To be opened on receipt

A2 GCE LAW

G156/01/RM Law of Contract Special Study

PRE-RELEASE SPECIAL STUDY MATERIAL

JUNE 2015

2692819854

INSTRUCTIONS TO TEACHERS

- This Resource Material **must** be opened and given to candidates on receipt.

INSTRUCTIONS TO CANDIDATES

- This copy may **not** be taken into the examination room.

INFORMATION FOR CANDIDATES

- This document consists of **8** pages. Any blank pages are indicated.

G156 LAW OF CONTRACT

SPECIAL STUDY MATERIAL

SOURCE MATERIAL

SOURCE 1

Extract adapted from *Beswick v Beswick* [1967] UKHL 2

Lord Reid:

Before 1962 the Respondent's deceased husband carried on business as a coal merchant. By agreement of 14th March, 1962, he assigned to his nephew the Appellant the assets of the business and the Appellant undertook first to pay to him £6 10s. per week for the remainder of his life and then to pay to the Respondent an annuity of £5 per week in the event of her husband's death. The husband died in November, 1963. Thereupon the Appellant made one payment of £5 to the Respondent but he has refused to make any further payment to her. The Respondent now sues for £175 arrears of the annuity and for an order for specific performance of the continuing obligation to pay the annuity. The Vice Chancellor of the County Palatine of Lancaster decided against the Respondent but the Court of Appeal reversed this decision… .

….

It so happens that the Respondent is Administratrix of the estate of her deceased husband and she sues both in that capacity and in her personal capacity.

….

For clarity I think it best to begin by considering a simple case where, in consideration of a sale by A to B, B agrees to pay the price of £1,000 to a third party X.

….

Lord Denning's view, expressed in this case not for the first time, is that X could enforce this obligation. But the view more commonly held in recent times has been that such a contract confers no right on X and that X could not sue for the £1,000. Leading counsel for the Respondent based his case on other grounds, and as I agree that the Respondent succeeds on other grounds, this would not be an appropriate case in which to solve this question. It is true that a strong Law Revision Committee recommended so long ago as 1937 (Cmd. 5449) that "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…" (page 31). And if one had to contemplate a farther long period of Parliamentary procrastination, this House might find it necessary to deal with this matter. But if legislation is probably at an early date I would not deal with it in a case where that is not essential. So for the purposes of this case I shall proceed on the footing that the commonly accepted view is right.

….

Applying what I have said to the circumstances of the present case, the Respondent in her personal capacity has no right to sue, but she has a right as administratrix of her husband's estate to require the Appellant to perform his obligation under the agreement.

SOURCE 2

Extract adapted from *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1993] UKHL 4

Lord Browne-Wilkinson:

McAlpine accept that, since the attempted assignment by Corporation of its rights under the contract to Investments was ineffective, Corporation has retained those rights and is entitled to judgment against McAlpine for any breach of contract. But, McAlpine submits, Corporation is only entitled to nominal damages. Corporation has suffered no loss: it had parted with its interest in the property (and therefore with the works when completed) before any breach of the building contract: moreover Corporation received full value for that interest on its disposal to Investments. Therefore, it is said, neither of the plaintiffs has any right to substantial damages: Investments has incurred damage (being the cost of rectifying the faulty work) but has no cause of action; Corporation has a cause of action but has suffered no loss. If this is right, in the words of my noble and learned friend, Lord Keith of Kinkel … "… the claim to damages would disappear…into some legal black hole, so that the wrongdoer escaped scot-free."

….

This is a formidable, if unmeritorious, argument since it is apparently soundly based on principle and is supported by authority. … [In a recent case involving a similar issue] [t]his House held that the plaintiffs were not entitled to substantial damages. Lord Diplock treated the general rule as being clear: a party who has no property in the goods at the date of breach has suffered no loss. However he recognised that there were exceptions to this general rule … .

….

If the law were to be established that damages for breach of a supply contract were not quantifiable by reference to the beneficial ownership of goods or enjoyment of the services contracted for but by reference to the difference in value between that which was contracted for and that which is in fact supplied, it might also provide a satisfactory answer to the problems raised where a man contracts and pays for a supply to others, e.g., a man contracts with a restaurant for a meal for himself and his guests or with a travel company for a holiday for his family. It is apparently established that, if a defective meal or holiday is supplied, the contracting party can recover damages not only for his own bad meal or unhappy holiday but also for that of his guests or family; see Jackson v. Horizon Holidays Ltd. [1975] 1 W.L.R. 1468 as explained in Woodar Investment Development Ltd. v. Wimpey Construction U.K. Ltd. [1980] 1 W.L.R. 277 … .

….

I am reluctant to express a concluded view on this point since it may have profound effects on commercial contracts which effects were not fully explored in argument. In my view the point merits exposure to academic consideration before it is decided by this House. Nor do I find it necessary to decide the point since, on any view, the facts of this case bring it within the class of exceptions to the general rule … .

"[T]hat in a commercial contract concerning goods where it is in the contemplation of the parties that the proprietary interests in the goods may be transferred from one owner to another after the contract has been entered into and before the breach which causes loss or damage to the goods, an original party to the contract, if such be the intention of them both, is to be treated in law as having entered into the contract for the benefit of all persons who have or may acquire an interest in the goods before they are lost or damaged, and is entitled to recover by way of damages for breach of contract the actual loss sustained by those for whose benefit the contract is entered into."

SOURCE 3

Extracts from *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com No.242, pp39–41

Arguments for Reform

A first argument in favour of reform, as stated in the Consultation Paper, is that the third party rule prevents effect being given to the intentions of the contracting parties. If the theoretical justification for the enforcement of contracts is seen as the realisation of the promises or the will or the bargain of the contracting parties, the failure of the law to afford a remedy to the third party where the contracting parties intended that it should have one frustrates their intentions, and undermines the general justifying theory of contract…

A second argument focuses on the injustice to the third party where a valid contract, albeit between two other parties, has engendered in the third party reasonable expectations of having the legal right to enforce the contract particularly where the third party has relied on that contract to regulate his or her affairs… In a standard situation, the third party rule produces the perverse, and unjust, result that the person who has suffered the loss (of the intended benefit) cannot sue, while the person who has suffered no loss can sue…

In *Beswick v Beswick*, the promisee, as represented by the widow as administratrix, clearly wanted to sue to enforce the contract made for her personal benefit. However, in many other situations in which contracts are made for the benefit of third parties, the promisee may not be able to, or wish to, sue, even if specific performance or substantial damages could be obtained. Clearly the stress and strain of litigation and its cost will deter many promisees who might fervently want their contract enforced for the benefit of third parties…

The existence of the rule, together with the exceptions to it, has given rise to a complex body of law and to the use of elaborate and often artificial stratagems and structures in order to give third parties enforceable rights. Reform would enable the artificiality and some of the complexity to be avoided…

In Part II, we saw that there had been criticism of the third party rule and calls for its reform from academics, law reform bodies and the judiciary. We shall see in Part IV that the rule has been abrogated throughout much of the common law world, including the United States, New Zealand, and parts of Australia. The extent of the criticism and reform elsewhere is itself a strong indication that the privity doctrine is flawed.

SOURCE 4

Extracts from Morgan, J, *Great Debates in Contract Law*, Palgrave Macmillan, 2012, p266–267, 271

What rights should third parties have?

This might appear a non-debate. For years judges were dismissive of the doctrine of privity, most notably Lord Denning in, for example, his great dissent in the leading case *Scruttons v Midland Silicones* [1961] UKHL 4 [and the] influential judgment [*Darlington BC v Wiltshier Northern* [1995] 1 WLR 68]… . This judicial criticism culminated in the Contracts (Rights of Third Parties) Act 1999, based on a report by the Law Commission.

However … some commentators did seriously defend the doctrine of privity. Their defence of the common law position stands now as a challenge to the 1999 Act. It is worth considering these views since it is usually assumed that privity was wholly indefensible and that its abrogation by the 1999 Act must be an unqualified Good Thing.

Privity's defenders argue that the rule is required by the notion of contracts as bilateral promises. By contrast, there is no coherent doctrinal basis for granting rights to non-parties. Privity reform has placed pragmatic convenience, the satisfaction of commercial expectations, above theoretical coherence. But sceptics argue that the problems laid at privity's door were usually the result of entirely different rules (such as the definition of loss, or the effect of death on contractual rights). It would be more rational to address such failings directly. Finally, to the extent that privity itself was commercially obstructive, familiar devices such as agency and collateral contracts were available to prevent defeated expectations while deftly avoiding a direct challenge to privity itself. Accordingly the pragmatic case for reform was considerably weaker than appears at first sight, and whether it outweighs the requirement for coherent principles may be questioned.

….

The Coherence of the 1999 Reforms

The Law Commission's Report (and therefore the 1999 Act) have been criticized for lacking any coherent theory of the third party's rights. The Commission seemed to view the intentions of the parties as the prime justification for the third party's rights: if such rights were desired by the parties, the law should give effect to their intentions. This is reflected in the test for creation of rights in ss.1(1)-(2) of the 1999 Act. However … the third party's rights effectively take precedence over those of the parties when the latter wish to vary the contract but the third party's rights have 'crystallized', through reliance or communicated consent: s. 2. At this stage, as Catherine Mitchell puts it, the Law Commission seem to view third parties as the main victims of the privity rule, without acknowledging (let alone justifying) the switch from the earlier justification (thwarting the intentions of the parties). As Mitchell points out, if protecting the expectations of the third party were the main concern, 'recourse to the intentions and will of the contracting parties is unnecessary in justifying reform'. Conversely, if the parties' intentions truly were the driver for reform, the third party's rights would rise and fall with the fluctuations thereof. Presenting both (inconsistent) justifications at once is simply incoherent.

SOURCE 5

Extracts from McKendrick, E, *Contract Law*, 9th Edition, Palgrave Macmillan, 2011, pp121–122, 134–135

The first situation where the third party is given a right to enforce a term of the contract [by the Contracts (Rights of Third Parties) Act 1999] arises where 'the contract expressly provides that he may' (s1(1)(a)). The right of action given to the third party may be a right to sue to enforce a positive right, for example to payment, or it may be a right to rely on an exclusion or limitation clause contained in the contract between the two contracting parties (s1(6)). Thus it applies both to the *Beswick v Beswick* type fact situation and to [the stevedore cases]… The need for complex drafting or judicial ingenuity in order to give effect to third party rights has been significantly reduced as a result of the enactment of the 1999 Act.

….

Much more difficult is the case where the contracting parties do not make their intention express and the contract term 'purports to confer a benefit on' the third party (s1(1)(b)). In such a case the third party may have a right to enforce the term… There is a further important limit on the right of the third party to enforce the term pursuant to section 1(1)(b), which is that the right of action is not triggered where 'on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party' (s1(2)).

….

Turning now to the pre-1999 exceptions to the doctrine of privity, one exception which was employed on a number of occasions by the courts was the device of finding a collateral contract between the promisor and the third party. The mechanism now appears rather artificial and its practical significance is likely to be reduced considerably in the light of the enactment of the 1999 Act. An example of the device in practice is provided by the case of *Shanklin Pier Ltd v Detel Products Ltd* [1951] 2 KB 854. Contractors employed by the claimants to paint the claimants' pier were instructed by the claimants to use paint manufactured by the defendants. The contract to purchase the paint was actually made between the contractors and the defendants but a representation was made by the defendants to the claimants that the paint would last for seven years. The paint only lasted three months. It was held that the claimants were entitled to bring an action for breach of contract against the defendants on the ground that there was a collateral contract between them to the effect that the paint would last for seven years, the consideration for which was the instruction given by the claimants to their contractors to order the paint from the defendants.

SOURCE 6

Extracts from *Nisshin Shipping Co Ltd. v Cleaves & Company Ltd. & Others* [2003] EWHC 2602

There were nine relevant time charters negotiated by Cleaves on behalf of the Applicant, Nisshin …

It is accepted on behalf of Cleaves that in none of the charters did the commission clauses expressly provide that Cleaves could enforce such clauses directly against the owners. However the real issues are (i) whether those clauses purported to confer a benefit on Cleaves within sub-section (1)(b) of section 1 and (ii) whether sub-section 1(b) is disapplied by sub-section (2) because "on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party". …

…it is argued by Mr Ashcroft on behalf of Nisshin that there is no positive indication in the charterparties that the parties did intend the brokers to have enforceable rights…

It is to be noted that section 1(2) of the 1999 Act does not provide that subsection 1(b) is disapplied unless on a proper construction of the contract it appears that the parties intended that the benefit term should be enforceable by the third party. Rather it provides that sub-section 1(b) is disapplied if, on a proper construction, it appears that the parties did not intend third party enforcement. In other words, if the contract is neutral on this question, sub-section (2) does not disapply sub-section 1(b)…

Mr Ashcroft [also] submits that the parties' mutual intention on the proper construction of the contracts was to create a trust of a promise in favour of the brokers – a trust enforceable against the Owners at the suit of the Charterers as trustees… Accordingly, the mutual intention evidenced by the contracts was that the enforcement of the promise to pay commission would be at the suit of the Charterers who must be joined by the brokers as co-claimants…

…the argument advanced by the Owners can only succeed if it is to be inferred from the existence of the underlying trustee relationship that it was the mutual intention of Owners and Charterers that the broker beneficiary should not be entitled to avail himself of the facility of direct action by the 1999 Act.

This proposition is, in my judgment, entirely unsustainable. The fact that prior to the 1999 Act it would be the mutual intention that the only available facility for enforcement would be deployed by the broker does not lead to the conclusion that, once an additional statutory facility for enforcement had been introduced, the broker would not be entitled to use it, but would instead be confined to the use of the pre-existing procedure. Indeed, quite apart from the complete lack of any logical basis for such an inference, the very cumbersome and inconvenient nature of the procedure based on the trustee relationship (described by Lord Wright as a "cumbrous fiction") would point naturally to the preferred use by the broker of the right to sue directly provided by the 1999 Act.