

CHAPTER SEVEN

Conclusion

I. Introduction

The growth of contracts made for the benefit of third parties necessitates a review of the doctrine of privity in Malaysia. The reasons for the growth of these contracts are discussed in Chapter 1 Part II(B). Accordingly, this thesis argues that the application of the doctrine of privity to contracts made for the benefit of third parties in Malaysia is in need of statutory reform. There are five objectives of this thesis as follows:

- (a) To examine whether there is a need to reform the doctrine of privity in Malaysia.
- (b) To examine the possibility of accommodating third party rights in contract law.
- (c) To analyse the judicial application of the doctrine and the common law mechanisms to avoid the doctrine.
- (d) To undertake a comparative study on the legal position and development of the law relating to the doctrine in selected countries.
- (e) To make recommendations to improve the law in relation to contracts made for the benefit of third parties in Malaysia.

This thesis is aimed to achieve the above objectives in the following manner.

Firstly, Chapter 2 discussed the legal effects of the doctrine of privity to show the various problems created by the doctrine and examined the validity of the argument that the extent of the problems created justifies reform of the doctrine. Chapter 2 also sought to highlight

the fact that the rationale for the doctrine cannot justify its application to contracts made for the benefit of third parties. The theoretical justifications for and against third party rights were provided to determine whether contract theory can encompass these rights. Chapter 2 went on to propose the responsive bargain theory to justify third party rights.

Secondly, Chapter 3 examined the recognition and application of the privity doctrine and its statutory exceptions in Malaysia. Cases applying the doctrine and its statutory exceptions were analysed to determine the judicial attitude towards the doctrine.

Thirdly, Chapters 4 and 5 examined the various common law mechanisms to circumvent the difficulties created by the privity doctrine. Chapter 4 focused on promisee's remedies for breach of contract whereas Chapter 5 focused on the mechanisms providing a direct right to the third party to enforce the contract. The judicial development in relation to these mechanisms in England, Australia and Canada was examined to determine the possible options available to Malaysian judges in dealing with contracts made for the benefit of third parties. The discussion of these two chapters also determined whether common law can provide a satisfactory solution to the problems created by the doctrine.

Fourthly, Chapter 6 examined the legal position of the doctrine of privity in England, New Zealand, Australia and United States as well as the Principles of European Contract Law applicable to member states of the European Union. The strengths and weaknesses of the various legal positions were evaluated. This discussion showed the feasibility of adopting a comprehensive statutory reform of the doctrine and the preferable model for reform.

In this concluding chapter, the analysis of the legal issues identified in the preceding chapters are brought together to support the argument that Malaysia is in need of a statutory reform of the doctrine of privity. This chapter is divided into three parts (i) findings and arguments (ii) recommendations and (iii) conclusion.

II. Findings and Arguments

As examined in Chapter 2, there are a number of problems created by the privity doctrine which applies generally to all countries adopting it. The main problem created is the failure to give effect to the contracting parties' intention to allow a third party to enforce the contract. This leads to a number of further difficulties.

Firstly, injustices are created because the existing principles of contract law¹ places the promisor in an unduly advantageous situation in some circumstances where he escapes from the losses he causes due to his own breach of contract, merely because the third party is the person who suffers the losses.

Secondly, uncertainties and complexities in the law ensue as a result of judicial development of common law mechanisms to redress the possible absurdities and injustices caused by the doctrine. As shown in Chapters 4 and 5, there are various common law mechanisms to evade the doctrine. This incremental approach where judges develop the law on a case to case basis is not very desirable as there is no general consensus by courts as to the scope, applicability and expansion of these mechanisms. Furthermore, each of the common law mechanisms is burdened with its own requirements and limited scope that

¹ These refer to the doctrine of privity and the rules governing recovery of damages for breach of contract.

dampens the possibility for every contract made for the benefit of third parties to be given effect to. As a result, these mechanisms do not resolve the difficulties created by the doctrine satisfactorily.

Thirdly, additional transactional costs are incurred because contracting parties have to arrange alternative arrangements in ensuring that third parties can enforce the contract. Cost of litigation also increases due to the time spent to determine the availability and applicability of the various common law mechanisms to assist third parties to enforce a contract successfully.²

Due to the difficulties created by the privity doctrine, there is a need for the law to change to provide contracting parties with the power to create enforceable rights for the third party in accordance to their intention.

Third party rights can be accommodated by the responsive bargain theory proposed in Chapter 2. This theory evolves from the strict bargain theory as understood in the 19th century. This evolution is necessary to ensure that the strict bargain theory can continue to justify enforcement of contracts in the 21st century and that there is a principled development of the law in relation to the privity doctrine.

Third party rights are allowed in contract law to give effect to the bargain created by the contracting parties. To accommodate third party rights, dominance is placed on giving effect to the contracting parties' intention rather than the process in which a bargain is

² As discussed in Chapters 4 and 5, the scope of the common law mechanisms is not very clear-cut and requires judicial consideration in extending the availability of these mechanisms to contracts made for the benefit of third parties.

formed where only parties offering and accepting an offer are entitled to enforce a contract. Such a change in attitude towards the bargain theory is necessary as it is responsible to redress the problems created by the doctrine of privity which it endorses. This also ensures that the contract theory and practice are consistent with one another. The legislature and the courts have from time to time allowed third party rights to be created or enforced directly or indirectly. The responsive bargain theory is able to provide the rationale and understanding behind the stance taken by the legislature and the courts. This is something which the strict bargain theory fails to address. According to the responsive bargain theory, the contract law must be responsive to the needs of the society, one of which is to ensure that their bargain will be given effect to. The bargain made in contracts created for the benefit of third parties will only be satisfactorily given effect to if they are given enforcement rights over these contracts in accordance with the contracting parties' intention. Thus, it is justified for the legislature and the courts to grant third party rights in relation to these contracts.

Although more flexibility is injected into the bargain theory, its major characteristics remain intact. The emphasis of the responsive bargain theory is still on protecting the interest of the contracting parties. Third party rights are only generated as a remedy for the promisor's breach of contract in order to give effect to the contracting parties' intention. This new remedy in the form of third party rights will cut through all the unnecessary complexities involved in assisting the contracting parties to arrange their affairs to benefit third parties. Accordingly, there remain differences between the rights of the contracting parties and the third party.³

³ For eg., certain rights are reserved only for the contracting parties. This includes the right to terminate the contract and the right to claim restitutionary damages; Merkin, Robert, ed., *Privity of Contract: The Impact of the Contracts (Right of Third Parties) Act 1999*, (LLP, London, 2000) (hereinafter referred to as 'Merkin'), at para 5.49. In addition, Peel, Edwin, *Treitel - The Law of Contract*, 12th Edition, (Sweet & Maxwell, 2007) at 705, states that the rights of third parties under the 1999 (E&W) Act is *sui generis*.

Chapter 3 showed that Malaysia recognises and applies the doctrine of privity. The Malaysian Parliament has created numerous exceptions to the doctrine. These statutory exceptions are either inherited from or modelled on the statutory exceptions found in England. However, these statutory exceptions only apply to limited number of contracts made for the benefit of third parties. Chapter 3 also showed that the responsive bargain theory is equally applicable in Malaysia. In fact, the differences found in Malaysian contract law compared to English contract law prove that the Malaysian contract law can be justified better by the responsive bargain theory.

There are a number of findings on the judicial approach in Malaysia in relation to the application and circumvention of the doctrine gathered from Chapters 3, 4 and 5. Firstly, the Malaysian courts, particularly, the Federal Court has not voiced any dissatisfaction against the doctrine. This may be defended as most of the cases decided by the Federal Court do not involve contracts made for the benefit of third parties. Therefore, the application of the doctrine in these cases is correct. In some of the cases decided, the Federal Court could apply an existing conventional common law mechanism to evade the doctrine.⁴ This indicates that the Federal Court may not be persuaded to develop further exceptions to the doctrine.

Secondly, in cases involving contracts made for the benefit of third parties, the Court of Appeal and the High Court are willing to adopt a more liberal approach either in interpreting statutory exceptions to the doctrine or in applying the common law mechanisms to ensure that the third party is entitled to enforce the contract. Particularly, the trend in the Malaysian courts is to find the existence of an implied or constructive trust to

⁴ These are agency, collateral contract and trust mechanism.

provide the third party with direct rights to enforce a contract made for his benefit. Other possible mechanisms indicated by decided cases which may be utilised by Malaysian judges in evading the doctrine are the doctrine of promissory estoppel and the tort of negligence.

Thirdly, in relation to the promisee's remedies for breach of contract, it can be safely argued that Malaysian courts will order specific performance or injunction, whichever relevant to assist the promisee to fulfill his intention of benefiting the third party. In relation to the remedy of stay of proceedings and damages, it is too early to state whether the Malaysian courts will follow the footsteps of the English judges, especially in relation to the 'narrow ground' and the 'broad ground'.⁵

Fourthly, Malaysia adopts all the conventional mechanisms laid down in Chapter 5 Part II. However, there is yet to be any cases which adopt the Canadian Supreme Court decision in *London Drugs Ltd v Kuehne & Nagel International Ltd*⁶ or the Australian High Court decision in *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd*.⁷ In *London Drugs* and *Trident*, third party rights are created according to the contracting parties' intention.⁸ In relation to enforcement of exclusion clauses, only the agency mechanism is applied by Malaysia judges.

⁵ The 'narrow ground' and the 'broad ground' are discussed in Chapter 4 Part IV. The 'narrow ground' is developed by judges to allow recovery of third party losses whereas the 'broad ground' is a liberal application of the principles governing damages to allow the promisee to recover damages for cost of repair or diminution of value to properties belonging to third parties.

⁶ [1992] 3 SCR 299 (hereinafter referred to as '*London Drugs* exception').

⁷ [1988] 165 CLR 107 (hereinafter referred to as '*Trident* exception').

⁸ See Chapter 5 Part III(E) and Part IV(A) respectively.

Fifthly, the existing position in the Malaysian law regarding contracts made for the benefit of third parties is unsatisfactory. There is judicial divergence as to the scope of some of the common law mechanisms, particularly the trust mechanism where there are a number of unresolved issues. There is also no exception which recognises the creation of third party rights based solely on the contracting parties' intention to benefit a third party.

Sixthly, in terms of the judicial development of the law to circumvent the doctrine of privity, there are a number of alternative options available to Malaysian judges. This includes the 'narrow ground' and the 'broad ground', the '*London Drugs* exception', the '*Trident* exception', bailment on terms, tortious analysis of exclusion clauses and restitution. As discussed later in this Part, the various legal mechanisms are marred by difficulties. Nonetheless, reliance is still placed on the judicial development, as at present, in Malaysia, no statutory reform of the doctrine is undertaken. Thus, the common law mechanisms are the second best option available to judges to ensure that the contracting parties' intention are given effect to and that fairness is achieved.

There are a number of findings made on the growth and development of the common law mechanisms in England, Australia and Canada to ameliorate the harshness of the doctrine gathered from Chapters 4 and 5.

Firstly, the trend seen in England, Australia and Canada is that the law has to accommodate third party rights. The law cannot avoid problems created by the doctrine of privity. It is just a matter of time for these problems to reach the courts. An examination of cases illustrates that the fair and just solution is to give effect to third party rights whether directly or indirectly, by liberalising existing common law mechanisms or introducing new

mechanisms. This liberalising process involves the relaxation of the requirements of the common law mechanisms and applies generally to the different types of common law mechanisms. The requirements behind enforcement of Himalaya clauses by third parties and the ‘narrow ground’ have been watered down in recent cases. Similarly, the utilisation of the tort principles to give effect to exclusion clauses which at one time was treated with disfavour has found its way into the law reports. Attempts have also been made to extend the application of the restitution principle to apply to contracts made for the benefit of third parties. The liberalisation process of these various mechanisms reveals that the all important and common criteria is whether recognising third party rights is in accordance with the contracting parties’ intention.

Secondly, among the exceptions created by judges to deal specifically with the privity doctrine, the ‘*London Drugs* exception’ is preferable compared to the ‘*Trident* exception’. The ‘*London Drugs* exception’ does not require the third party to prove any reliance, actual or presumed. It is applicable as long as the contracting parties intend the exclusion, limitation or waiver of subrogation clause to cover the third party. In relation to the ‘*Trident* exception’, there is a query whether there is a need to prove reasonable or likelihood of reliance⁹ which may prevent third parties from having recourse to the contract if they are not aware of its existence at the time breach of contract occurs or could not prove any likelihood of reliance on the contract. Nonetheless, from cases applying the *Trident* exception, judges seem to be paying lip service to the requirement of reliance as it is easily satisfied. In addition, looking at the basis to reform the privity doctrine (respecting the contracting parties’ intention), reliance should not be a requirement to determine the creation of third party rights.

⁹ Cf *Woodside Petroleum Development Pty Ltd v H & R – E & W Pty Ltd* [1999] WASCA 1024.

As such, the principles behind the '*London Drugs* exception' are commendable with one modification. It should apply to positive benefits as well. Otherwise, there will be a lacuna in relation to the situations where third parties are entitled to enforce contracts made for their benefit. However, if the Federal Court of Malaysia is to introduce this exception, some of the points which remain unsettled in Canada as stated in Chapter 5 must be resolved by the Federal Court.¹⁰

There are a number of disadvantages of undertaking a judicial reform of the doctrine compared to statutory reform. The examination on the operation of the common law mechanisms and statutory reform to the doctrine in Chapters 5 and 6 respectively showed that it is more effective to undertake a statutory reform.¹¹

There are a number of findings from the comparative study on the legal position of a third party in a contract made for his benefit in the selected countries. Firstly, the underlying basis of reform is to give effect to the contracting parties' intention. Thus, third party rights can be shaped in accordance to their intention. As a result, the particular third party's right can be greater or lesser depending on the terms of the contract.

Secondly, the scope and rules of each of the statutory reform varies from country to country in some significant aspects.

Thirdly, the problems encountered by the operation of the statutory reform as seen from cases are similar. In all the statutory reforms, judges face interpretive difficulties in

¹⁰ For eg., the events leading to the crystallisation of third party rights remain unclear.

¹¹ For eg., there is no important development of the '*Trident* exception' since its creation twenty years ago. In fact, a number of cases had confined its application to insurance cases only.

determining the scope of the rules of reform. From the cases examined, particularly, in the United States, England and New Zealand, generally, judges adopt a benevolent interpretation of the rules of reform.

Fourthly, although this thesis argues that it is necessary to give effect to the contracting parties' intention, it is submitted that in some circumstances, the priority placed on protecting the contracting parties may be abused and becomes detrimental to third parties.¹² The priority given to the contracting parties' intention is justified as they are the donors who give rights to the third party. The burden is placed on third parties to check on the scope of their rights. However, in circumstances where the third party has carried out his part in checking the terms of the contract but is prevented from doing so without reasonable excuse or is misled as to his rights under the contract by the contracting parties, the law should intervene to protect the third party. In these situations, the doctrine of promissory estoppel and the tort of negligence may be utilised to redress any unfairness.

Overall, the current legal position in Malaysia in relation to the doctrine of privity and its circumvention is inadequate to deal with the problems arising from contracts made for the benefit of third parties. Unless the contracting parties have resorted to the creation of an express trust, collateral contracts/warranties, agency relationship or assignment, the third party is left at the mercy of the courts in determining whether he can enforce the contract. At present, certainty in the law and clear guidance from the Federal Court on this matter are clearly lacking. Although Malaysian judges are willing to ensure that justice is done in

¹² For eg., the third party does not know that there is a term in the contract excluding his right to enforce the contract or that his rights can be taken away without his consent even after he accepts the benefit or relies on the benefit.

relation to contracts made for the benefit of third parties, the current means to do so are not satisfactory. As a result, Malaysia is in need of a statutory reform of the doctrine.

III. Recommendations

This part examines the reasons for the recommendations and provides details of the recommendations, including a draft bill.

A. Reasons for Recommendations

Based on the findings and discussion in this thesis, it is proposed that Malaysia should undertake a comprehensive statutory reform to the doctrine of privity. Reform should be modelled based on the Contracts (Rights of Third Parties) Act 1999 in England with some modifications as explained in this chapter at Part III(B). This recommendation is made due to the following reasons.

Firstly, the recommendation of a statutory reform is to address the problems created by the privity doctrine as discussed in Chapter 2. The contracting parties are given power to create enforceable rights over the contract to the third party. The various rules relating to the enforceability test, variation of the benefit intended for the third party and promisor's defences are subject to the contracting parties' intention which must be expressly stated in the contract. The terms of contract will be construed using the ordinary rules of interpretation of contract to determine their intention.

By giving effect to the contracting parties' intention to benefit a third party, the recommendation proposed in this chapter is also beneficial to third parties. However, the interest of the contracting parties and the third party may conflict with one another in situations where the former revoke or vary the contract to the detriment of the latter. In these circumstances, the emphasis placed on protection of contracting parties' interest by the statutory reform can be prejudicial to the third party. This is highlighted in the conclusion to Chapter 6 which also provides a solution, adopted into the recommendation proposed in this chapter to strike a fair balance between the contracting parties and the third party. In situations where it is not unfair to allow the contracting parties to rescind or vary the contract despite the crystallisation of the third party's right, judges are given discretion to waive the requirement of consent of the third party.

By allowing third parties to enforce contracts made for their benefit and recover damages for the losses suffered will also ensure that the losses created by the promisor will not disappear into the 'legal black hole'.¹³ A statutory reform of the doctrine of privity along the rules proposed in this chapter is also simpler and more convenient to the contracting parties. They can prepare their contractual arrangements by referring to the Act reforming the doctrine. They can achieve their intention to benefit third parties by expressly allowing the latter to enforce the contract. Transactional cost and time are reduced.¹⁴ Undertaking a statutory reform will also reduce artificiality¹⁵ and uncertainty in the law created by the common law mechanisms.

¹³ The 'legal black hole' refers to situations where losses suffered by third parties are not recoverable from the promisor either by the promisee or the third parties.

¹⁴ Inertia and reluctance to adopt the 1999 Act (E&W) are slowly changing. The construction industry is now willing to utilise the 1999 Act (E&W) to save cost and time; Davies, Jake "A Constructive Alternative", October 13, 2007 *Estate Gazette*.

¹⁵ For eg., statutory reform avoids artificiality of some of the legal mechanisms to override the doctrine such as the Himalaya clause and the trust method.

It must be noted that the statutory reform proposed in this chapter may create some new uncertainties especially in difficult cases. There is room for different approaches and conclusions to be taken in relation to the application of the enforceability test of the statutory reform.¹⁶ The principles governing the remedies for breach of contract such as specific performance and damages have to be modified in relation to claims of a third party to prevent unfairness to the promisor as seen in Chapter 6 Part III(A)(4). Despite these arguments, overall, undertaking a statutory reform yields more benefit than harm to the law. Complexity may not be avoided totally but the law is very much improved. The unjustified application of the doctrine to contracts made for the benefit of third parties is acknowledged. The main problem caused by the doctrine (frustrate the contracting parties' intention) is addressed. Furthermore, Chapter 6 has attempted to provide answers for the possible difficulties created by the statutory reform to the doctrine which can be adopted by the courts.

Secondly, undertaking a comprehensive statutory reform of the privity doctrine is more effective than judicial reform. This is evidenced by the fact that in recent years, countries undertaking or proposing reform of the doctrine opted for comprehensive statutory reform.¹⁷ In England and New Zealand, there are no major difficulties with the operation of the statutory reform. Particularly, in Malaysia, since judges have not dealt with the various common law mechanisms, a statutory reform will take away the burden from the court to decide the appropriate measure to be adopted to resolve the problems created by the doctrine. This reduces the uncertainties and difficulties faced in Australia and Canada as a

¹⁶ It is inevitable that some difficulties in the application of the law are encountered when a new law is enacted by the Parliament. These difficulties will be ironed out in the years to come when judges are given the opportunity to clarify the law.

¹⁷ This is seen in England, Singapore, Hong Kong, Nova Scotia and Ireland.

result of the '*London Drugs* exception' and the '*Trident* exception'. It is submitted that although Malaysian judges, especially the Federal Court have yet to review the difficulties created by the application of the doctrine, this does not mean that its application is not problematic in Malaysia. It is just that the problematic cases have yet to reach the courts. Besides, one possible reason for the lack of opportunity to review the doctrine is that legal advisers may prefer to utilise the cumbersome common law mechanisms to circumvent the doctrine of privity rather than challenging the application of the doctrine or inviting the courts to introduce a new exception as the chances of success of these arguments are uncertain.

Thirdly, statutory reform is more appropriate in Malaysia as the main source of law of contract is governed by statute that is, the Contracts Act 1950 (hereinafter referred to as 'CA 1950').¹⁸ Looking at the current judicial attitude in relation to the doctrine of privity, judicial reform is simply not forthcoming.

Fourthly, the 1999 Act (E&W) is chosen as the preferred model for reform as it is a more moderate measure which is consistent with the approach taken in Malaysian contract law. For instance, the legal position governing liability to third parties under the law of tort is similar to English law. Thus, a too radical approach in the law such as that practised in the United States is not suitable as it is too liberal and may lead to unforeseen liability on the promisor's part. Reform of the doctrine should not be too wide and open the floodgate of litigation to third parties. Reform should be confined to situations where the contracting parties' intention to benefit third parties is manifested in the contract.

¹⁸ There are also other statutes which govern specific areas of contract law such as Specific Relief Act 1950 (remedies), Civil Law Act 1956 (frustration of contracts), Hire-Purchase Act 1967 (Act 212) (Revised 1978) (hire-purchase contracts) and Consumer Protection Act 1999 (consumer contracts).

B. Details of Recommendations

According to the recommendation proposed in this chapter, the privity doctrine will not be abolished. A general exception is created to provide contracting parties with a simpler method to create enforceable third party rights over a contract. It is proposed to the Parliament to enact a new Act to allow for the creation of third party rights. This thesis provides a draft bill (Part C) to reform the doctrine in Malaysia. This draft bill is prepared after analysing and evaluating the various statutory reforms discussed in Chapter 6 and the Law Commission Reports produced in Nova Scotia (Canada), Hong Kong and Ireland.

The expressions of the draft bill follow to a large extent, the wordings used in the 1999 Act (E&W). However, there are a number of differences from the 1999 Act (E&W). Firstly, in relation to the power of the courts to authorise variation or rescission of the benefit, the position in the Contracts (Privity) Act 1982 (hereinafter referred to as '1982 Act (NZ)') is adopted with a modification.¹⁹ The rules of the 1982 Act (NZ) adopted are firstly, either one of the contracting parties can apply for the variation or rescission order. Secondly, judges will grant this order if it is 'just and practicable' to do so.²⁰ Nonetheless, the recommendation made in this chapter differs from the 1982 Act (NZ) in one respect.²¹ In imposing conditions on the variation or rescission order, it is proposed that judges are given the power to impose a condition on the promisor or promisee or both to compensate the third party for any losses suffered as a result of the variation or rescission. Malaysian

¹⁹ See Clause 4 of the Draft Bill in this chapter.

²⁰ The Hong Kong Law Commission also came up with similar recommendation in their Consultation Paper (hereinafter referred to as 'HKLC'); Recommendation 8, Chapter 4.

²¹ This discussion is found in Chapter 6 Part IV(B)(5).

judges will appreciate the discretion granted by the recommendation in this chapter as this will allow them to ensure that fairness is achieved.

The matters which are unclear in the 1999 Act (E&W) are clarified.²² For example, the draft bill provides that the contracting parties can reserve the right to vary or rescind the benefit by agreement or unilaterally without the consent of the third party.²³ In relation to communication of acceptance by the third party through post, communication is deemed to be made when the letter is received by the promisor. This is consistent with the existing rule on communication of acceptance found in s.4(2)(b) CA 1950.²⁴ It will also be clarified that the contracting parties can expressly provide that defences available to the promisee against the third party in a separate but related transaction are equally applicable to the promisor.²⁵ The definition of ‘contracts’ which will fall under the reform is included in the draft bill.

Fourthly, no recommendation is made in relation to the inclusion of provisions relating to a third party right’s to refer his dispute with the contracting parties to arbitration and the types of contracts which are to be excluded by the statutory reform. These matters are not discussed in this thesis as they are more appropriately dealt with by a Law Commission.²⁶

²² This discussion is found in Chapter 6 Part III(A).

²³ Similar recommendation was also found in HKLC; Recommendation 7, Chapter 4.

²⁴ Section 4(2)(b) provides that “The communication of an acceptance is complete as against the acceptor, when it comes to the knowledge of the proposer.” Illustration (b) to s.4(2)(b) reads, “B accepts A’s proposal by a letter sent by post. The communication of the acceptance is complete as against B, **when the letter is received by A.**” (emphasis added)

²⁵ See Clause 5(5) of the Draft Bill in this chapter.

²⁶ For eg., the Singaporean Contracts (Rights of Third Parties) Act 2001 does not have any specific provisions on arbitration.

C. Draft Bill

This part provides a draft bill for the statutory reform of the doctrine of privity. Clause 2 of the draft bill allows contracting parties to grant third party rights. This clause is intended to uphold the contracting parties' intention to benefit third parties. Benefit includes positive and negative benefits, including defences that can be relied on in a legal action brought against the third party.

Clause 3 deals with the limits on the contracting parties' power to rescind or vary terms intended to benefit third parties without the consent of the latter. Clause 4 provides that the third party's consent in rescinding or varying the term can be waived if the court finds it 'just and practicable' to do so. Situations that may fall under this Clause include situations where the third party's whereabouts are unknown and where the third party is mentally incapable to give consent.²⁷

Clause 5 states the defences that the promisor can rely on in relation to a claim brought by the third party to enforce the benefit provided for the latter. Clause 6 clarifies the promisee's rights under a contract made for the benefit of third parties and Clause 7 protects the promisor from double liability. Lastly, Clause 8 preserves the common law mechanisms available to assist the third party to circumvent the doctrine of privity.

²⁷ These are the situations provided in s.2(4) 1999 Act (E&W).

The following are the provisions for the draft bill:

Contracts (Rights of Third Parties) Bill 2008

Arrangement of clauses

Clause

1. Short title, commencement and extent
2. Right of third party to enforce the contract
3. Variation and rescission of contract
4. Power of court to authorise variation and rescission
5. Defences etc. available to promisor
6. Enforcement of contract by promisee
7. Protection of promisor from double liability
8. Supplementary provisions relating to third party

A Bill

INTITULED

An Act to make provision for the enforcement of contractual terms by third parties.

ENACTED by the Parliament of Malaysia as follows:

Short title and commencement

1. (1) This Act may be cited as the Contracts (Rights of Third Parties) Act 2008.
(2) This Act comes into effect . . .

Right of third party to enforce contractual term

2. (1) Subject to the provisions of this Act, a person who is not a party to a contract ("third party") may in his own right enforce a term of the contract if:
 - (a) the contract expressly provides that he may, or
 - (b) subject to subsection (2), the term purports to confer a benefit on him.
- (2) Subsection (1)(b) does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party.
- (3) The third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description but need not be in existence when the contract is entered into.
- (4) This section does not confer a right on a third party to enforce a term of a contract otherwise than subject to and in accordance with any other relevant terms of the contract.
- (5) For the purpose of exercising his right to enforce a term of the contract, there shall be available to the third party any remedy that would have been available to him in an action for breach of contract if he had been a party to the contract (and the rules relating to damages, injunctions, specific performance and other relief shall apply accordingly).
- (6) Where a term of a contract excludes or limits liability in relation to any matter references in this Act to the third party enforcing the term shall be construed as references to his availing himself of the exclusion or limitation.

- (7) In this Act, in relation to a term of a contract which is enforceable by a third party-

“contract” means a contract made by deed or in writing, or orally, or partly in writing and partly orally;

"the promisor" means the party to the contract against whom the term is enforceable by the third party, and

"the promisee" means the party to the contract by whom the term is enforceable against the promisor.

Variation and rescission of contract

3. (1) Subject to the provisions of this section, where a third party has a right under section 1 to enforce a term of the contract, the parties to the contract may not, by agreement, rescind the contract, or vary it in such a way as to extinguish or alter his entitlement under that right, without his consent if-
- (a) the third party has communicated his assent to the term to the promisor,
 - (b) the promisor is aware that the third party has relied on the term, or
 - (c) the promisor can reasonably be expected to have foreseen that the third party would rely on the term and the third party has in fact relied on it.
- (2) The assent referred to in subsection (1)(a)-
- (a) may be by words or conduct, and
 - (b) if sent to the promisor by post or other means, shall not be regarded as communicated to the promisor until received by him.
- (3) Subsection (1) is subject to any express term of the contract under which-

- (a) the parties to the contract may by agreement or unilaterally rescind or vary the contract without the consent of the third party, or
- (b) the consent of the third party is required in circumstances specified in the contract instead of those set out in subsection (1)(a) to (c).

Power of court to authorise variation and rescission

4. (1) Where the consent of a third party is required under s.3(1) or (3), a Court, may, on application by one of the contracting parties, if it is just and practicable to do so, make an order authorising the variation or rescission of the term 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 third party has been injuriously affected by his own reliance on the term benefiting him,

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

Defences etc. available to promisor

5. (1) Subsections (2) to (6) apply where, in reliance on section 2, proceedings for the enforcement of a term of a contract are brought by a third party.

(2) The promisor shall have available to him by way of defence or set-off any matter that-

- (a) arises from or in connection with the contract and is relevant to the term, and

(b) would have been available to him by way of defence or set-off if the proceedings had been brought by the promisee.

(3) The promisor shall also have available to him-

(a) by way of defence or set-off any matter, and

(b) by way of counterclaim any matter not arising from the contract,

that would have been available to him by way of defence or set-off or, as the case may be, by way of counterclaim against the third party if the third party had been a party to the contract.

(4) Subsections (2) and (3) are subject to any express term of the contract as to the matters that are not to be available to the promisor by way of defence, set-off or counterclaim.

(5) The promisor shall also have available to him by way of defence or set-off any matter if-

(a) an express term of the contract provides for it to be available to him in proceedings brought by the third party, and

(b) it would have been available to him by way of defence or set-off if the proceedings had been brought by the promisee, or it would have been available to the promisee by way of defence or set-off if the proceedings had been brought by the third party.

(7) Where in any proceedings brought against him, a third party seeks in reliance on section 2 to enforce a term of a contract (including, in particular, a term purporting to exclude or limit liability), he may not do so if he could not have done so (whether by reason of any particular

circumstances relating to him or otherwise) had he been a party to the contract.

Enforcement of contract by promise

6. Section 2 does not affect any right of the promisee to enforce any term of the contract.

Protection of promisor from double liability

7. (1) Where under section 1 a term of a contract is enforceable by a third party, and the promisee has recovered from the promisor a sum in respect of-
 - (a) the third party's loss in respect of the term, or
 - (b) the expense to the promisee of making good to the third party the default of the promisor,

then, in any proceedings brought in reliance on that section by the third party, the court or arbitral tribunal shall reduce any award to the third party to such extent as it thinks appropriate to take account of the sum recovered by the promisee.

Supplementary provisions relating to third party

8. Section 2 does not affect any right or remedy of a third party that exists or is available under common law or any other Act of Parliament apart from this Act.

V. Conclusion

The doctrine of privity is very crucial in understanding the nature of contracts and the limits of contractual liabilities. However, the doctrine fails to take into account the fact that contracting parties may intend the contract to benefit a third party. Applying the doctrine to contracts made for the benefit of third parties runs counter to the fundamental principle behind contract law to respect freedom of contract and give effect to agreements created by contracting parties. Naturally, numerous problems arise in relation to contracts made for the benefit of third parties as explained in this thesis. It is high time for the law to recognise that there are differences between these contracts and ordinary two party contracts. Third party rights should be granted in accordance to the contracting parties' intention. Evaluation of the legal development in other common law countries illustrates that this is the solution that should be taken.

The doctrine of privity, as it stands today in Malaysian contract law, is problematic as it continues to apply to contracts made for the benefit of third parties. Although statutory exceptions and common law mechanisms are utilised whenever possible to redress injustices caused by the doctrine, this thesis shows that these solutions are unsatisfactory. Judicial reform of the doctrine suffers from two major weaknesses. Firstly, there is lack of opportunity for the Federal Court to introduce a generic exception to the doctrine. Secondly, the Federal Court may be reluctant to do so due to the doctrine of separation of powers, as it does not want to be seen to usurp legislative powers of the Parliament. Hence, it will be more effective to undertake a comprehensive statutory reform of the doctrine. To ensure that the statutory reform is utilised effectively, the Malaysian government can provide Explanatory Notes on the new Act reforming the doctrine and invite legal experts

to comment on the application of the new Act in the major newspaper and on the Internet. It is hoped that such widespread dissemination on the effects of the new Act will raise the awareness of the public on the advantages and the possible traps of the reform. This ensures that the respective parties involved (contracting parties and third party) will know how to safeguard their own position.