has incurred expense or undertaken an obligation in the expectation that the contract would be performed and the contracting party knew that such reliance would be or had been incurred.

[11]New Brunswick, Law Reform Branch, Office of the Attorney General, *Commentary on the "Law Reform Act"* (1993) 21 [emphasis added].

These provisions would seem to provide insufficient protection for the beneficiary. The strong words 'at any time' would, on their face, suggest that variation and termination is possible not only after the due date of performance but after litigation has been commenced to enforce the promise and perhaps even after judgment. If this is so, the parties can always avoid the cost of the beneficiary's expectation interest by compensating for reliance losses. Furthermore, there will be occasions where the beneficiary has relied on the promise but the contracting parties had no knowledge that the reliance had been or would be incurred. In these circumstances, the beneficiary's rights will again be defeated.

4. Defences

Section 4(2) states that the promisor may raise any defences against the beneficiary that would have been available against the other contracting party. This is, of course, consistent with all legislation and proposals dealing with privity. No mention, however, is made of set-offs or counterclaims that the promisor may wish to raise.

5. Procedure

The Law Reform Bill is silent on a number of procedural issues such as the question of joinder and the precise nature of the promisor's and promisee's rights.

6. Miscellaneous

The implementation of a legislative privity reform and its retroactivity is not an issue that has been addressed at length either in existing legislation or in law reform reports. It is, however, clear from the commentary of the Law Reform Act that this is an issue which received a great deal of attention in New Brunswick. Section 4(4) applies the Act to contracts entered into both before and after the commencement of the Act. This retroactivity is balanced by the qualification that section 4(3), allowing the recovery of reliance losses by a beneficiary whose expectation has been disappointed by a variation or termination of the contract, does not apply if that reliance occurred before the statute comes into force.

The reason given for this retroactivity is that it would avoid having two parallel systems of privity rules, one applying to contracts made before the commencement of the Act and one after. It was also suggested that this disadvantage would be complicated by commercial deals that are open to construction as either one long term deal subject to common law privity rules or as many separate deals, only the later of which would be subject to the legislation. Given these concerns, it was decided that retroactivity was appropriate and that, given the generous right of variation and termination, it should provide few problems.

Overall, this does not seem to be a major issue. Law reform often results in two systems of law for a relatively short time and judges can be depended upon to construe a contractual arrangement as a long term contract or repetitive short term contracts with relative ease. The usual prospective reform would seem to create fewer difficulties.

CHAPTER 7

REFORM OF THE PRIVITY RULE; ISSUES, OPTIONS AND PROPOSALS

A. INTRODUCTION

In this Chapter, we review the issues that arise in considering reform of the privity rule, assess the available options for change and make proposals for the reform of the privity rule in Manitoba. At the outset, we canvass four broad approaches of reform to determine which is best suited for Manitoba. We then consider the issues arising in the implementation of the chosen approach.

B. MODELS FOR REFORM

For the purposes of analysis, we adopt the framework developed by the English Law Commission. The Commission identified four models of reform: the creation of additional legislative exceptions to the privity rule; abolition of the rule preventing the promisee from suing to recover the third party beneficiary's loss; legislation of a general enabling provision allowing courts to enforce third party rights (the Ontario Law Reform Commission model); and passage of a detailed legislative scheme (the New Zealand model). We review each in turn.

1. Further Legislative Exceptions to the Privity Rule

The strength of this model is that it permits the most troublesome situations to be addressed by discrete, tailor-made legislative provisions. Special treatment can be afforded, for example, to insurance contracts or actions by consumers against manufacturers (now achieved in many circumstances under *The Business Practices Act*, enacted in Manitoba in 1990). Such an approach permits a high degree of specificity and certainty to be achieved in limited areas. The disadvantage is that the complexity of the law is increased by adding further exceptions to a rule which is fundamentally flawed. Such an approach is also likely to impede any chance of judicial reform.

2. Abolition of the Rule Preventing the Promisee from Recovering Third Party's Loss

This approach solves a number of the problems in privity. It involves very little dislocation of basic contractual principles and avoids the necessity of resolving the numerous issues that arise in drafting a detailed legislative scheme. The disadvantage is that it is an incomplete solution, unavailable when the promisee cannot or will not enforce the contract.

3. A General Enabling Provision

This approach calls for a legislative provision which frees judges from the constraints of the privity rule and permits them to recognize and enforce third party rights where it is deemed appropriate. It anticipates the kind of judicial development of third party doctrine which has taken place in the United States. We have discussed this approach at some length in our description of the proposals of the Ontario Law Reform Commission which favour such an approach and in our discussion of the Working Paper of the English Law Reform Commission which rejects such an approach. Here we briefly summarize the advantages and disadvantages. The advantages include a degree of flexibility in dealing with the great variety of cases that arise and the avoidance of having to find normative solutions which produce appropriate results in a broad range of cases. The critics of this approach focus on the inevitable period of uncertainty and unpredictability while authorities accumulate, the need for expensive litigation to resolve even those issues that are capable of clear and easy solution (defences, joinder, etc.), the abdication of legislative responsibility to provide some guidance in the resolution of difficult issues and the undervaluation of contract law as a planning device requiring a high degree of certainty and predictability of legal principles.

4. A Detailed Legislative Scheme

This approach has found favour in Western Australia, Queensland, Québec, New Zealand and is the preferred approach of the English Law Commission. It favours legislation which defines, with reasonable clarity, the nature of third party rights, rights of variation and termination, defences, joinder, etc. Its advantage is certainty, clarity and predictability and it facilitates commercial and contractual planning. However, broad normative solutions must be found to resolve the main issues relating to third party rights in a way which provides appropriate results across a broad diversity of circumstances.

We favour a detailed legislative scheme. The most compelling factors in reaching this conclusion are the need for a general reform of the privity rule and the importance of certainty, predictability and clarity. Furthermore, we believe that, in reforming the law, the Legislature ought not to abdicate its responsibility to provide normative solutions which will produce appropriate results in the great majority of cases. We therefore recommend:

RECOMMENDATION 1

Manitoba should adopt a detailed legislative scheme for reform of the privity rule.

We now proceed to examine the issues to be resolved in such a detailed scheme.

C. SCOPE OF THE LEGISLATION

The scope of the legislation is controlled by resolution of a number of individual issues including the test of enforceable benefit, the definition of benefit, designation of third parties, and the ascertainment and existence of third parties. They will be examined in turn.

1. Test of Enforceable Benefit

A number of tests compete for recognition.

(a) Expressly conferred benefit directly on a third party

The Western Australia and Queensland legislation recognizes third party rights where the contract confers a benefit directly on a third party. The test has the advantage of excluding incidental and implied beneficiaries and, consequently, does ensure that only deserving third parties have enforceable rights. The disadvantage is that the exclusion of implied promises renders the legislation overly restrictive. Abandonment of the 'express' requirement, however, leaves a very broad 'intent to benefit' test which will be discussed below. The concept of intention to create an enforceable right is not used.

(b) Intent to benefit

This test gives enforceable rights to those third parties who are intended to benefit under the contract. Its disadvantage is that it is a very broad test and may prove insufficient to exclude incidental beneficiaries. It may, for example, be interpreted as giving enforceable rights to a large class of the public who are designed to benefit from a contract between a governmental body and a provider of public services. Its advantage is in the degree of judicial discretion it provides to develop a broad and generous protection of third party rights.

(c) Justifiable and reasonable reliance by the third party

This test favours reliance as the test of third party rights without regard to the intentions of the contracting parties. The test is generally perceived as insufficient to control third party rights within appropriate boundaries and, in particular, to exclude an indeterminate class of incidental beneficiaries.

(d) Intent to benefit an identifiable person

This test is favoured by the New Brunswick Law Reform Bill. Its disadvantage is a lack of certainty in respect of both 'identification' and 'intent'. If 'identification' is interpreted to mean 'named' and 'intent' is defined as 'intent to create an enforceable right', the scope of protection would be too narrow.

(e) Intention to benefit and intention to create an enforceable right

This test is premised on the view that the intent to benefit test is too wide. Consequently, intent to provide a benefit in fact is complemented by also requiring proof of an intent to provide a benefit in law, that is, to give a legally enforceable right to the third party. This test is favoured by the English Law Commission. It has the advantage of being consistent with basic contractual principles and, in the requirement of an intention to create an enforceable right, it provides a strong control device which excludes incidental beneficiaries. One disadvantage is that the scope of protection may be overly narrow. It is also true that, in some circumstances, it may be difficult to determine an unexpressed intention.

(f) Intention to benefit and intention to create an enforceable right with reverse onus

This test is similar to that favoured by the English Law Commission but reverses the onus of proof relating to the intention to create an enforceable right. This test is found in the New Zealand legislation. It has the advantages alluded to above in (e) but is less restrictive in the scope of enforceable rights.

The Commission is of the view that the intent to benefit test and the reliance test should not be adopted on the grounds that the tests are too broad and are insufficient to guard against

incidental beneficiaries. We also reject the tests requiring the express conferring of a benefit directly on the third party and intent to benefit an identifiable person on the grounds that they are overly restrictive. We favour a test requiring both an intent to benefit and the normal contractual requirement of an intention to create an enforceable right. We also favour a reverse onus provision in respect of the latter requirement. This test clearly excludes incidental beneficiaries and allows for some degree of flexibility to avoid overly restrictive results. It also provides a test which facilitates commercial and contractual planning, allowing contracting parties to directly address the issue of whether or not a third party is to be given an enforceable right.

RECOMMENDATION 2

A test requiring both an intent to benefit and the normal contractual requirement of an intention to create an enforceable right should be adopted with a reverse onus provision in respect of the latter requirement.

2. Definition of Benefit

Many jurisdictions do not specifically address the nature of the benefit that the legislation is designed to secure. Only the New Zealand Act and the English Law Commission define benefit as an advantage promised by the promisor or the extension of an immunity or restriction of liability to a third party. This approach, however, appears to be implicit in the law of the other jurisdictions canvassed. We favour the more explicit approach of the New Zealand legislation and that proposed by the English Law Commission.

RECOMMENDATION 3

The definition of 'benefit' should include both the advantage of a promised performance in favour of a third party and the protection of exemptions and immunities contained in a contract for the benefit of third parties.

3. Designation of the Third Party

Some jurisdictions demand further designation of protected third parties. The specificity of designation can range from requiring that the third party be named in the contract, which is arguably required by the Queensland legislation, to the more general words of designation used in the New Zealand legislation ("designated by name, description or reference to a class"). The requirement of designation would narrow the protection of third party rights significantly. The New Zealand requirement ensures that the contracting parties turn their minds, in a general way, to whom they intend to benefit. This provides a strong control device against incidental beneficiaries. It may, however, be overly restrictive, particularly in respect of the range of protection given by exemption clauses, contractual warranties and to nominees.

We do not believe that further words of designation need be included. In our view, the dual test of an intent to benefit and an intention to create an enforceable right is sufficient to keep liability within reasonable and appropriate boundaries.

4. Ascertainment and Existence of the Third Party

Of the jurisdictions and proposals surveyed, the majority view (United States, New Zealand, Western Australia and the English Law Commission) is that the third party does not need to be ascertained or be in existence at the time of the contract. Ascertainment and existence

is only necessary when the benefit is due. This permits rights to be created in favour of unincorporated companies, future spouses and employees, and unborn children. Three jurisdictions take a narrower view. In Queensland, acceptance by the third party is a pre-condition of third party rights. Consequently, no right arises until the third party is in existence and ascertained. Québec seems to require the third party to be in existence at the time of the stipulation (time of contract) and be ascertainable at the time the stipulation takes effect. The New Brunswick proposal's use of the concept of identification may also lead to a narrow interpretation. The issue is not, however, dealt with directly.

We believe that requiring that the third party be ascertainable or in existence at the time of the contract is overly restrictive. Existence and ascertainment are only necessary for the third party to secure the benefit once it becomes due. Therefore, we recommend:

RECOMMENDATION 4

The third party need not be ascertainable or in existence at the time of the contract.

D. VARIATION AND TERMINATION OF THIRD PARTY RIGHTS

This is one of the most contentious issues in reform of the privity rule. An examination of the issues is facilitated by considering three situations: where there is an express power to vary or terminate third party rights in the contract, where there is no express provision and the right of courts to order variation and termination where it would otherwise be barred. Each will be considered in turn.

1. Express Power of Variation and Termination of Third Party Rights

Most jurisdictions allow the contracting parties to reserve an express power of variation and termination. This is consistent with basic contractual principles which uphold the clearly stated intentions of the contracting parties. The express provision may recognize a unilateral right to vary or terminate third party rights or it may require mutual agreement. Only the New Zealand Act seeks to control the exercise of an express power. It may only be exercised where the beneficiary knows of the provision and has not materially altered his or her position in reliance on the contract before becoming aware of the provision. This encourages the contracting parties to make the beneficiary aware of the insecurity of the promised benefit. We agree with the approach taken by New Zealand and recommend:

RECOMMENDATION 5

Contracting parties should be permitted to reserve an express power of unilateral or mutual variation or termination subject to protection of the beneficiary where his or her position has been materially altered by his or her or another person's reliance on the contract before the beneficiary became aware of the existence of the express power of variation and termination.

2. No Express Provision of Variation or Termination of Third Party Rights

This issue relates to the inherent power of the contracting parties to vary or terminate their contract. The difficulty is to find a balance between the right of contracting parties to vary and terminate their contract by mutual agreement and an appropriate degree of protection for the beneficiary. There are a number of competing options.

(a) No variation or termination at any time after contract

This would mirror the position in trust law where the beneficiary's right is irrevocable once the trust is created. It would provide extraordinary protection for the beneficiary. The disadvantage in this position would be that it is incompatible with contractual principles and unfair to the legitimate interests of the contracting parties. Furthermore, the third party beneficiary is often the donee of a gratuitous promise and, as such, is undeserving of such strong protection.

(b) No variation or termination at any time after the beneficiary knows of the contract

Knowledge is of significance because it engenders a reasonable expectation of a benefit. Protection of the reasonable expectations of promisees is compatible with contractual principles. Nevertheless, this option also unduly prefers the beneficiary's interest over that of the contracting parties. Furthermore, it threatens injustice at the borderlines where knowledge is more a matter of luck than design.

(c) No variation or termination after consent/adoption/acceptance by the beneficiary (trust model)

This option, which is often referred to as the 'trust' model entrenches the third party beneficiary's rights when the beneficiary has, in some way, signified his or her consent to or acceptance of the benefit. This is the preferred approach in Western Australia, Queensland and Québec. This solution relies on formation of contract principles. In essence, the third party is taken to have accepted the offer of the contracting parties. This solution has the advantage of certainty and provides a strong but not unreasonable protection of third party rights. It is a particularly appropriate solution in respect of creditor beneficiary situations where the promise to the third party is designed to satisfy a pre-existing debt owed by the promisee to the third party. In such a case, the third party beneficiary contract is operating in a manner similar to an assignment or a novation and rights of variation and termination should be limited. There are, however, disadvantages in this approach. Satisfaction of the 'acceptance' requirement may be secured more by good luck than good management. Beneficiaries may be ignorant of the contract and/or the legal consequences of making an acceptance. The test is also less appropriate in respect of 'donee beneficiaries' where the contract is designed to bestow a gift from the promisee to the beneficiary. Variation or termination is often more appropriate here even if an acceptance has occurred. The donor may have suffered financial reversals or the beneficiary may have subsequently acted in a manner which was undeserving of such a gift. There seems to be no good reason to disallow termination if the beneficiary has not relied on the promise. Finally, there is difficulty in providing a compelling reason why mere acceptance of or consent to the benefit (saying thank you) should vest rights to the benefit.

(d) No variation or termination after the position of the beneficiary has been materially altered by reliance on the contract (contract model)

This option, which is sometimes referred to as the 'contract' model, is more protective of the fundamental right of the contracting parties to vary or terminate their contract by mutual agreement. The power to alter the contract is only curtailed on grounds of fairness to the beneficiary. If the position of the beneficiary has been materially altered by reliance upon the promise, the normal power of the contracting parties to vary or terminate their contract is foreclosed. This solution is favoured in the United States and in New Zealand. The disadvantage of this approach is that it may create some difficulties for contracting parties who are unable to determine whether or not reliance has taken place. For reasons that we have

discussed earlier, it may also be less appropriate in creditor beneficiary situations. It has also been questioned why reliance is utilized as a concept to secure an expectation interest. On the positive side, the test is consistent with basic estoppel principles and is particularly suitable in respect of donee beneficiary situations.

(e) No variation or termination after judgment

This option provides the minimum degree of protection to the beneficiary. Unless the beneficiary's right is to be illusory, variation and termination must be unavailable after judgment is rendered in favour of the beneficiary. If alteration was permitted after judgment, the promisor would be tempted to pay off the promisee for less than the amount of the judgment and terminate the beneficiary's right. This option clearly provides insufficient protection for the beneficiary.

(f) Variation at any time subject to recompense for reliance losses

This position is most protective of the contracting parties' right to terminate or vary the contract. It is favoured by the New Brunswick Law Reform Bill and would appear to allow unlimited right to vary or terminate the contract and rob the beneficiary of his or her expectation interest subject to compensation for reliance losses. This option also provides insufficient protection for the beneficiary.

It is clear that a reasonable and fair balance must be found between the interests of the contracting parties to vary and terminate third party rights and the interest of the beneficiary in securing the promised benefit. In the last analysis, our choice was between the 'trust' model (acceptance) and the 'contract' model (reliance). Both provide a reasonable solution to the problem. The 'trust' model favours the beneficiary marginally. The 'contract' model tilts the law in favour of the contracting parties. On balance, we favour the 'contract' model and we believe that the right of the contracting parties to vary or terminate their contract should be foreclosed only where the position of the beneficiary has been materially altered by his or her own or another person's reliance. We believe that tilting the balance marginally in favour of the contracting parties is reasonable and consistent with general contractual principles. The beneficiary will be protected when variation or termination would cause unfairness or hardship.

RECOMMENDATION 6

The right of the contracting parties to vary or terminate their contract should be foreclosed only where the position of the beneficiary has been materially altered by his or her own or another person's reliance.

3. Judicial Power to Order Variation or Termination Where It Would Otherwise Be Barred

We have already recommended that, in certain circumstances, the normal power of the contracting parties to vary or terminate their contract should be foreclosed. The issue that then arises is whether or not, in spite of such circumstances, a court may order a variation or termination of third party rights on terms which will protect the beneficiary. Such a power is designed to deal with exceptional and anomalous cases where termination or variation is appropriate and desirable notwithstanding that it is *prima facie* barred. Only the New Zealand legislation provides for a judicial override to the bars to variation and termination. It is tightly controlled. A judicial discretion is given when reliance has taken place or it is unclear whether or not reliance has taken place but it does not appear to be available if judgment has been given or when variation or termination under an express power has been lost because of reliance before there is knowledge of the express power of alteration. Furthermore, compensation must be paid

to the beneficiary. The advantage of such a power is that there is a mechanism to allow variation in anomalous but deserving cases. Its disadvantages include the reduction of certainty arising from judicial discretion and difficulties in the assessment of appropriate compensation. It also introduces a judicial discretion which is unavailable in the two-party contract situation.

RECOMMENDATION 7

The court should be granted the power to terminate or vary third party rights in all circumstances where alteration is otherwise barred, except where judgment has been entered in favour of the beneficiary.

RECOMMENDATION 8

The court should also be granted the power to award compensation to the beneficiary for losses caused by reliance on the promise.

E. THE AVAILABILITY OF DEFENCES

It is generally accepted that the rights of the third party beneficiary are governed by the contract and are valid only to the extent that the contract is valid. Third party rights are essentially derivative and not independent and direct. Consequently, as a general proposition, the promisor ought to have available to him or her in an action by the beneficiary all defences, set-offs and counterclaims that he or she could raise in an action by the promisee. This position, which is accepted in Western Australia, Queensland, Québec, the United States, New Zealand, and is proposed in the New Brunswick Bill and by the Law Commission in England, is consistent both with the rule that assignments are subject to equities and the belief that the third party's rights should not be more extensive than those of the promisee. The wording of the legal principles implementing this view varies from jurisdiction to jurisdiction but the fundamental policy appears uniform.

There is less agreement, however, over whether or not there should be some constraints on the right of the promisor to assert counterclaims and set-offs. The first issue relates to counterclaims and set-offs which do not arise from or relate to the contract. The New Zealand view is that such claims should not be permitted on the grounds that the beneficiary ought to have some protection from the past dealings of the contracting parties. The contrary view is based on the policy that the beneficiary's rights should be no greater than the promisee's. The second issue raises the propriety of further protections against counterclaims arising out of or in connection with the contract. The New Zealand position is that the beneficiary cannot be liable on counterclaims unless he or she elects to proceed with the claim once he or she has knowledge of the counterclaim and in no event can he or she be made liable beyond the value of the promised benefit. There are advantages in this approach from the point of view of fairness to the beneficiary but once again it raises the spectre of derivative rights being broader than the primary right of the promisee. The issue is an evenly balanced one on which the English Law Commission had no tentative proposal.

We believe that the claim of the beneficiary should be subject to the same defences that the promisor could maintain in an action by the promisee. The beneficiary's claim should also be subject to set-offs and counterclaims which could be maintained by the promisor against the promisee. We do, however, accept some qualifications in respect of counterclaims and set-offs. Such claims must arise out of or in connection with the contract. Furthermore, we believe that the beneficiary should be protected from a counterclaim if he or she discontinues his or her action to enforce the benefit of the contract being fully aware of such a claim. However, we do not favour any further protection relating to the amount of the counterclaim. We therefore recommend:

RECOMMENDATION 9

The claim of the beneficiary should be subject to the same defences that the promisor could maintain in an action by the promisee.

RECOMMENDATION 10

The beneficiary's claim should also be subject to set-offs and counterclaims which could be maintained by the promisor against the promisee so long as such claims arise out of or in connection with the contract.

RECOMMENDATION 11

The beneficiary should be protected from a counterclaim if, with full knowledge of such a claim, he or she discontinues his or her action to enforce the benefit of the contract and no further protection should be accorded to the beneficiary relating to the amount of the counterclaim.

F. JOINDER

The issue is a narrow but important one. Most jurisdictions, including the United States, Queensland and New Zealand, do not require that the promisee be joined in any action brought by the beneficiary against the promisor. The added expense and problems in serving the promisee are often cited as reasons. The situation is analogous to actions by an assignee where requirements to join the assignor to litigation have been abandoned. The preferred policy is to simplify and expedite litigation. We are of the same view as the above jurisdictions and therefore recommend:

RECOMMENDATION 12

The promisee need not be joined in any action brought by the beneficiary against the promisor.

G. SUIT BY PROMISEE

The issue which arises here is whether or not the promisee should have a right to enforce the contract. One approach is to maintain the promisee's right to enforce the contract in addition to the third party's rights. The other is to view the third party as having the sole right to enforce the benefit. It appears that no jurisdiction takes this latter view. This is not surprising for it seems to have little merit. The promisee's interests are entirely compatible with those of the beneficiary - to ensure the performance of the contract by the promisor.

There is less agreement on whether or not legislation should specifically deal with this matter. Most jurisdictions are silent on this issue (Western Australia, Queensland, New Zealand, New Brunswick). The effect of silence is to leave the promisee with the contractual rights that he or she would have enjoyed at common law. The impact of legislation is merely to extend rights to the third party, not to diminish the rights of the promisee. The American position and that of the English Law Commission is that both the promisee and the third party should have a right of enforcement and that this should be specified. The Law Commission mirrors the Restatement in proposing that both have enforceable rights but insofar as performance is made to or released by the beneficiary, all remedies inure to him or her. We believe that the point can be

appropriately left to the common law. The promisee will continue to have the usual contractual rights to enforce the contract.

RECOMMENDATION 13

There should be no specific legislative provision regarding the promisee's right to enforce the contract in addition to the third party's rights. This can be appropriately left to the common law whereby the promisee will continue to have the usual contractual rights to enforce the contract.

H. SUIT BY THE THIRD PARTY AFTER THE PROMISOR HAS MADE PERFORMANCE TO THE PROMISEE

There is a possibility that the promisor may perform the third party promise in favour of the promisee. This would raise the likelihood of the beneficiary bringing an action against the promisor. This situation would appear to be governed by the rules of termination and variation of the contract. If termination is possible, reception of the benefit by the promisee may indicate that the parties have mutually agreed to terminate the beneficiary's right. If termination is not possible, the promisor's obligation to the beneficiary is not discharged. The only question is whether or not this needs to be specifically addressed in the legislation. We believe that our recommendations relating to variation and termination of the third party's rights are sufficient to deal with the issue.

RECOMMENDATION 14

There should be no specific provision as to the consequences of the promisor performing the third party promise in favour of the promisee. The provisions relating to variation and termination of the third party's rights are sufficient to deal with this.

I. CONCURRENT REMEDIES AGAINST THE PROMISOR AND THE PROMISEE

A creditor beneficiary will normally have concurrent remedies against the promisor under the contract and against the promisee under the earlier arrangement from which the debt arose. The creation of an additional right against the promisor does not discharge the earlier debt and the beneficiary has a choice to sue the promisor or the promisee. Common law principles would prevent double recovery by the beneficiary. Payment by the promisor would discharge the promisee's obligation. Reception of payment from the promisor will prevent the beneficiary from asserting himself or herself as a creditor of the promisee. The English Law Commission, however, favours following the lead of the American *Restatement (Second) of Contract* by proposing a specific provision to deal with this issue. The Commission provisionally recommended that the third party be able to pursue a claim against either the promisor or promisee and that the acceptance of benefits would discharge his or her rights against the promisee to the same extent as the obligation is fulfilled. It was also suggested that, if the beneficiary sued the promisee as a consequence of the promisor's failure of performance, the promisee would, in turn, be able to claim an indemnity against the promisor. However, we feel that the matter is adequately handled by the common law.

RECOMMENDATION 15

There should be no specific provision to deal with concurrent remedies as the matter is adequately dealt with by the common law.

J. EXISTING EXCEPTIONS

There is a choice to be made between a detailed legislative scheme in the nature of a Code which displaces all current vehicles for the enforcement of third party rights and a detailed legislative scheme as one method of facilitating the enforcement of third party rights. The latter method would ensure the survival of agency, trust and tort as methods to enforce third party rights in tandem with a legislative scheme. All jurisdictions favour this view. There is no reason to prevent resort to the general law if no relief is available under the Act. Similarly, there is no reason to change legislative vehicles such as are found in *The Insurance Act*[1] and *The Manitoba Public Insurance Act*[2] which deal with the intricacies of individual circumstances. We therefore recommend:

RECOMMENDATION 16

The proposed Act should be available as one method for the enforcement of third party rights and all rights and remedies available to a third party beneficiary, both now and in the future, should be preserved by the Act.

K. NO CREATION OF DUTIES IN THIRD PARTIES

At the beginning of this Report, we stated that we had no desire to modify the privity rule as it relates to preventing contracting parties from imposing duties on third parties. For the purpose of clarity, we reiterate that position here. This does not, however, prevent the contracting parties from imposing a condition on the enjoyment or reception of a benefit. In such a case, an obligation is not imposed but is accepted as a consequence of receiving a benefit which the beneficiary is free to decline. It would also seem clear that, if a third party was suing for the benefit of a contract to which he or she was not a party, he or she may be subject to limitations and exemptions contained in the contract. This is a corollary to the rule that the promisor may raise all defences available against the promisee. Again, the burden is not imposed by the contracting parties. It is a consequence of a voluntary decision to enforce a provision in the beneficiary's favour. We therefore recommend:

RECOMMENDATION 17

No power should be available beyond that already available at common law for contracting parties to impose duties on third parties to the contract.

[1] *The Insurance Act*, C.C.S.M. c. I40.

[2] *The Manitoba Public Insurance Act*, C.C.S.M., c. P215.

CHAPTER 8

DRAFT ACT AND COMMENTARY

In this Chapter, we present a draft Act with commentary on each section to identify its general thrust and salient points. This draft Act is based on the New Zealand statute and has been amended to conform with our recommendations. Although we realize it is not drafted in the style used in Manitoba, we provide it as an illustration and to assist the reader in better understanding how our recommendations might be implemented.

DRAFT ACT

An Act to permit a person who is not a party to a contract to enforce a promise made in it for the benefit of that person.

1. This Act may be cited as *The Privity Act.*

2. In this Act, unless the context otherwise requires -

"benefit" includes

(a) any advantage, or

(b) any immunity, or

(c) any limitation or other qualification of an obligation to which a person (other than a party to the contract) may be subject, or

(d) any extension or other improvement of a right or rights to which a person (other than a party to the contract) is or may be entitled;

"beneficiary", in relation to a promise to which Section 4 of this Act applies,

COMMENTARY

(a) The notion of benefit is defined broadly to include both promises to pay money, to transfer property, to provide services, to extend rights and to restrict obligations. Such a definition will cover both the situation in Beswick v. Beswick[1] *(payment of money to a third party) and in the New Zealand Shipping Co. Ltd. v. A.M. Satterthwaite & Co.*[2] *(defence to an action contained in an exemption clause).*

(b) The Act applies to both contracts and deeds.

(c) The Act specifically defines promise to include an implied promise.

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[1]*Beswick* v. *Beswick*, [1968] A.C. 58 (H.L.).

[2]*New Zealand Shipping Company* v. *A.M. Satterthwaite & Co.*, [1975] A.C. 154 (P.C.).

means a person (other than the promisor or promisee) on whom the promise confers a benefit;

"contract" includes a contract made by deed or in writing, or orally or partly in writing and partly oral or implied by law;

"promise", in relation to this Act, may be express or implied;

"promisee", in relation to a promise to which section 3 of this Act applies, means a person who is both

(a) a party to the contract; and

(b) a person to whom a promise is made or given;

"promisor", in relation to a promise to which section 3 of this Act applies, means a person who is both

(a) a party to the contract, and

(b) a person by whom the promise is made or given.

3(1) Subject to subsection (2), where a promise contained in a contract confers or purports to confer a benefit on a person who is not a party to the contract (whether or not the person is in existence at the time the contract is made), the promisor shall be under an obligation to perform that promise.

3(2) Subsection (1) does not apply where the promisor proves that, on the proper construction of the contract, the promise was not intended by the parties to create an enforceable obligation in respect of the benefit.

(a) The beneficiary need only prove an express or implied promise to benefit him or her. To escape liability, the promisor must show, on the basis of proper construction principles, that the parties did not intend the beneficiary to have an enforceable right.

(b) The test in section 3 is not further restricted by the New Zealand gloss that requires the beneficiary to be "designated by name, description, or reference to a class".

(c) There is no need for the beneficiary to be identified or identifiable at the time the contract is entered into.

(d) The section permits the parties to expressly plan their contractual relationship so as to secure or deny third party rights.

(e) If the intention to create an enforceable obligation test is construed restrictively, existing rights and remedies

may provide some relief at the margins (see s. 9).

(f) Difficulties in language in the New Zealand Act, which require a defence to be set up by counterclaim, have been avoided by omitting reference to enforcement 'by suit'.

4. The obligation imposed on a promisor by section 3 of this Act shall be enforceable by the beneficiary as if he or she were a party to the contract and relief in respect of the promise shall not be refused on the ground that the beneficiary is not a party to the contract in which the promise is contained or that as against the promisor the beneficiary is a volunteer.

(a) To avoid all doubt, s. 4 removes both the privity rule and the rule that consideration must move from the promisee as potential defences to a claim by a third party beneficiary under the Act.

5. Subject to sections 6 and 7 of this Act, where in respect of a promise to which section 3 of this Act applies, the position of a beneficiary has been materially altered by the reasonable reliance of that beneficiary or any other person on the promise (whether or not that beneficiary or any other person has knowledge of the precise terms of the promise), the promise may not be varied or terminated without the consent of the beneficiary.

(a) This section implements the 'contract model' of variation and alteration of the contract. It isolates reliance as the key element foreclosing the power to alter the contract. No special provision is made preventing alteration after the issue of proceedings or judgment. Such actions will satisfy the reliance bar. The reliance may be that of the beneficiary or another person. However, the reliance of the other person must materially alter the beneficiary's position. An example would be an endowment insurance arranged between an insurer and an employer for the benefit of an employee on retirement. On the faith of this, a spouse of the employee might cancel private insurance arrangements to protect them in their retirement.

6. Nothing in this Act prevents a promise to which section 3 of this Act applies from being varied or terminated at any time:

(a) by agreement between the parties to the contract and the beneficiary; or

(b) by any party or parties to the contract, if:

(i) the contract contained,

(a) Nothing prevents the parties, by agreement, altering the contract with the consent of the beneficiary at any time.

(b) Alteration pursuant to an express and known power in the contract is permissible so long as the position of the beneficiary has not been altered by reliance before she was aware of the clause. This provides an incentive to the contracting parties to warn the beneficiary of the power of variation or termination.

when the promise was made, an express provision to that effect; and

(ii) the provision is known to the beneficiary (whether or not the beneficiary has knowledge of the precise terms of the provision); and

(iii) the position of the beneficiary has not been materially altered by the reasonable reliance of that beneficiary or any other person before the provision became known to him or her; and

(iv) the variation or termination is in accordance with this provision.

7(1) Where, in a case of a promise to which section 3 of this Act applies,

(a) the variation or termination of that promise is precluded by section 5 or 6 of this Act; or

(b) it is uncertain whether the variation or termination of the promise is so precluded

a court on application by the promisor or promisee may, if it is just and practical to do so, make an order authorizing the variation or termination of the promise on such terms and conditions as the court thinks fit.

(a) This section gives the Court the power to order the variation or termination of a contract which under ss. 5 or 6 would otherwise be barred.

(b) No order can be made if judgment or an award of an arbitrator has been made enforcing the promise.

(c) Compensation must be provided to the beneficiary where an order is made.

7(2) If a court

(a) makes an order under subsection 1 of this section; and

(b) is satisfied that the beneficiary has been injuriously affected by the reasonable reliance of the beneficiary or any other person on the promise

the court shall make it a condition of the variation or termination that the promisor

pay to the beneficiary by way of compensation such a sum as the court thinks just.

7(3) No order shall be made under this section if the beneficiary has secured a judgment against the promisor or an award of an arbitrator upon a submission relating to the promise.

8(1) Subject to subsections (2) and (3) of this section, in the proceedings relating to the enforcement of a promise to which section 3 of this Act applies, the promisor shall have available to him or her by way of defence, counterclaim, set-off or otherwise any matter which would be available to him or her if

(a) the beneficiary had been a party to the contract; or

(b) the proceedings had been brought by the promisee.

(a) This section sets up the general rule that the promisor has all defences against an action by the beneficiary that the promisor would have in an action brought by the promisee.

(b) Subsections (2) and (3) restrict the right of the promisor to raise set-offs and counterclaims to those which are connected with the contract and limit liability on counterclaims to those situations where the beneficiary persists in his or her claim after knowledge of the counterclaim is acquired.

8(2) The promisor shall not avail himself or herself of a counterclaim or set-off by virtue of subsection (1) of this section if the subject matter of the counterclaim or set-off does not arise out of or in connection with the contract in which the promise is contained.

8(3) Notwithstanding subsections (1) and (2) of this section, in the case of a counterclaim brought under either of these subsections against a beneficiary, the beneficiary shall not be liable on the counterclaim unless the beneficiary elects with full knowledge of the counterclaim to proceed with his or her claim against the promisor.

9. Nothing in this Act limits or affects any right or remedy that may be available apart from this Act.

(a) This section preserves those legal vehicles which exist for the protection of third party rights and permits future common law developments to supplement the protection provided by the Act.

10. This Act shall bind the Crown.

11. This Act does not apply to any contract made before the commencement of this Act.

CHAPTER 9

LIST OF RECOMMENDATIONS

1. Manitoba should adopt a detailed legislative scheme for reform of the privity rule. (p. 57)

2. A test requiring both an intent to benefit and the normal contractual requirement of an intention to create an enforceable right should be adopted with a reverse onus provision in respect of the latter requirement. (p. 59)

3. The definition of 'benefit' should include both the advantage of a promised performance in favour of a third party and the protection of exemptions and immunities contained in a contract for the benefit of third parties. (p. 59)

4. The third party need not be ascertainable or in existence at the time of the contract. (p. 60)

5. Contracting parties should be permitted to reserve an express power of unilateral or mutual variation or termination subject to protection of the beneficiary where his or her position has been materially altered by his or her or another person's reliance on the contract before the beneficiary became aware of the existence of the express power of variation and termination. (p. 60)

6. The right of the contracting parties to vary or terminate their contract should be foreclosed only where the position of the beneficiary has been materially altered by his or her own or another person's reliance. (p. 62)

7. The court should be granted the power to terminate or vary third party rights in all circumstances where alteration is otherwise barred, except where judgment has been entered in favour of the beneficiary. (p. 63)

8. The court should also be granted the power to award compensation to the beneficiary for losses caused by reliance on the promise. (p. 63)

9. The claim of the beneficiary should be subject to the same defences that the promisor could maintain in an action by the promisee. (p. 64)

10. The beneficiary's claim should also be subject to set-offs and counterclaims which could be maintained by the promisor against the promisee so long as such claims arise out of or in connection with the contract. (p. 64)

11. The beneficiary should be protected from a counterclaim if, with full knowledge of such a claim, he or she discontinues his or her action to enforce the benefit of the contract and no further protection should be accorded to the beneficiary relating to the amount of the counterclaim. (p. 64)

12. The promisee need not be joined in any action brought by the beneficiary against the promisor. (p. 64)

13. There should be no specific legislative provision regarding the promisee's right to enforce the contract in addition to the third party's rights. This can be appropriately left to the common law whereby the promisee will continue to have the usual contractual rights to enforce the contract. (p. 65)

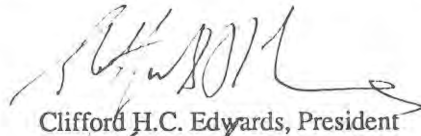
14. There should be no specific provision as to the consequences of the promisor performing the third party promise in favour of the promisee. The provisions relating to variation and termination of the third party's rights are sufficient to deal with this. (p. 65)

15. There should be no specific provision to deal with concurrent remedies as the matter is adequately dealt with by the common law. (p. 65)

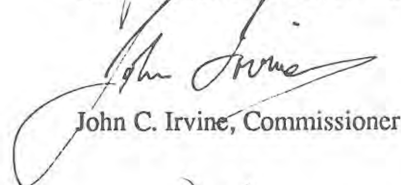
16. The proposed Act should be available as one method for the enforcement of third party rights and all rights and remedies available to a third party beneficiary, both now and in the future, should be preserved by the Act. (p. 66)

17. No power should be available beyond that already available at common law for contracting parties to impose duties on third parties to the contract. (p. 66)

This is a Report pursuant to section 15 of *The Law Reform Commission Act*, C.C.S.M. c. L95, signed this 5th day of October 1993.



Clifford H.C. Edwards, President



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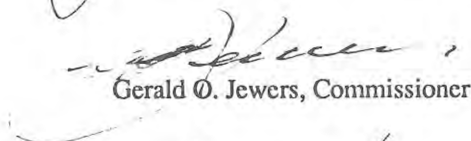
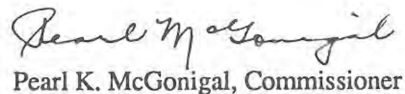


Gerald O. Jewers, Commissioner

Eleanor R. Dawson, Commissioner



Pearl K. McGonigal, Commissioner

APPENDIX A

DRAFT PRIVITY ACT

An Act to permit a person who is not a party to a contract to enforce a promise made in it for the benefit of that person.

1. This Act may be cited as *The Privity Act.*

2. In this Act, unless the context otherwise requires -

"benefit" includes

(a) any advantage, or

(b) any immunity, or

(c) any limitation or other qualification of an obligation to which a person (other than a party to the contract) may be subject, or

(d) any extension or other improvement of a right or rights to which a person (other than a party to the contract) is or may be entitled;

"beneficiary", in relation to a promise to which section 4 of this Act applies, means a person (other than the promisor or promisee) on whom the promise confers a benefit;

"contract" includes a contract made by deed or in writing, or orally or partly in writing and partly oral or implied by law;

"promise", in relation to this Act, may be express or implied;

"promisee", in relation to a promise to which section 3 of this Act applies, means a person who is both

(a) a party to the contract; and

(b) a person to whom a promise is made or given;

"promisor", in relation to a promise to which section 3 of this Act applies, means a person who is both

(a) a party to the contract, and

(b) a person by whom the promise is made or given.

3(1)Subject to subsection (2), where a promise contained in a contract confers or purports to confer a benefit on a person who is not a party to the contract (whether or not the person is in existence at the time the contract is made), the promisor shall be under an obligation to perform that promise.

3(2) Subsection (1) does not apply where the promisor proves that, on the proper construction of the contract, the promise was not intended by the parties to create an enforceable obligation in respect of the benefit.

4. The obligation imposed on a promisor by section 3 of this Act shall be enforceable by the beneficiary as if he or she were a party to the contract and relief in respect of the promise shall not be refused on the ground that the beneficiary is not a party to the contract in which the promise is contained or that as against the promisor the beneficiary is a volunteer.

5. Subject to sections 6 and 7 of this Act, where in respect of a promise to which section 3 of this Act applies, the position of a beneficiary has been materially altered by the reasonable reliance of that beneficiary or any other person on the promise (whether or not that beneficiary or any other person has knowledge of the precise terms of the promise), the promise may not be varied or terminated without the consent of the beneficiary.

6. Nothing in this Act prevents a promise to which section 3 of this Act applies from being varied or terminated at any time:

(a) by agreement between the parties to the contract and the beneficiary; or

(b) by a party or the parties to the contract, if:

(i) the contract contained, when the promise was made, an express provision to that effect; and
(ii) the provision is known to the beneficiary (whether or not the beneficiary has knowledge of the precise terms of the provision); and
(iii) the position of the beneficiary has not been materially altered by the reasonable reliance of that beneficiary or any other person before the provision became known to him or her; and
(iv) the variation or termination is in accordance with this provision.

7(1) Where, in a case of a promise to which section 3 of this Act applies,

(a) the variation or termination of that promise is precluded by section 5 or 6 of this Act; or

(b) it is uncertain whether the variation or termination of the promise is so precluded

a court on application by the promisor or promisee may, if it is just and practical to do so, make an order authorizing the variation or termination of the promise on such terms and conditions as the court thinks fit.

7(2) If a court

(a) makes an order under subsection 1 of this section; and

(b) is satisfied that the beneficiary has been injuriously affected by the reasonable reliance of the beneficiary or any other person on the promise

the court shall make it a condition of the variation or termination that the promisor pay to the beneficiary by way of compensation such sum as the court thinks just.

7(3) No order shall be made under this section if the beneficiary has secured a judgment against the promisor or an award of an arbitrator upon a submission relating to the promise.

8(1) Subject to subsections (2) and (3) of this section, in the proceedings relating to the enforcement of a promise to which section 3 of this Act applies, the promisor shall have available to him or her by way of defence, counterclaim, set-off or otherwise any matter which would be available to him or her if

(a) the beneficiary had been a party to the contract; or

(b) the proceedings had been brought by the promisee.

8(2) The promisor shall not avail himself or herself of a counterclaim or set-off by virtue of subsection (1) of this section if the subject matter of the counterclaim or set-off does not arise out of or in connection with the contract in which the promise is contained.

8(3) Notwithstanding subsections (1) and (2) of this section, in the case of a counterclaim brought under either of these subsections against a beneficiary , the beneficiary shall not be liable on the counterclaim unless the beneficiary elects with full knowledge of the counterclaim to proceed with his or her claim against the promisor.

9. Nothing in this Act limits or affects any right or remedy that may be available apart from this Act.

10. This Act shall bind the Crown.

11. This Act does not apply to any contract made before the commencement of this Act.

APPENDIX B

CONTRACTS (PRIVITY) ACT 1982 (New Zealand)

An Act to permit a person who is not a party to a deed or contract to enforce a promise made in it for the benefit of that person *[16 December 1982*

BE IT ENACTED by the General Assembly of New Zealand in Parliament assembled, and by the authority of the same, as follows:

1. **Short Title and commencement** - (1) This Act may be cited as the Contracts (Privity) Act 1982.

(2) This Act shall come into force on the 1st day of April 1983.

2. **Interpretation** - In this Act, unless the context otherwise requires, -

"Benefit" includes -

(a) Any advantage; and
(b) Any immunity; and
(c) Any limitation or other qualification of -
(i) An obligation to which a person (other than a party to the deed or contract) is or may be subject; or
(ii) A right to which a person (other than a party to the deed or contract) is or may be entitled; and
(d) Any extension or other improvement of a right or rights to which a person (other than a party to the deed or contract) is or may be entitled:

"Beneficiary", in relation to a promise to which section 4 of this Act applies, means a person (other than the promisor or promisee) on whom the promise confers, or purports to confer, a benefit:

"Contract" includes a contract made by deed or in writing, or orally, or partly in writing and partly orally or implied by law:

"Court" means -

(a) The High Court; or
(b) A District Court that has jurisdiction under section 10 of this Act; or
(c) A Small Claims Tribunal that has jurisdiction under section 11 of this Act:

"Promisee", in relation to a promise to which section 4 of this Act applies, means a person who is both -

(a) A party to the deed or contract; and
(b) A person to whom the promise is made or given:

"Promisor", in relation to a promise to which section 4 of this Act applies, means a person who is both -

(a) A party to the deed or contract; and
(b) A person by whom the promise is made or given.

3. **Act to bind the Crown** - This Act shall bind the Crown.

4. **Deeds or contracts for the benefit of third parties** - Where a promise contained in a deed or contract confers, or purports to confer, a benefit on a person, designated by name,

description, or reference to a class, who is not a party to the deed or contract (whether or not the person is in existence at the time when the deed or contract is made), the promisor shall be under an obligation, enforceable at the suit of that person, to perform that promise:

Provided that this section shall not apply to a promise which, on the proper construction of the deed or contract, is not intended to create, in respect of the benefit, an obligation enforceable at the suit of that person.

5. **Limitation on variation or discharge of promise** - (1) Subject to sections 6 and 7 of this Act, where, in respect of a promise to which section 4 of this Act applies, -

(a) The position of a beneficiary has been materially altered by the reliance of that beneficiary or any other person on the promise (whether or not that beneficiary or that other person has knowledge of the precise terms of the promise); or

(b) A beneficiary has obtained against the promisor judgment upon the promise; or

(c) A beneficiary has obtained against the promisor the award of an arbitrator upon a submission relating to the promise, -

the promise and the obligation imposed by that section may not be varied or discharged without the consent of that beneficiary.

(2) For the purposes of paragraph (b) or paragraph (c) of subsection (1) of this section, -

(a) An award of an arbitrator or a judgment shall be deemed to be obtained when it is pronounced notwithstanding that some act, matter, or thing needs to be done to record or perfect it or that, on application to a Court or on appeal, it is varied:

(b) An award of an arbitrator or a judgment set aside on application to a Court or on appeal shall be deemed never to have been obtained.

6. **Variation or discharge of promise by agreement or in accordance with express provision for variation or discharge** - *Nothing in this Act prevents a promise to which section 4 of this Act applies or any obligation imposed by that section from being varied or discharged at* any time -

(a) By agreement between the parties to the deed or contract and the beneficiary; or

(b) By any party or parties to the deed or contract if -

(i) The deed or contract contained, when the promise was made, an express provision to that effect; and

(ii) The provision is known to the beneficiary (whether or not the beneficiary has knowledge of the precise terms of the provision); and

(iii) The beneficiary had not materially altered his position in reliance on the promise before the provision became known to him; and

(iv) The variation or discharge is in accordance with the provision.

7. **Power of Court to authorise variation or discharge** - (1) Where, in the case of a promise to which section 4 of this Act applies or of an obligation imposed by that section, -

(a) The variation or discharge of that promise or obligation is precluded by section 5(1) (a) of this Act; or

(b) It is uncertain whether the variation or discharge of that promise is so precluded, -

a Court, on application by the promisor or promisee, may, if it is just and practicable to do so, make an order authorising the variation or discharge of the promise or obligation or both on such terms and conditions as the Court thinks fit.

(2) If a Court -

(a) Makes an order under subsection (1) of this section; and

(b) Is satisfied that the beneficiary has been injuriously affected by the reliance of the beneficiary or any other person on the promise or obligation, -

the Court shall make it a condition of the variation or discharge that the promisor pay to the beneficiary, by way of compensation, such sum as the Court thinks just.

8. Enforcement by beneficiary - The obligation imposed on a promisor by section 4 of this Act may be enforced at the suit of the beneficiary as if he were a party to the deed or contract, and relief in respect of the promise, including relief by way of damages, specific performance, or injunction, shall not be refused on the ground that the beneficiary is not a party to the deed or contract in which the promise is contained or that, as against the promisor, the beneficiary is a volunteer.

9. Availability of defences - (1) This section applies only where, in proceedings brought in a Court or an arbitration, a claim is made in reliance on this Act by a beneficiary against a promisor.

(2) Subject to subsections (3) and (4) of this section, the promisor shall have available to him, by way of defence, counterclaim, set-off, or otherwise, any matter which would have been available to him -

- (a) If the beneficiary had been a party to the deed or contract in which the promise is contained; or
- (b) If -
  - (i) The beneficiary were the promisee; and
  - (ii) The promise to which the proceedings relate had been made for the benefit of the promisee; and
  - (iii) The proceedings had been brought by the promisee.

(3) The promisor may, in the case of a set-off or counterclaim arising by virtue of subsection (2) of this section against the promisee, avail himself of that set-off or counterclaim against the beneficiary only if the subject-matter of that set-off or counterclaim arises out of or in connection with the deed or contract in which the promise is contained.

(4) Notwithstanding subsections (2) and (3) of this section, in the case of a counterclaim brought under either of those subsections against a beneficiary, -

- (a) The beneficiary shall not be liable on the counterclaim, unless the beneficiary elects, with full knowledge of the counterclaim, to proceed with his claim against the promisor; and
- (b) If the beneficiary so elects to proceed, his liability on the counterclaim shall not in any event exceed the value of the benefit conferred on him by the promise.

10. Jurisdiction of District Courts - (1) A District Court shall have jurisdiction to exercise any power conferred by section 7 of this Act in any case where -

- (a) The occasion for the exercise of the power arises in the course of civil proceedings properly before the Court; or
- (b) The value of the consideration for the promise of the promisor is not more than $12,000; or
- (c) The parties agrees, in accordance with section 37 of the District Courts Act 1947, that a District Court shall have jurisdiction to determine the application.

(2) For the purposes of section 43 of the District Courts Act 1947, an application made to a District Court under section 7 of this Act shall be deemed to be an action.

11. Jurisdiction of Small Claims Tribunals - (1) A Small Claims Tribunal established under the Small Claims Tribunals Act 1976 shall have jurisdiction to exercise any power conferred by section 7 of this Act in any case where -

- (a) The occasion for the exercise of power arises in the course of proceedings properly before that Tribunal; and
- (b) The value of the consideration for the promise of the promisor is not more than $500.

(2) A condition imposed by a Small Claims Tribunal under section 7(2) of this Act shall not require the promisor to pay a sum exceeding $500 and an order of a Tribunal that exceeds any such restriction shall be entirely of no effect.

12. Amendments of Arbitration Act 1908 - The Second Schedule to the Arbitration Act 1908 is hereby amended by inserting, after clause 10B (as inserted by section 14(2) of the Contractual Remedies Act 1979), the following clause:

"10C. The arbitrators or umpire shall have the same power as the Court to exercise any of the powers conferred by section 7 of the Contracts (Privity) Act 1982."

13. Repeal - Section 7 of the Property Law Act 1952 is hereby repealed.

14. Savings - (1) Subject to section 13 of this Act, nothing in this Act limits or affects -

(a) Any right or remedy which exists or in available apart from this Act; or
(b) The Contracts Enforcement Act 1956 or any other enactment that requires any contract to be in writing or to be evidenced by writing; or
(c) Section 49A of the Property Law Act 1952; or
(d) The law of agency; or
(e) The law of trusts.

(2) Notwithstanding the repeal effected by section 13 of this Act, section 7 of the Property Law Act 1952 shall continue to apply in respect of any deed made before the commencement of this Act.

15. Application of Act - Except as provided in section 14 (2) of this Act, this Act does not apply to any promise, contract, or deed made before the commencement of this Act.

This Act is administered in the Department of Justice.

REPORT ON PRIVITY OF CONTRACT

EXECUTIVE SUMMARY

EXECUTIVE SUMMARY

The Manitoba Law Reform Commission's Report on *Privity of Contract* proposes reform of the privity rule in contract law. That rule states that only parties to a contract may sue or be sued on it. This Report does not concern itself with that aspect of the rule which restricts the power of contracting parties to impose a burden on a third party. It concerns itself with the right of a third party to the contract to enforce a benefit which the contracting parties intended the third party to receive.

THE CURRENT LAW

Since the 19th century, the third party beneficiary to a contract has had no personally enforceable right to receive a benefit promised to him or her under the contract. This rule has been criticized by judges, academics and other law reform agencies. It defeats the intentions of the parties to the contract and the reasonable expectations of the third party. The Commission recognizes that much of the harshness of this rule has been mitigated by a variety of statutory and common law exceptions. However, these exceptions do not foreclose the potential for injustice and they do not increase simplicity, certainty and predictability in the law.

The Supreme Court of Canada has recently joined those calling for reform of the privity rule. In *London Drugs Ltv.* v. *Kuehne & Nagel International Ltd.*, the Supreme Court was able to craft a further limited exception to the privity rule to extend the protection of an exemption clause contained in a contract to an employee of one of the contracting parties. The Court, however, made it clear that, while the courts could be relied on to make further incremental and limited changes to the rule, major revision must come from the Legislature.

RECOMMENDATION

The Manitoba Law Reform Commission proposes that, where a contract contains an express or implied promise of a benefit in favour of a person who is not a party to the contract, that person shall have a right to enforce the promise so long as the contracting parties intended that person to have an enforceable obligation. It is incumbent on the third party beneficiary to show an intent to benefit him or her under the contract. Having established this, a claim could only be defeated by proof by the *promisor* that there was no intention to create an enforceable obligation.

In order to provide a reasonable degree of protection of third party rights, the Commission recommends that there be some restriction of the usual power of the contracting parties to terminate or vary their contract and thereby defeat the third party's right. The contracting parties may vary or terminate the third party' rights at any time where they expressly make provision to that effect. In all other cases, the power to vary or terminate the third party's rights is foreclosed where the position of the beneficiary has been materially altered by the reasonable reliance of the beneficiary or any other person on the promise. However, where variation or termination is foreclosed, the contracting parties may apply to the court for permission to vary or terminate the third party's rights so long as appropriate compensation is made to the beneficiary for losses resulting from reliance on the promise.

Where a claim is brought by the beneficiary, the promisor may raise all defences that would be available to the promisor in a claim by the promisee (the other contracting party). We recommend some restrictions, however, on the power to raise set-offs and pursue counterclaims against the beneficiary.

The proposed *Privity Act* is not intended to be a codification of third party rights. The proposed legislation would expressly preserve those legal vehicles which exist or may be developed to protect third party rights. We do anticipate, however, that much less reliance will need to be placed on these other vehicles. We believe that the proposed legislation not only empowers contracting parties to plan for the express recognition or non-recognition of third party rights but also contains a sufficient degree of flexibility and discretion to permit the courts to seek appropriate results in a diversity of current and future contractual arrangements where the intentions of the parties are not expressly declared.