

CHAPTER FIVE

Judicial Circumvention of Doctrine of Privity – Other Legal Mechanisms

I. Introduction

In stark contrast with the promisee's remedies for breach of contract explained in Chapter 4, the legal mechanisms discussed in this chapter provide third parties with a direct right to enforce a contract. These mechanisms constitute better protection for third parties. This chapter is divided into three parts. The first part examines the conventional legal mechanisms which assist third parties to enforce contracts in Malaysia. The second part examines the mechanisms developed in England, Australia and Canada allowing third parties to rely on exclusion, limitation and waiver of subrogation clauses. The third part examines the innovations adopted by Australian courts in creating new exceptions to the doctrine and utilising the existing principles of the law such as the doctrine of promissory estoppel and restitution to accommodate third party claims.

In relation to each of the mechanisms, the following issues are analysed:-

- (a) Explain the mechanisms in solving problems created by the doctrine of privity.
- (b) Evaluate the mechanisms and their possible development in Malaysia.

II. Conventional Mechanisms Allowing Third Party to Enforce a Contract

This part examines the conventional means of circumventing the privity doctrine in Malaysia¹ which comprise (i) a liberal construction of ‘party’ to a contract, (ii) collateral contract, (iii) agency, (iv) trust and (v) tort.

A. Liberal Construction of ‘Party to a Contract’

Generally, the law in Malaysia in determining parties to a contract is similar to English law as explained in Chapter 2. Parties to a contract refer to those who are involved in an exchange of promises or those who are stated in the contract to be a party to it. The fact that a person is a signatory to an agreement does not necessarily mean that he is a party to the contract. It depends on the capacity in which he signs the agreement.² Mere mention of a person’s name in the agreement without more will not elevate his position to that of a contracting party.³ If the courts adopt a liberal approach in determining who is a party to a contract, a third party may be able to prove privity with the promisor by arguing that he is a party to the contract. As a consequence, the third party is entitled to contractual remedies in the event of breach of contract by the promisor.

¹ These are not true exceptions to the privity doctrine as they are consistent with the application of the doctrine. These methods (except tort), if applicable will build privity between the third party and the promisor. For tort of negligence, since it represents a separate branch of law from contract, there is no need to adhere to the privity requirement.

² This is illustrated in *Borneo Housing Mortgage Finance Bhd v Personal Representatives of the Estate of Lee Lun Wah Maureen* [1994] 1 MLJ 209. In this case, the second defendant signed in the acceptance note of a loan agreement entered into by the first defendant (the second defendant’s wife) and the plaintiff. The High Court held that the second defendant was not a party to the loan agreement as she signed as a guarantor for the loan and not as a recipient of the loan. As a consequence, the second defendant could not claim benefits of the loan agreement.

³ *Syed Mansor bin Syed Hassan v Official Administrator* (Civil Suit No 139 of 1979) Unreported. It was held in this case that the mere mention of the plaintiff’s name in the instrument of transfer of land was insufficient to make him a party to the sale and purchase contract of the land.

There is one case which displays a liberal construction as to who is a party to the contract. In *Parimala a/p Muthusamy v Projek Lebuhraya Utara-Selatan*,⁴ the plaintiffs were passengers in a motorcar driven by the deceased along the highway at the time of accident. The deceased died on the spot after hitting a stray cow which had found its way to the highway through a breach in the fencing system. The plaintiffs claimed damages for injuries that they suffered as a result of the accident. The High Court allowed the plaintiffs' claim based on the tort of negligence and breach of statutory duty. However, Suriyadi J (as he then was) went on to hold that there was also a breach of contract by the defendant. The moment a ticket was extracted at the toll gate, a contract was struck between the plaintiffs and the defendant. There was an implied warranty that the highway would be safe for the use of the deceased and the plaintiffs.

As such, it appears that the learned judge treated the plaintiffs as parties to the contract between the deceased and the defendant though this was not made clear in his judgment nor was it clear as to how the plaintiffs became parties to the contract. It must be remembered that the deceased was the person who entered into the contract with the defendant as he was the one who purchased and paid for the ticket.⁵ Thus, only the deceased can sue the defendant for breach of contract. The plaintiffs who were passengers of the car should not be taken as parties to the contract and accordingly, could not sue the defendant in contract. Therefore, arguably, this case is unlikely to be followed in subsequent cases.⁶ In brief, whether a third party should be taken as a party to the contract depends on the intention and conduct (including the contractual terms agreed) of the contracting parties. If their intention

⁴ [1997] 5 MLJ 488. 'Projek Lebuhraya Utara-Selatan' refers to the North-South Highway Project in English.

⁵ Syed Ahmad Alsagoff, *Principles of the Law of Contract in Malaysia*, 2nd Edition, (MLJ, 2003), at 149.

⁶ This case was referred to without disapproval in *Mohamad Khalid bin Yusuf v The Datuk Bandar Kuching Utara* [2007] 5 MLJ 414, at 427-428.

and conduct treat the third party as a party to the contract, the courts should give effect to this intention.⁷

B. Collateral Contract

Instead of arguing that the third party is a party to the contract between the promisor and the promisee, collateral contract⁸ focuses on the creation of a separate contract between the promisor and the third party. This creates a contractual relationship between them. In England, this device has been used to circumvent the doctrine of privity as seen in *Shanklin Pier Ltd v Detel Products Ltd*.⁹ In this case, the plaintiffs (owners of Shanklin Pier) wanted to repaint the pier. They made an inquiry with the defendants as to the quality of their paint. The plaintiffs were informed that the paint lasted for between seven and ten years. The plaintiffs then hired contractors to repaint the pier and specified that the defendants' paint was to be used. However, the paint proved unsuitable for the pier and began to deteriorate after three months. The plaintiffs sued the defendants for damages for the cost to repaint the pier.¹⁰ It was held by McNair J that there was a collateral contract between the plaintiffs and the defendants due to the representation made by the defendants that the paint would last. Consideration was provided by the plaintiffs as they made the request to the contractor to use the defendants' paint. Thus, the plaintiffs were entitled to succeed in their legal action.

⁷ In fact, the approach taken by the minority in *Coulls v Bagot's Executor and Trustee Co Ltd* (1967) 119 C.L.R. 460 discussed in Chapter 2 Part III should be adopted. The minority in *Coulls* stated that in construing the contracting parties' intention, judges should not limit themselves to the legal definition of the words used by the contracting parties but rather must determine the real meaning as intended by the contracting parties.

⁸ Similarly, if there is a novation contract between the contracting parties and the third party, the latter can enforce the contract. Another popular legal mechanism used in the property industry to evade the doctrine of privity is collateral warranty or known as 'duty of care deeds' executed between the promisor and the third party.

⁹ [1951] 2 KB 854.

¹⁰ The plaintiffs were not privy to the contract of the sale of the paint as it was entered into by the contractor and the defendants.

Shanklin Pier Ltd was referred to in *Oriental Bank Bhd v Uniphoenix Corp Bhd*¹¹ and *Ng Chun Lin v Foo Lian Sin*.¹² In fact, in *Oriental Bank Bhd*, Abdul Malik Ishak J in explaining the use of collateral contracts, expressly stated that this device “provides a means of avoiding the rule as to the privity of contract.”¹³ However, the usefulness of this device in solving problems created by the privity doctrine is limited. This device is only useful if the requirements of a valid contract can be proven. Its application is usually restricted to situations where the third party is involved in a transaction, most likely business in nature, with the promisee and where there is some dealing or exchange of communication between the third party and the promisor. The requirements that the third party must provide consideration¹⁴ and that there must be an intention to create legal relations between the third party and the promisor will exclude the application of this device from many contracts made for the benefit of third parties. There are many situations where the third party does not know of the benefit intended for him before the breach of contract occurs or there are no dealings or exchange of information between the promisor and the third party. In these situations, these two requirements cannot be fulfilled. Besides, remedy for breach of collateral contract lies only in damages. Courts will not grant specific performance of the main contract.¹⁵ As such, this device is only suitable for third parties who want to claim damages only.

¹¹ [2005] 7 MLJ 315.

¹² [2000] 6 MLJ 81.

¹³ At 332 (*Oriental Bank*). The device of collateral contract is a well-established principle in Malaysia. It was discussed in *Tan Swee Hoe Co Ltd v Ali Hussain Bros* [1980] 2 MLJ 16; *Kluang Wood Products Sdn Bhd v Hong Leong Finance Bhd* [1994] 4 CLJ 141; *Foo Lian Sin v Ng Chun Lin* (CA) [2006] 1 MLJ 457; *Bank Bumiputra Bhd v Malek & Joseph Au* [1995] 4 MLJ 251.

¹⁴ Consideration is proven if the third party will not enter into a contract with the promisee but for the promisor’s representation or he must have done something beneficial to the promisor.

¹⁵ *Oriental Bank Bhd v Uniphoenix Corp Bhd* [2005] 7 MLJ 315; *Industrial & Agricultural Distribution Sdn Bhd v Golden Sands Construction Sdn Bhd* [1993] 3 MLJ 433.

C. Agency

Agency is another mechanism to get around the doctrine of privity. In Malaysia, agency is governed by the CA 1950.¹⁶ A, an agent enters into a contract with B¹⁷ to secure a benefit for C.¹⁸ There are two types of agency, disclosed and undisclosed agency. Disclosed agency refers to a situation where B knows that A is acting as an agent for C and knows that he is entering into the contract with C. As a general rule, C is able to sue and be sued by B as long as A has authority to enter into the contract or where C ratifies A's act. A has no rights and liabilities arising from the contract.¹⁹ Undisclosed agency²⁰ refers to situations where B does not know that A is acting on behalf of C. Thus, in the contract between B and A, there is usually no mention of C having interest in the contract. In view of this peculiar characteristic of undisclosed agency, it is often stated that this represents the exception to the doctrine of privity rather than disclosed agency. An undisclosed principal (C) may as a general rule entitled to benefits and burden of the contract entered into by A with his authority.²¹ C can enforce the contract on the terms that A has agreed with B. C is also bound by any changes made to the contract between A and B before his position is made known.

¹⁶ According to s.135 CA 1950, an "agent" is a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done or who is so represented, is called the "principal".

¹⁷ In agency law, B refers to the 'third party' that is, the person who enters into the contract with the 'agent' who acts on behalf of the principal. By contrast, the phrase 'third party' used in this thesis refers to the person who the 'agent' intends to benefit from the contract created that is, the 'principal'. Thus, for the purposes of this thesis, B is the promisor in a contract made for the benefit of third party.

¹⁸ In this part of Chapter 5, C refers to the 'principal', the third party intended to benefit from the contract. A refers to the 'agent' that is, the promisee in a contract made for the benefit of third party.

¹⁹ This principle is subject to a number of exceptions.

²⁰ Tan, Cheng Han in his article entitled "Undisclosed Principals and Contract" (2004) 120 *LQR* 480–509 has sought to rationalise the doctrine of undisclosed principal and the doctrine of privity by the use of implied contract. He argues that the undisclosed principal is entitled to enforce the contract as there is an implied contract between the third party (undisclosed principal) and the promisor.

²¹ As per Lord Denning in *Teheran-Europe Co Ltd v ST Belton (Tractors) Ltd* [1968] 2 All ER 886, at 889.

In relation to contracts made for the benefit of third parties, the intention to benefit C is made clear in the contract. Accordingly, the type of agency applicable is usually disclosed agency. In *The Golf Cheque Book Sdn Bhd v Nilai Springs Bhd*, Gopal Sri Ram JCA stated that:

But it is central to the doctrine of privity of contract that the parties to the contract are contracting on their own behalf and not as the agent of some third party, be that third party a disclosed or an undisclosed principal. **Because it is a well established principle that agency is an exception to the privity doctrine.** (emphasis added)²²

This device was applied in a number of cases by Malaysian judges to sidestep the doctrine of privity.²³ If contracting parties intend to utilise this method to avoid the doctrine, this can be achieved easily by proper drafting of the contract where A states clearly that he is acting on behalf of C. However, C will be subject to the technical rules and requirements of agency in his quest to assert his claim on the contract.²⁴ In the absence of an express term creating agency relationship, courts can infer the existence of this relationship from surrounding circumstances.²⁵ The circumstances taken into account by courts in inferring the existence of an agency relationship includes who makes payment or performs obligations under the contract or entitled to the contractual benefit, the existence of any

²² [2006] 1 MLJ 554, at 559.

²³ The principle of disclosed agency was applied in *Interschiff Schiffahrtsagentur Gmbh v Southern Star Shipping & Trading Pte Ltd.* [1984] MLJ 342; *The Viva Ocean* [2004] 2 AMR 284; *Wong Yan Mok v Indo-Malaya Trading Co* [1975] MLJ 147. The principle of undisclosed principal was applied in *Tara Rajaratnam v Datuk Jagindar Singh* [1983] 2 MLJ 127 and *Anika Insurance Brokers Sdn Bhd v Public Bank Bhd* [2004] 6 MLJ 268. In *Tara Rajaratnam*, the principle of undisclosed agency was relied on to made the undisclosed principal liable to the plaintiff (passing of burden). In *Anika Insurance*, the principle of undisclosed agency was relied on to allow the undisclosed principal to sue the defendant (passing of benefit).

²⁴ For eg., the rules relating to ratification, defences and set-off.

²⁵ *Sri Sutera Sdn Bhd v Mohamed Abid* [2004] 1 CLJ 139; *KGJ Jaya Sdn Bhd v Pan Reliance Sdn Bhd* [1996] 2 CLJ 611.

instruction or request by C and whether creation of an agency relationship will defeat claims of unsecured creditors of B if B is insolvent or bankrupt.²⁶

In England, in the past, judges sometimes try to extend the situations in which agency relationship exists. In *Lockett v A.M. Charles*,²⁷ the plaintiffs (a pair of husband and wife) had lunch at a hotel. The husband paid for the meal. The wife suffered from food poisoning whose cause was attributed to the food served by the hotel. The couple sued the hotel for compensation. The trial judge held that the husband who paid for the meal acted as agent for the wife in entering the contract with the restaurant for the food served. As such, the plaintiffs were entitled to succeed. With due respect, the husband and wife most probably did not consider that a relationship of agency existed between them at the time when they ordered the food. Moreover, the more preferable inference from the facts is that the husband was the one intended to enter into the contract with the hotel as he was the one who assumed the contractual obligation by paying for the lunch. As such, it is not surprising that the use of the agency device has been criticised by the Court of Appeal in *Jackson v Horizon Holidays*.²⁸ It was held in *Jackson* that it would be totally unrealistic and fictional to imply a relationship of agency between the father who entered into a contract and paid for a holiday package and his wife and twins of three years old.²⁹ Furthermore, if third party rights are dependent on inference of agency made by judges, this may lead to unpredictability and uncertainty as to when such inference is made.

²⁶If creation of relationship of agency between the promisee and third party will prejudice the claims of unsecured creditors of the promisor, the courts may not be willing to infer such a relationship; Merkin, Robert, ed., *Privity of Contract: The Impact of the Contracts (Right of Third Parties) Act 1999*, (LLP, London, 2000), at 33.

²⁷ [1938] 4 All ER 170.

²⁸ [1975] 3 All ER 92. The facts and decision of this case are laid down in Chapter 4 Part IV(A)(1)(i).

²⁹ As per Lord Denning M.R., at 95 and as per James LJ, at 96 (*Jackson*).

Agency mechanism is also not suitable in situations where the parties involved have never given thought to creating an agency relationship between A and C. A may not intend to act as an agent and be bound by fiduciary duties to C especially where the contract is intended as a gift to C. Moreover, contracting parties may not intend C to have full contractual rights arising from the contract. Particularly, in domestic situations, A may still want to retain discretion to alter or revoke the benefit in the event of any change of circumstances. But once a relationship of agency exists, the benefit cannot be altered without C's consent since he is a party to the contract. It may be arguable that an implied term can be added to the contract stating that the contract can be modified without C's consent. However, to adopt such approach will increase complexities in this area of law.

Hence, agency mechanism is not applicable to all contracts made for the benefit of third parties. This mechanism is more apt for commercial contracts where the contracting parties have given thought to the scope and extent of their liability under the contract and their willingness to benefit C. Once an agreement is reached on this matter, they can arrange their affairs by utilising the concept of agency to achieve their intentions through proper drafting of their contract by legal professionals.

D. Trust of a Contractual Right

The doctrine of privity can also be circumvented by the imposition of a trust in favour of the third party. Contractual right being a chose in action can be the subject matter of a trust. A promisee who enters into a contract for the benefit of a third party is a trustee whereas the third party is the beneficiary under the trust. The promisee can sue the promisor for breach of contract and is entitled to contractual remedies such as specific performance or

claim of damages on behalf of the third party. If the trustee refuses to sue, the beneficiary is able to take legal action against the promisor and join the trustee as a defendant.

This part examines (i) the utilisation of trust mechanism in England, Australia and Malaysia and (ii) evaluation of the effectiveness of this mechanism in dealing with problems created by the doctrine of privity. The position in England is discussed as English trust cases are followed by Malaysian judges. The Australian position is discussed as it differs from the English position and is recommended to be adopted in Malaysia.

1. Position in England

The possibility of the use of trust to solve the problems created by the doctrine of privity begins with *Tomlinson v Gill*.³⁰ In this case, the defendant promised a widow that if she allowed him to be the administrator of her husband's estate, he would pay off debts owed by the deceased. The plaintiff, one of the creditors of the deceased, sued the defendant for payment of debt. It was held by Lord Harwicke that the widow entered into the agreement with the defendant as a trustee for the creditors. Thus, the plaintiff was entitled to sue the defendant to recover the debt owed by the deceased.

The trust mechanism is then used successfully in other cases to allow the third party to sue the promisor. These include the case of *Gregory and Parker v Williams*,³¹ *Fletcher v*

³⁰ (1756) Ambler 330. This acknowledgment is due to the writings of Corbin, Arthur L., "Contracts for the Benefit of Third Persons" (1930) 46 *LQR* 12–45. A contrary view is seen in Andrews, Neil H., "Book Review: The Paths to Privity: The History of Third Party Beneficiary Contracts at English Law" (1995) 69 *Tul LR*. 1393-1408.

³¹ (1817) 3 Mer 582. Here, Parker owed money both to Gregory and Williams. He agreed with Williams to assign him the whole of his property, if Williams would pay the debt due to Gregory. Williams failed to pay

Fletcher,³² *Lloyd's v Harper*³³ and *Les Affreteurs Reunis Societe v Leopold Walford (London) Ltd.*³⁴ It is important to note that in all these cases, the contracting parties failed to use the word 'trust' in their contract. The contracts entered into were mere ordinary contracts. Yet, the courts held that a trust existed. The reason behind the courts' decision was because the contracts concerned were intended to benefit third parties and the courts wanted to give effect to the contracting parties' intention. In *Tomlinson*, the widow never regarded herself as a trustee for her husband's creditors. There was also no obligation of the widow to enter into the contract to benefit the creditors. The motive of the widow in doing so was also unclear. The decision that a trust existed was based not on the intention of the widow to create a trust. Rather, this device was utilised by Lord Harwicke to ensure that the defendant performed his promise.³⁵ Otherwise, this will be unfair as the widow had performed her part of the promise. Similarly, in *Lloyd's*, the contract involved was an ordinary contract of guarantee created by a father to guarantee any losses created by his son as an underwriting member of Lloyd's. The son was declared bankrupt and Lloyd's sought to enforce the guarantee provided by the father to recover losses suffered by persons who dealt with his son. The issue was whether Lloyd's could recover substantial damages since it suffered no loss. Cotton LJ held that:

. . . the Plaintiffs are suing here as trustees for the benefit of all those with whom Mr. Harper, jun., entered into contracts of insurance. That is quite supported by the cases referred to in the judgment of

Gregory. Both Gregory and Parker were allowed to sue Williams for breach of contract as Parker was held to be a trustee for Gregory as a result of the contract between Parker and William.

³² (1844) 4 Hare 67. Here, the settlor created a covenant that upon his death, his personal representatives would transfer a sum of money to the trustees upon trust for his surviving sons. This constituted a valid trust in favour of the surviving son. Accordingly, the son could enforce the covenant.

³³ (1880) 16 Ch 290.

³⁴ [1919] AC 801. This involved a charterparty contract where the shipowners promised the charterer that they would pay commission to the broker. It was held that the charterer was a trustee for the broker in relation to the charterparty contract. Thus, the broker could enforce his claim of commission against the shipowners.

³⁵ Corbin, Arthur L., "Contracts for the Benefit of Third Persons" (1930) 46 *LQR* 12–45, at 21.

Mr. Justice Fry, *Gregory v Williams*, before Lord Grant, and the older case of *Tomlinson v Gill*, before Lord Hardwicke . . . This principle is, I think, a good and sound one, and one upon which we can properly act, and are bound to act in the present case, treating the Plaintiffs Lloyd's as trustees for those for whose benefit this contract was entered into.³⁶

The flexible attitude adopted by the courts will result in the imposition of a trust in every contract made for the benefit of third parties where the promisee has performed his part of his promise. However, such cavalier judicial attitude waned in the late 19th century. Judges began to adopt a stricter approach in deciding whether a trust occurs in a contract made for the benefit of third parties. Such a strict approach remains until today. To determine whether a trust exists, judges must be satisfied that the contracting parties intend to create a trust. A mere intention to benefit a third party will not suffice.

An often cited case as authority for this strict approach is *Vandepitte v Preferred Accident Insurance Corporation of New York*.³⁷ In this case, a policy insurance covered a motor vehicle by which the insurer agreed to indemnify the insured and anyone operating the car with the permission of the insured against third party risks. The issue arose was whether the daughter of the assured was entitled to indemnity from the insurer for damages of personal injuries caused by her negligent driving. The Privy Council held that a contracting party can constitute himself a trustee for a third party of a right under a contract so that the third party is able to enforce the contract. But Lord Wright held that the intention to create a trust must be affirmatively proven and cannot be generally inferred from the words stated in the

³⁶ At 317 (*Lloyd's v Harper*).

³⁷ [1933] AC 70.

policy.³⁸ On the facts, the daughter was not entitled to claim indemnity as no trust was created in her favour.

The instructive case today is *Re Schebsman*.³⁹ The Court of Appeal in this case rejected the argument that a trust existed on the facts due to insufficient evidence to prove that an intention to create a trust existed. Lord Green M.R. stated that “It is not legitimate to import into the contract the idea of a trust when the parties have given no indication that such was their intention.”⁴⁰ It was further held that where there existed a possibility that the promisee wants to retain the freedom to change the party benefited, then it cannot be said that an intention to create a trust is proven. It appears that the Court of Appeal had in mind the creation of an irrevocable trust in overriding the privity doctrine.

Since *Vandepitte* and *Re Schebsman* specify that the intention to create a trust must be proven, it is necessary to determine the test used to prove this intention under the law of trust. An examination of the general principles of trust law suggests that the test used to prove an intention to create a trust is not as strict as seen in *Vandepitte* and *Re Schebsman*. It is not necessary to use the ‘word’ trust. The settlor does not need to know that he is creating a trust at the time it is created as long as the effects that he intends are similar to the effects of a trust.⁴¹ Arguably, if the contracting parties intend the third party to enforce the contract, this must necessarily mean that they intend to give the benefit of the contract to the latter. This can be achieved through the creation of a trust where the promisee holds

³⁸ At 79–80 (*Vandepitte*).

³⁹ [1944] Ch 83. The facts of this case have been explained in Chapter 2 Part II.

⁴⁰ At 89 (*Re Schebsman*). Du Parcq LJ, at 104 also provided that “. . . unless an intention to create a trust is clearly to be collected from the language used and the circumstances of the case, I think that the court ought not to be astute to discover the indications of such an intention.”

⁴¹ Hayton, David and Charles Mitchell, *The Law of Trusts and Equitable Remedies*, 12th Edition, (Sweet & Maxwell, London, 2005), at 154; Martin, Jill E., *Hanbury & Martin: Modern Equity*, 17th Edition, (Sweet & Maxwell, London, 2005), at 95.

the benefit of the contract on behalf of the third party. Thus, the intention to create a trust may be proven. However, this intention may be defeated if the promisee does not intend to be bound by fiduciary duties to the third party.

Due to the strict approach advocated in *Vandepitte* and *Re Schebsman*, it is very difficult to prove the existence of a trust in favour of a third party unless the contracting parties expressly intend to do so. As a result, this mechanism is seldom used successfully today to avoid the doctrine of privity. However, there is a High Court decision which adds a slight twist to the application of the trust device. In *Rolls-Royce Power Engineering plc v Ricardo Consulting Engineers Ltd*,⁴² Seymour J held that a trustee could recover damages of which he was trustee if it was known to both parties to the contract at the time it was concluded that one party was contracting as trustee. As such, there seems to be two requirements to be proven to utilise the trust device. Firstly, a trust must exist on the facts of the case. Secondly, both the promisee and the promisor must be aware that the former is contracting as a trustee on behalf of the third party. Accordingly, the use of trust is strictly limited to situations where promisee knowingly creates a trust in favour of the third party and the promisor is informed of this fact.

It is submitted that the second requirement imposed by Seymour J is redundant. In relation to contracts made for the benefit of third parties, *Re Schebsman* had made it clear that a trust will only be imposed if the intention to create a trust is clearly shown in the dealing of the contracting parties. Hence, the trust device will apply in situations where the promisor is aware that a trust is created in favour of the third party. Besides, Seymour J held that the second requirement is consistent with the cases of *Lloyd's v Harper* and *Darlington*

⁴² [2003] QBD 129. This case is discussed in Chapter 4 Part IV(A)(1)(ii).

*Borough Council v Wiltshier Northern Ltd.*⁴³ With due respect, in the judgment of these two cases, it was not stated that the promisor realised that the promisee was acting as a trustee for the third party at the time the contract was created. All that the parties had in mind was that the contract was to benefit the third party. Accordingly, it is not appropriate to rely on these cases⁴⁴ to support the learned judge's finding.

2. Position in Australia

In Australia, the High Court (Mason CJ, Wilson and Deane JJ) in *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd*⁴⁵ adopted a more flexible approach in determining the intention to create a trust involving enforceable promises. In this case, the claimants in appealing to the High Court did not put forward the argument that a trust was created in their favour. As such, the trust device was not applicable in this case. In relation to the imposition of a trust out of contracts made for the benefit of third parties, Deane J stated that:

Indeed, the "reluctance" of courts to find a trust in such cases seems often to have been caused by a misunderstanding of the nature of equity's requirement of an intention to create an express trust, or put differently, by a **failure to appreciate the innate flexibility of the law of trusts:**

. . . In the context of such a contractual promise, **the requisite intention should be inferred if it clearly appears that it was the intention of the promisee that the third party should himself be entitled to insist upon performance of the promise⁴⁶ and receipt of the benefit and if trust is, in the circumstances, the appropriate legal mechanism for giving effect to that intention.** A fortiori,

⁴³ [1995] 1 WLR 68. In this case, Dillon and Waite LJ held that a constructive trust was imposed in favour of the council and any money recovered from the breach of contract was held on trust for it. This case represents a friendlier approach towards reliance on the trust mechanism. The trust was imposed due to a term in the contract between the council and the employer of a construction contract that rights, benefits and causes of action arising under the construction contract would be assigned to the council at the end of the construction period or at any time requested by the council.

⁴⁴ In fact, these two cases represent a broader approach towards creation of trust.

⁴⁵ (1988) 165 CLR 107. The facts of this case are discussed in Chapter 3 Part III.

⁴⁶ Mason CJ and Wilson J also shared the same opinion in relation to this matter.

equity's requirement of an intention to create a trust will be at least prima facie satisfied if the terms of the contract expressly or impliedly manifest that intention as the joint intention of both promisor and promisee. (emphasis added)⁴⁷

Deane J also stated that the contracting parties can determine the scope of the trust. The trust can extend to the whole contract or only to certain contractual obligations.⁴⁸ The issue as to whether the requirements stated by Deane J in the above quotation are satisfied is decided through construction of terms of the contract.⁴⁹ Applying trust principles to the facts of *Trident*, Deane J held that the nature of contracts of insurance to indemnify sub-contractors from losses suffered as evidenced from the terms of the insurance policy⁵⁰ could be construed to amount to an intention that the promisee held the chose in action (right to enforce the insurance policy) upon a trust on behalf of the relevant contractor or sub-contractor.

Mason CJ and Wilson J in *Trident* dismissed concerns that the use of trust device would lead to uncertainties as it is difficult to predict the situations in which a trust will be imposed. To allay these concerns, the learned judges stated that in determining the existence of such intention, courts can take into account the language used by the

⁴⁷ At 147 (*Trident*). Deane J agreed with Fullagar J in *Wilson v Darling Island Stevedoring* (1956) 95 C.L.R. 43, at 67 where the latter opined that it is "difficult to understand the reluctance which courts have sometimes shown to infer a trust in such cases".

⁴⁸ At 147 (*Trident*).

⁴⁹ At 148 (*Trident*).

⁵⁰ In *Trident*, the insurance contract provided that:

The Insurance . . . indemnifies the Assured against all sums which the Assured shall become legally liable to pay in respect of

1. death of or bodily injury to or illness of any person not being a person who at the time of the occurrence is engaged in and upon the service of the Assured under a Contract or service or apprenticeship . . .

Any claim arising under any Workmen's Compensation Law was excluded from the above provision. The 'assured' was defined as Blue Circle Southern Cement Ltd (main contractor who entered into the contract of insurance), all its subsidiaries, associated and related companies, all contractors and sub-contractors and/or suppliers.

contracting parties, the nature of the transaction and the relevant circumstances such as commercial necessity.⁵¹ However, it was not clarified clearly in *Trident* as to whose intention is to be looked at in inferring the intention to create a trust. There are two alternatives, either the joint intention of the contracting parties or the promisee's intention is considered. Deane J accepted both alternatives in *Trident*.⁵² Subsequent cases were divided on this matter though majority of the cases placed importance on the joint intention of the contracting parties.⁵³

In conclusion, in Australia, it is not necessary to prove that the contracting parties expressly intend to create a trust unlike the position taken in England. All that is required to infer such intention are (i) intention to allow the third party to enforce the contract, (ii) intention to benefit the third party (express or implied) and (iii) trust is the appropriate mechanism to give effect to the intention of the contracting parties.

3. Position in Malaysia

The trust device is applicable in Malaysia. In *ESPL (M) Sdn Bhd v Radio & General Engineering Sdn Bhd*,⁵⁴ Gopal Sri Ram JCA acknowledged that “the device of a trust is an

⁵¹ At 121 (*Trident*).

⁵² At 149 (*Trident*). Mason CJ and Wilson J, at 121 (*Trident*), were not very clear on this point. The learned judges acknowledged that in the creation of a trust, it should be the promisee's intention that is to be taken into account but they also noted that in relation to contracts made for the benefit of third parties, it is usually the joint intention of the contracting parties that is emphasised.

⁵³ *Winterton Constructions Pty. Ltd v Hambros Australia Ltd* (1991) 101 ALR 363; *Re Elizabethan Theatre Trust*; *Lord v Commonwealth Bank of Australia* (1997) 15 ACLC 341; *Bernard Marks v CCH Australia & University of Melbourne* [1999] 3 VR 513; *Chipper v Octra Nominees Pty Ltd* [2006] FCA 1633 *cf* *Mizzi v Reliance Financial Services Pty Ltd* [2007] NSWSC 37 (emphasis is on the intention of the promisee (settlor) although there are situations where the promisor's intention is also relevant); *Fluor Australia Pty Ltd v ASC Engineering Pty Ltd* [2007] VSC 262.

⁵⁴ [2005] 2 MLJ 422, at 428. Wan Azlan and Paul Linus had also stated that a trust may be created by inference in contracts made for the benefit of third parties to circumvent the doctrine of privity in their book entitled *Equity and Trusts in Malaysia*, (Sweet & Maxwell Asia, 2005), at 23.

exception to the privity doctrine. That there can be a trust of the benefit of a contract is too well settled. See *Fletcher v Fletcher* (1844) 67 ER 594.” This part examines the (i) application of the trust device by courts and (ii) difficulties created by the judicial application of this device.

(i) Judicial Application of Trust Mechanism

This part examines the judicial application of the trust mechanism to avoid the doctrine of privity. The first case examined is *Malaysian Australian Finance Co. Ltd. v The Law Union & Rock Insurance Co Ltd.*⁵⁵ In this case, the applicant was the owner of a motor vehicle (caterpillar tractor) who entered into a hire-purchase agreement with Choong. Choong entered into a contract for an insurance policy with the respondent to insure the tractor against losses as required under the hire-purchase agreement. The insurance policy contained a clause which acknowledged that the applicant was the owner of the motor vehicle insured in the insurance policy and any money payable under the policy should be paid to the owner. An issue arose whether the owner had the right to institute a claim in its own right to recover damages for the loss of the tractor against the respondent as the contract of insurance was created by Choong and the respondent.

It was held that the owner was entitled to make the claim on the insurance contract. The owner’s right under the contract of insurance was “co-extensive” with the rights of the hirer who contracted with the respondent. This conclusion was reached on the basis that the owner was a party to the contract of insurance. Alternatively, if the owner was not a party to the contract, the exceptions to the privity doctrine were applicable to assist him.

⁵⁵ [1972] 2 MLJ 10.

Mohamed Azmi J held that there were two exceptions to the doctrine of privity, trust and promise of direct payment to third party (estoppel).⁵⁶ The learned judge also relied on the Halsbury's Laws of England,⁵⁷ which stated that:⁵⁸

There may be a trust of a contract. If one of two contracting parties contracts expressly as trustee for another person, that third person can enforce the trust. **A clear intention to create such a trust must be shown to render it enforceable.** (emphasis added)

It was held that the respondent should be regarded as a trustee or agent for the owner because the insurance policy was created for his benefit. This conclusion was reached as the respondent had promised to pay the proceeds of the insurance to him directly.⁵⁹

There are two points to be made on this case. Firstly, the judge appeared to reason that a promise of direct payment to the third party coupled with an intention to benefit him were sufficient to create a trust. This seems to be in line with *Tomlinson* as the terms of the insurance policy created by the insurer and Choong never mentioned about the creation of a trust. The trust device was used to enable the owner to sue. A contrary view can be taken as Mohamed Azmi J also referred to the requirement of proving a clear intention to create a trust. There was no express intention to create a trust in this case but since it dealt with a contract of insurance, it may be easier to infer an intention to create a trust. Yet, this point was not discussed in the judgment. Secondly, it must be noted that in this case, instead of the promisee becoming a trustee, it was the promisor (insurer) who was regarded as the

⁵⁶ At 12 (*Malaysian Australian Finance*), citing Sanjiva Row's *Commentaries on Indian Contract Act and Law Relating to Tenders*, 6th Edition, Vol 1, at 282 and 278.

⁵⁷ 3rd Edition, Vol 38, at 822.

⁵⁸ At 12 (*Malaysian Australian Finance*).

⁵⁹ At 12 (*Malaysian Australian Finance*).

trustee.⁶⁰ However, the effect of this case on insurance policies had been avoided by a change in the drafting of insurance policies.⁶¹

The second case examined is *G R Nair v Eastern Mining & Metals Co Sdn Bhd*.⁶² This case dealt with whether an employer which entered into a group policy insurance to cover losses suffered due to injuries to its employees was a trustee for its employees in relation to the insurance policy. Ibrahim J held that both express trust and constructive trust were not applicable in this case. In discussing the creation of an express trust, the learned judge referred to the English cases such as *Vandepitte v Preferred Accident Insurance Corporation of New York, Re Sinclair's Policy*⁶³ and *Green v Russell*⁶⁴ which held that an intention to benefit a third party by direct payment of proceeds of insurance policy was not sufficient in creating a trust. Any proceeds of the insurance policy recovered were not held on trust for the third party. Applying these cases to *G R Nair*, since there was no mention of any trust in the insurance policy, no trust was created.

Ibrahim J also distinguished *Prudential Staff Union v Hall*.⁶⁵ In *Prudential Staff*, it was held that the trade union who entered into an insurance policy to cover losses suffered by its members was a trustee of the members. The trade union was formed by its members to protect their interest. By contrast, the insurance policy taken by the employer in *G R Nair*

⁶⁰ Usually, it is the promisee who is the trustee rather than the promisor as the latter is burdened with the obligation of the contract. It seems difficult for a promisor to hold a benefit as trustee for the third party where he himself owes the obligation to provide the benefit.

⁶¹ As seen in *United General Insurance Co Sdn Bhd v Progress Credit Sdn Bhd* [1988] 1 LNS 8 where the endorsement clause clearly stated that the insured was not acting as an agent or trustee for the owner of the motor vehicle.

⁶² [1974] 1 MLJ 176.

⁶³ [1938] Ch 799.

⁶⁴ [1959] 2 QB 256. The facts of *GR Nair* were similar to *Green v Russell*. The case of *Green v Russell* was followed by Abdul Malek J (as he then was) in *Anuar bin Ismail v Tan Sri Tan Chin Tuan* [1992] 1 MLJ 155.

⁶⁵ [1947] 1 KB 685.

was to protect its own interest. Moreover, unlike the members of the union in *Prudential* who contributed to the payment of premium of the insurance policy, the employees in *G R Nair* did not make such contribution to the insurance contract.⁶⁶

The argument on the creation of a constructive trust was also rejected because the employer had stressed in previous payments to the employees that the payments were made *ex gratia*. The employer entered into the insurance policy mainly for its own purpose so that it would be entitled to claim compensation for injuries or death of its employees. This ensured that it was able to make voluntary payments to its employees irrespective of its financial position.

Nonetheless, the strict approach applied in *G R Nair* has to be viewed in light of *Bank Bumiputra Malaysia Bhd v Mohamed Salleh*.⁶⁷ In *Mohamed Salleh*, the employee suffered from permanent disabilities after he was involved in an accident. The employer was the insured of a “Group Accident Insurance Policy” covering various risks in respect of its employees and was entitled to receive benefits due to its employees under the policy. The amount payable by the insurer in this case was RM75,000. The employee claimed this amount from his employer in accordance with the terms of his employment.⁶⁸ The employer refused to pay the amount to the employee.

The Court of Appeal held that this was a case of breach of contract. Under the terms of employment, once an employee suffered permanent total disablement, the employer was

⁶⁶ *G R Nair* leads to the impression that it is very difficult to argue that a group policyowner is a trustee for the insured persons unless the persons protected also contribute to the payment of the premium of the policy; Dass, Santhana S, *Law of Life Insurance in Malaysia*, (Alpha Sigma, 2000), at 529.

⁶⁷ [2000] 2 CLJ 13.

⁶⁸ The terms of the contract of employment were found in the Officers Handbook of the company which provided that officers shall be insured for 24 hours in respect of death or total permanent disablement due to any accident. The amount payable for such death or injury varied according to the different categories of employment.

obliged to make the requisite payment to the employee. As such, there was no necessity to resort to the creation of a trust to avoid the doctrine of privity. Nonetheless, in the course of the judgment, Gopal Sri Ram JCA observed (obiter remark) that:⁶⁹

In the absence of an agreement to the contrary, under the ordinary principles that govern the law of trusts, any employee would be able to lodge a claim, as a beneficiary of the policy, against MNI. This would cause great difficulties to the insurer because it will then be faced with a multitude of claims. To avoid such a result, there is inserted in the relevant policy the following clause:

9. The insurers shall be entitled to treat the insured as the absolute owner of the Policy and shall not be bound to recognize any equitable or other claim to or interest in the Policy.

The effect of this clause is that the person such as the respondent cannot recover anything under the policy from MNI directly. However, the appellant is entitled to receive any benefit due to the respondent. **Once received it will hold the monies as trustee for the respondent.** This then is what a group insurance is all about. (emphasis added)

Gopal Sri Ram JCA took the view that employees protected under the group policy insurance were beneficiaries under a trust though they did not pay any contribution to the insurance policy. They could sue the insurance company but for the term which prohibits them from doing so. The question is how such trust arises. His Lordship merely supported his argument by relying on the “ordinary principles governing the law of trust” but did not provide any authority for his conclusion. The existing legal authorities seem to point to the other direction. In *Vandepitte* or *Re Sinclair*'s, the beneficiary named under the insurance policy failed in his or her attempt to argue that a trust existed. The approach taken by Gopal Sri Ram JCA in treating the employees as having interest in the insurance policy also seems to go contrary to the decision of Ibrahim J in *G R Nair* which held that the group insurance policy was for purposes of the employer to ensure that payments paid to employees were

⁶⁹ At 15 (*Mohamed Salleh*).

recoverable. This case was not referred to in *Mohamed Salleh*. In terms of the doctrine of precedent, the Court of Appeal is not bound by a High Court decision. But it will achieve consistency in the law if Gopal Sri Ram JCA had referred to *G R Nair* and provided more explanation to justify the different approach that he took.

In fact, Clause 9 as found in the insurance policy in *Mohamed Salleh* was also found in the insurance policy in *Green v Russell*. Yet, the Court of Appeal in *Green* did not emphasise on the ‘commercial expediency’ argument as the purpose behind the insertion of such clause in the insurance policy. Gopal Sri Ram JCA in *Mohamed Salleh* also stated that:

It is quite true that Courts of Equity have been careful not to permit a litigant from relying on the concept of constructive trust willy-nilly. Decisions of the English Courts show that the device of a constructive trust is not to be readily inferred in the absence of a clear intention to create a trust. (see *Green v Russell* [1959] 3 WLR 17; *Re Schebsman*). However, as we understand the principle, equity has always recognized the trust of a benefit of a contract.⁷⁰

The above quotation causes a number of difficulties. Firstly, the learned judge referred to the strict approach in English law without any disagreement. Accordingly, it can be argued that Malaysian law adopts the same approach.⁷¹ As such, it is difficult to see how employees can prove that a trust existed merely by the creation of an insurance policy which include them as the insured. But, since a different conclusion was reached (trust existed), it is also arguable that Gopal Sri Ram JCA adopted a more flexible approach in determining the existence of a trust. Unfortunately, this was not explained in further detail by the learned judge.

⁷⁰ At 17 (*Mohamed Salleh*).

⁷¹ *Re Schebsman* [1944] Ch 83 should be binding on Malaysian courts as it was decided in 1944 due to s.3 Civil Law Act 1956.

Mohamed Salleh was applied in a number of cases. It was first applied in *Poominathan Kuppusamy v Besprin Stationers Sdn Bhd*.⁷² This case dealt with group insurance policy similar to the one in *Mohamed Salleh*. However, there was no formal or written contract of employment between the employee and the employer. Following *Mohamed Salleh*, the High Court held that the group insurance policy should be interpreted as constituting a term of the employment contract. As such, the policy was one of the additional benefits which the employee was entitled to. It was also held that the employee who was named as an 'insured person' under the policy should be taken as a beneficiary under it. Thus, the employer was under a duty to pay the employee the sum given by the insurance company for the injuries suffered by the employee. Zaleha Zahari J came to this conclusion as the insurance policy was never meant to cover the employer for costs incurred as a result of the loss of manpower due to employees' accidents or injuries. Instead, it was to cover the losses suffered by employees as a result of accidents. With due respect, no emphasis was given to this reason in *G R Nair and Green v Russell* which were not referred to in this case. *Mohamed Salleh* was followed without further discussion on the principles relating to the imposition of trusts in relation to contracts made for benefit of third parties.

In *Tan Guat Lan v Aetna Univeral Insurance Sdn Bhd*,⁷³ the plaintiffs were administrators of the estate of LHH who entered into a contract of insurance with the defendant. The defendant was to pay LHH's named beneficiary, Tan Guat Lan (the first plaintiff and LHH's wife, 'TGL') the sum of RM 100,000 upon his death. The defendant refused to pay the sum.⁷⁴ The plaintiffs sued the defendant for specific performance of the policy and for

⁷² [2003] 3 CLJ 118.

⁷³ [2003] 5 CLJ 384.

⁷⁴ The reason for the defendant's refusal was on the ground that LHH had failed to disclose to the defendant when he signed his second reinstatement policy his real state of health when he was actually suffering from "hypertensive/ischaemic heart disease.

payment of the sum to TGL. One of the issues that arose was whether the plaintiffs, as administrators of the estate of LHH, had the right to sue. The defendant's counsel contended that since TGL was the beneficiary under the policy, according to s.23 Civil Law Act 1956,⁷⁵ the action ought to have been commenced by TGL as a beneficiary and not by the administrators.

Ramli Ali J held that the administrator had the right to enforce the insurance policy as LHH was a party to the contract. However, the judge further explained that TGL had a 'co-extensive'⁷⁶ right in the policy. 'A co-extensive' right is one which may be exercised by either party: that is both LHH and TGL could sue. LHH's right to sue the defendant was absolute as he was a party to the contract whereas TGL's right to sue would be available only if certain condition-precedents were present.

It is undoubted that LHH could sue under the insurance policy but any money recovered would be held on trust for TGL. This would have answered the argument of the defendant's counsel. Instead, Ramli Ali J in rejecting the counsel's argument explained that if TGL sued in her own name, there might be difficulty as she was not a party to the contract with the insurer and she did not provide consideration for the contract. The learned judge went on to apply the common law mechanisms to the privity doctrine as applied in *Malaysian Australian Finance*. There was no necessity to rely on common law mechanisms because it was clear that TGL could sue the defendant due to s.23 CLA 1956. Ramli Ali J stated that:

... where there is an agreement that **B should pay direct to C or a trust has been created for C**, then C may sue to enforce the contract and in such-event the right to sue between A and C are "co-

⁷⁵ This provision is discussed in Chapter 3 Part V(A)(1).

⁷⁶ Adopting the phrased used by Mohamed Azmi J in *Malaysian Australian Finance Co. Ltd v The Law Union & Rock Insurance Co. Ltd* [1972] 2 MLJ 10.

extensive”. . . Furthermore, in the case of *Bank Bumiputra Malaysia Bhd v Mohamed Salleh* [2000] 2 CLJ 13, the Court of Appeal held that where a contract is made with A for the benefit of B, A can sue on the contract for the benefit of B and recover all that B could have recovered if the contract had been made with B himself. (emphasis added)⁷⁷

The application of the trust device in this case raises a number of difficulties. Firstly, the learned judge never expressly held that a trust was created in favour of TGL. But this can be implied from the judgment as it was stated that “. . .Tan Guat Lan would only sue in her own name (as a beneficiary) if LHH’s administrators refused or neglected to sue on her behalf to recover the money.”⁷⁸ This is consistent with the rights of a beneficiary under a trust. No explanation was provided as to how such trust was created. No reference was made to the old English cases (*Tomlinson, Lloyd’s v Harper*). Secondly, *Tan Guat Lan* suggests that a trust can be created in relation to an individual insurance policy without the need to prove an intention to create a trust affirmatively.⁷⁹ The ease of proving the existence of a trust in this case leaves open the question as to whether a trust can be similarly created in other types of insurance policy. If so, this will plug the gap left by s.166 Insurance Act 1996.⁸⁰ In light of the above uncertainties and weaknesses of *Tan Guat Lan*, it remains to be seen whether the approach of Ramli Ali J will be followed in subsequent cases.

An interesting case involving the application of *Mohamed Salleh* to a situation outside insurance cases is *Mahfar bin Alwee v Jejaka Megah Sdn Bhd*.⁸¹ In 1984, the plaintiff entered into a sale and purchase agreement with Mideasia Sdn Bhd (housing developer) to

⁷⁷ At 394 (*Tan Guat Lan*).

⁷⁸ At 394–395 (*Tan Guat Lan*).

⁷⁹ This conclusion is derived from the fact that Ramli Ali J did not discuss about the intention to create a trust in *Tan Guat Lan*.

⁸⁰ As discussed in Chapter 3 Part V(A)(1), there are a number of life insurance policies which fall outside the protection of s.166 Insurance Act 1996.

⁸¹ [2004] MLJU 107.

buy a house at RM 29,000. Pursuant to this contract, Mideasia had to deliver the house to the plaintiff within 24 months after the creation of the contract but Mideasia failed to do so. Eight years later, the housing project fell into the hands of the first defendant. To finance the continuation of the housing project, the first defendant took a project loan from the second defendants. The plaintiff alleged that the first and the second defendants did not protect the plaintiff's interest in the house as the ultimate beneficiary nor complete the construction of the house. It was also alleged that the second defendant had permitted the first defendant to commit a breach of the sale and purchase agreement. The second defendants argued that it was not privy to the sale and purchase agreement and could not be sued by the plaintiffs. From this perspective, the plaintiff attempted to impose a burden on a third party (second defendants) to the contract. However, the plaintiff contended that his claim against the second defendant was based on the project loan agreement executed by the defendants for the plaintiff's benefit.

Low Hop Bing J (as he then was) in this case refused to dismiss the plaintiff's action against the second defendant. The learned judge stated that:

In my judgment, the factual background as alluded above does demonstrate that the second defendant is not a complete stranger to the housing project in which the plaintiff is one of the purchasers of one of the houses. . . such project . . . to revive, complete and deliver the houses to the purchasers, who are the ultimate beneficiaries upon completion and delivery of the houses to them including the plaintiff.

The project loan agreement was undoubtedly executed for the benefit of, inter alia the plaintiff. It is clear to me that there is a reasonable cause of action based on an implied trust of the plaintiff. Support for my view may be found in the Court of Appeal judgment in *Bank Bumiputra Malaysia Bhd v Mohamed Salleh*. (emphasis added)⁸²

⁸² At 7 and 8 (*Mahfar*) according to the pagination provided by *Lexis.com Research System*.

Thus, it was held that the second defendants owed fiduciary duties to the plaintiff to ensure completion and delivery of the house to him. It appears that Low Hop Bing J imposed an implied trust based on the fact that the project loan agreement was made for the benefit of the plaintiff. The intention of the contracting parties to create a trust was not discussed at all. The case did not mention the terms of the loan agreement as to whether the term expressly stated any benefit to the plaintiff. Without such reference, arguably, the plaintiff was an incidental beneficiary.⁸³ It is difficult to argue that there was a clear intention to benefit the plaintiff specifically.

The fourth case examined on the judicial application of the trust mechanism is *Ramli bin Shahdan v Motor Insurer's Bureau of West Malaysia*.⁸⁴ The Court of Appeal in *Ramli bin Shahdan* held that an implied trust arose from the contract between the Motor Insurer's Bureau and the Minister of Transport. PS Gill JCA after explaining *Tomlinson v Gill* and *Gregory and Parker v William* stated that:

Against this backdrop we can say with equanimity that when a contract as in our present instance is made between the first respondent and second respondent for the benefit of the appellants, then the second respondent can sue on the contract for the benefit of the appellants, and recover all that the appellants would have recovered as of the contract had been made by the appellant himself.⁸⁵ Implicit in this proposition of ours, is the fact that if the second respondent fails in his duty, the appellants as beneficiaries under the implied trust, may successfully maintain an action against the first respondent and second respondent as joint defendants. The issue of locus of the appellants to sue, is for purposes of this appeal *cadit quaestio*.⁸⁶

⁸³ It should be noted that even in countries which recognise third party rights, an incidental beneficiary is not entitled to sue the contracting parties as seen in Chapter 6.

⁸⁴ [2006] 2 MLJ 116. The facts of this case are stated in Chapter 3 Part III.

⁸⁵ This part of the judgment was very similar to the decision of *Lloyds v Harper* although this case was not expressly mentioned.

⁸⁶ At 130 (*Ramli Shahdan*).

Two queries arise from the use of trust in *Ramli Shahdan*. The first query is in relation to the requirements to be satisfied in order to create an implied trust. From the above quotation by PS Gill JCA, it seems that all that is necessary to prove is an intention of the contracting parties to benefit the third party. There was no discussion on cases such as *Vandepitte*, *Green v Russell* and *Re Schebsman* in PS Gill JCA judgment. It is unlikely that the Minister of Transport in entering the contract with the Motor Insurer's Bureau intends to create a trust for all the possible victims of road accident which fall within the contract. As such, it is possible to argue that the approach taken by PS Gill JCA is similar to the approach taken in *Tomlinson*. It is worthy to note that Gopal Sri Ram JCA who had earlier in *Mohamed Salleh* discussed the strict approach (no trust will be inferred unless a clear intention to create a trust is proven) concurred with PS Gill JCA's judgment. The second query is in relation to the nature of the trust implied. On the facts of *Ramli Shahdan*, the first agreement entered into by the Minister of Transport and Motor Insurer's Bureau was revoked. As a consequence, it was held that there was no longer any duty to perform the obligations under the first agreement. Hence, it can be argued that the trust implied by PS Gill JCA is revocable.

The fifth case examined is *ESPL (M) Sdn Bhd v Radio & General Engineering Sdn Bhd*.⁸⁷ In *ESPL*, the plaintiff was a sub-contractor for electrical and mechanical works. The defendant was the sub-sub-contractor. In the sub-sub contract, the plaintiff and the defendant agreed to open a bank account in the plaintiff's name to be jointly operated. It was also agreed that all monies received in respect of the works would be deposited into the bank account and subsequently disbursed in the mutually agreed manner. The contract also contained provisions for set-off in respect of defective work. Disputes arose between the

⁸⁷ [2005] 2 MLJ 422.

plaintiff and the defendant about the quality of the defendant's work. It was also disputed whether it was mandatory for the plaintiff to continue to pay monies received for the work into the said bank account. The plaintiff argued that it was not obliged to do so due to the contractual provisions for set-off. The resolution of this issue depended on whether a trust was created where the plaintiff was a trustee which held the monies received in favour of the defendant. If a trust existed, the plaintiff would be under a continuing obligation to deposit any money received for the work into the agreed bank account. One of the clauses in the sub-sub contract read 'Sub-Contractor will receive the payments made by Contractor and will hold the right to receive such payments as a trust fund . . .'

Gopal Sri Ram JCA stated that the intention to create an express trust must be proven in order to show the existence of a trust.⁸⁸ On the facts of *ESPL*, the above mentioned clause and the surrounding circumstances⁸⁹ displayed an intention of the contracting parties to create an express trust. Thus, the Court of Appeal decided in favour of the defendant.

(ii) Difficulties Created by Current Judicial Application of Trust Mechanism

This part examines the difficulties arising from the utilisation of the trust mechanism by Malaysian courts and the solutions to overcome these difficulties. In Malaysia, the existing application of the trust device is shrouded with uncertainty. Different cases apply different

⁸⁸ Gopal Sri Ram JCA repeated his stance on this issue in *Perman Sdn Bhd v European Commodities Sdn Bhd* [2006] 1 MLJ 97. The learned judge, at 108 stated that:

The standard of proving that an express trust exists in given circumstances is a high one. For, it is the policy of the law that no person's property should be burdened with the interest of another in the absence of the clearest proof. What the law requires is an intention to create a trust expressed in clear language.

ESPL was also applied by the Court of Appeal in *Fawziah Holdings Sdn Bhd v Metramac Corp Sdn Bhd* [2006] 1 MLJ 505.

⁸⁹ One of the surrounding circumstances was the setting up of a separate bank account in accordance to the terms of the sub-sub contract.

principles. Sometimes, the reasoning by judges is not very clear resulting in more than one interpretation of the decision. The law is thrown into a whirlpool of confusion as to when a trust will be invoked to assist the third party to evade the doctrine of privity. For instance, in *Malaysian Australian Finance, Tan Guat Lan, Mahfar and Ramli Shahdan*, the High Court and Court of Appeal judges took a very liberal view in creating a trust. In fact, the approach taken resembles closely the approach taken in the old English cases where a trust can be inferred if it is clear that the contract is made for the benefit of the third party. Although Gopal Sri Ram JCA did discuss the strict position in the English cases in *Mohamed Salleh*, yet, the same judge concurred in a more liberal approach in *Ramli Shahdan*. On the contrary, in relation to commercial contracts, in *ESPL* and *Perman*, Gopal Sri Ram JCA stated that the intention to create a trust must be strictly proven. The surrounding circumstances can be taken into account to demonstrate the existence of an intention to create a trust.

As a consequence, different treatment is given to different types of contracts. In relation to commercial contracts, the requirement of proving intention to create a trust is stricter. This may be due to the fact that commercial contracts are drafted by legal professionals appointed by the contracting parties. Thus, if they intend to create a trust, this would have been made clear in the contract. On the other hand, in relation to insurance contracts, the courts are more liberal in holding that a trust exists as judges may be more sympathetic with the plight of the claimants. Therefore, there is a need to clarify the law and adopt a general approach in applying the trust mechanism to contracts made for the benefit of third parties. There are three possible approaches that can be adopted such as the (i) strict approach, (ii) liberal approach (applied in the old English cases) and (iii) Australian approach.

In determining the proper approach to be taken, it is necessary to examine the reasons behind the strict approach and whether adopting a more flexible approach is inconsistent with these reasons. There are mainly five reasons behind the strict approach as adopted in England.

Firstly, the strict approach protects the contracting parties' freedom of contract. The imposition of an irrevocable trust will take away the right of the contracting parties to alter or revoke the contract. This is unjustified unless the contracting parties have shown clearly in their contract that they are willing to forgo such right.

Secondly, the imposition of a trust in relation to contracts made for the benefit of third parties (as seen in the old English cases) is a fiction as the intention to create a trust is absent in these cases.⁹⁰

Thirdly, a strict approach will bring consistency to the law of trust generally. By requiring an intention to create a trust to be proven affirmatively, this is in line with the law of express trust where this intention is proven only if there is unequivocal evidence that the settlor wants to divest all his interest in the subject matter of the trust to the beneficiary. There will be no difference in the application of the trust principles to situations involving contracts made for the benefit of third parties and other situations involving purely the imposition of a trust.

⁹⁰ Corbin, Arthur L., "Contracts for the Benefit of Third Persons", (1930) 46 *LQR* 12–45, at 45. This opinion is also shared by Stewart in his article entitled "Why Place Trust in a Promise?: Privity of Contract and Enforcement of Contracts by Third Party Beneficiaries" (1999) 73 *ALJ* 354–378, at 361 and Jaconelli in his article entitled "Privity: The Trust Exception Examined" (1998) 62 *Conv* 88–99, at 93.

Fourthly, it is questionable whether the promisee is willing to be burdened with the role of a trustee as well as the fiduciary duties owed by a trustee to its beneficiaries. Hence, the trust mechanism may not be appropriate in all circumstances involving contracts made for the benefit of third parties.

Fifthly, the strict approach avoids uncertainty in the law. Adopting the liberal approach will lead to difficulties in predicting when and what situations that courts are willing to impose a trust.

It is submitted that the above reasons are valid. Accordingly, it is not advisable to adopt the liberal approach. Moreover, this approach is not applicable in recent years in England and Australia. However, the strict approach is too restrictive as it may not apply to deserving situations. The Australian approach strikes a proper balance between the interest of the contracting parties and the third party. It is broader than the strict approach but is more restrictive compared to the liberal approach. Litigants are still required to prove an intention to create a trust though the requirement to prove an inference of such intention is watered down.⁹¹ As such, applying the Australian approach, it may be more plausible to invoke the trust mechanism to evade the privity doctrine.⁹²

Adopting the Australian approach does not go against the reasons behind the strict approach. The Australian approach equally emphasises proof of an intention to create a trust. This is consistent with the requirement imposed by the law of trust in determining the

⁹¹ Wright, David, "Trusts Involving Enforceable Promises" (1996) 70 *ALJ* 911–924, at 919.

⁹² Carter, JW and DJ Harland, *Contract Law in Australia*, 4th Ed. (Australia: Butterworths, 2002), at 344. The wider approach in *Trident* had been applied successfully in *Chipper v Octra Nominees Pty Ltd* [2006] FCA 1633. In *Symbion Pathology Pty Ltd v Healthscope Ltd* [2006] VSC 191, the court refused to strike out the claim as there may be a possibility that a trust was created by applying this approach.

existence of a trust. There will be no difficulty in relation to the imposition of fiduciary duties as a trust will only be imposed if this is the appropriate mechanism to give effect to the intention of the contracting parties. In situations involving complex arrangements between the contracting parties where no fiduciary duties are contemplated, no trust will be inferred. The fear of limiting the contracting parties' freedom of contract is also addressed by the possibility of imposing a revocable trust. The flexibility arising from the Australian approach ensures injustice will not result from the rigidities of the law. The Australian approach found in *Trident* has not been referred to in any Malaysian cases.

There are other issues surrounding the trust mechanism which remain unresolved. It remains unclear as to whose intention is taken into account in determining the intention to create a trust. In trust law, the required intention is that of the settlor. In relation to a contract made for the benefit of a third party, the promisee is the party who intends to benefit the third party. Accordingly, the intention of the promisee being the settlor cum trustee is taken into account in determining the existence of an intention to create a trust. However, in Malaysia, following *ESPL* and *Perman*, the joint intention of the contracting parties is considered. This is similar to the position in England.⁹³ By contrast, in Australia, two alternatives are applicable. The intention to create a trust is determined either by the joint intention of the contracting parties or the intention of the promisee. It is submitted that the courts should look at the joint intention of the contracting parties. This ensures that the promisor is aware of the liability he is assuming in entering into the contract. Thus, it is inevitable that the trust principles applying to an ordinary trust is slightly different from a

⁹³ This is evident from *Re Schebsman* and *Green v Russell* where the Court of Appeal referred to 'intention of the parties' in determining whether an intention to create a trust was proven.

trust arising from a contract made for the benefit of a third party.⁹⁴ Nonetheless, this difference does not really matter. The fact that the promisor's intention needs to be assessed will not render it too burdensome to establish the requisite intention compared to an ordinary trust situation. If the promisee's intention is made clear in the contract, the promisor should be taken to give assent to the intention by entering into the contract. Thus, the joint intention of the contracting parties can be proven.

There is also uncertainty as to the type of trust created. The requirements to prove different types of trust are different. If more than one type of trust is applicable, the third party enjoys more opportunities to assert his right in a contract made for his benefit. Gopal Sri Ram JCA in *Mohamed Salleh* referred to the creation of a constructive trust. In *G R Nair*, the creation of a constructive trust was pleaded as an alternative to the creation of an express trust.⁹⁵ It is unfortunate that Ibrahim J in rejecting the existence of a constructive trust in this case did not discuss the criteria to be satisfied in order to create a constructive trust. By contrast, in *Ramli Shahdan* and *Mahfar*, an implied trust was created.

Treitel states that the trust created can be express or implied.⁹⁶ This is consistent with the requirement to prove an intention to create a trust which can be expressly stated by the contracting parties or impliedly shown through the conduct of the parties and the circumstances of the case. Similarly, in Australia, the High Court in *Trident* decided conclusively that the trust created is an express trust.⁹⁷ The High Court's classification of

⁹⁴ This forms another reason why a separate exception to the privity doctrine under contract law should be created to cater for contracts made for the benefit of third parties.

⁹⁵ Similarly, in *Darlington*, a constructive trust was imposed in favour of the third party. It is submitted that this reasoning seems to be abandoned in subsequent cases.

⁹⁶ Peel, Edwin, *Treitel - The Law of Contract*, 12th Edition, (Sweet & Maxwell, 2007) (hereinafter referred to as '*Law of Contract*', at 685.

⁹⁷ An express trust is created due to an express declaration to create a trust by the settlor.

express trust also includes an implied trust as *Trident* also allows the intention to create a trust to be inferred. It is submitted that the type of trust imposed in favour of the third party is an express or implied trust. This is consistent with the present law as applied in England and Australia.

There are difficulties in relying on the concept of constructive trust. The traditional classification of situations which gives rise to constructive trusts does not cover contracts made for the benefit of third parties.⁹⁸ Furthermore, in imposing a constructive trust, unconscionability of acts of the trustee is the determinant factor. By contrast, in relation to contracts made for the benefit of third parties, usually, the trustee (promisee) is not the party who breaches the contract. Any act of unconscionability is on the promisor's part. Hence, the use of constructive trust is unsuitable unless judges are willing to create another category of constructive trust to cater for contracts made for the benefit of third parties.

The last uncertainty is whether the trust created is revocable or irrevocable. Following the discussion on *Ramli Shahdan*, it can be contended that the trust created can be revocable or irrevocable. This is similar to the approach taken in Australia⁹⁹ but is different from the position in England where the trust created is irrevocable. It is submitted that the English position on this matter is too strict. Trust law does recognise revocable trusts. It may be possible for a settlor to revoke the trust after it has been completely constituted if there is an express clause allowing him to do so.¹⁰⁰ Stoljar opines that courts can decide that a

⁹⁸ See Chapter 9 and 10 of Oakley, A.J., *Parker & Mellows: The Modern Law of Trusts*, (Sweet & Maxwell, London, 2003) for the recognised categories of constructive trust.

⁹⁹ Fullagar J held in *Wilson v Darlington Island Stevedoring & Lighterage Co. Ltd* (1956) 95 CLR 43, at 67 that "a revocable trust can be enforceable in Equity while it subsists." This suggests that judges can opt to create a revocable trust.

¹⁰⁰ *Lee Nellie v Wong Lai Kay* [1990] 2 MLJ 399.

revocable trust is created instead of an irrevocable trust¹⁰¹ because a trust can always be imposed by courts subject to certain conditions.¹⁰²

4. Evaluation

There are a few benefits of utilising the trust mechanism. Firstly, it avoids the doctrinal difficulty of squaring third party rights in contract theory. Secondly, the legal action is usually taken by the promisee. This enables courts to decide on all issues including defences of the promisor against the promisee or any set-offs between the parties. Even if the third party is bringing the action, the promisee has to be brought in as a joint defendant, thus allowing all relevant issues to be discussed during the trial. Thirdly, the existence of equitable maxims ensures sufficient flexibility for judges to achieve justice in any case decided. However, it is unavoidable that the trust mechanism is plagued by the argument of artificiality. What the contracting parties want is to provide a direct right for the third party to enforce the contract instead of creating an additional mechanism to achieve this intention which triggers another set of rules to be complied with. Thus, it is not surprising that calls for solution to the problems created by the privity doctrine are not centred on the liberalisation of trust law but rather on the doctrine itself.

¹⁰¹ “Contracts for Third Parties: In Search of the Problems” (1988) 13 *NZULR* 68 -96, at 89. Starke opines that the revocability of a transaction should not be taken conclusively to defeat the existence of a trust. Instead other relevant circumstances should be looked at to assist the court in coming to a conclusion; “Contracts for the Benefit of Third Parties - Part III” (1948) 21 *ALJ* 455–459, at 458. Atiyah in his book, *Introduction to the Law of Contract*, 5th Ed (OUP, 1995), at 371 also shares the same opinion.

¹⁰² Stoljar (1988) 13 *NZULR* 68-96, at 89 provides an example where a gift to a wife will not be operative if there is a divorce so that the person intended to benefit is no longer the promisee’s wife.

E. Tort of Negligence

The scope of the tort of negligence¹⁰³ has expanded to cover pure economic loss (expectation loss) which traditionally falls within the realm of contract only. As such, a third party to the contract who suffers pure economic loss due to the promisor's breach of contract to the promisee can sue the promisor for tort of negligence.¹⁰⁴

In *Majlis Perbandaran Ampang Jaya v Steven Phoa Cheng Loon*,¹⁰⁵ the Federal Court held that pure economic losses are recoverable under the tort of negligence but the courts must exercise caution in extending the law to claims of pure economic losses. The Federal Court adopted the three stage test in *Caparo Industries plc v Dickman*¹⁰⁶ in determining the existence of a duty of care. However, the Federal Court stated that the local courts must also consider s.3 Civil Law Act 1956 where adoption of the English common law must be suitable to the 'public policy' and the 'local circumstances' to decide whether it is fair, just and reasonable to impose a duty of care.

¹⁰³ Tort of negligence is defined as a "breach of a legal duty to take care which results in damage to the claimant"; Rogers, W.V.H in *Winfield & Jolowicz on Tort*, 17th Edition, (Sweet & Maxwell, 2007) (hereinafter referred to as 'Winfield & Jolowicz'), at 132. To succeed in proving this tort, the plaintiff needs to prove that the defendant owes him a duty of care which is breached by the defendant and causes the plaintiff to suffer losses which are not too remote.

¹⁰⁴ For eg., the privity rule is bypassed in *White v Jones* [1995] 2 AC 207 where the House of Lords allowed disappointed beneficiaries of a will to claim successfully for the loss of their legacies as a result of the solicitor's failure to prepare the will as instructed by the testator.

¹⁰⁵ [2006] 2 MLJ 389. *Majlis Perbandaran Ampang Jaya* was followed by the Federal Court in *The Co-Operative Central Bank Ltd v KGV & Associates Sdn Bhd* [2008] 2 MLJ 233. In *Ng Wu Hong v Abraham Verghese TV Abraham* [2007] 1 LNS 138, the High Court held that a legal action to recover pure economic loss in tort related to contract can be brought successfully if the various requirements of the tort of negligence can be satisfied.

¹⁰⁶ [1990] 1 All ER 568. The three requirements are firstly, the harm suffered must be reasonably foreseeable, secondly, there must be sufficient proximity between the plaintiff and the defendant and thirdly, it must be fair, just and reasonable to impose a duty of care.

There are a number of difficulties in pursuing a cause of action for tort of negligence in relation to a breach of a contract made for the benefit of third parties. Firstly, the imposition of a duty of care is largely dependent on the facts of a particular case. There is no guarantee that a duty of care will be imposed on the promisor.

Secondly, the tort of negligence deals with acts or omissions committed negligently. In relation to contracts made for the benefit of third parties, there are situations where the promisor chooses to disregard his obligations under the contract rather than being negligent. Therefore, it seems inappropriate for tort of negligence to apply in these situations. Nonetheless, it has been argued that the tort of negligence is capable of applying to wilfully inflicted harm.¹⁰⁷ If the tort of negligence is expanded to include wilful harm, the number of third parties who can utilise the tort mechanism will increase. Arguably, a third party to a contract made for his benefit is able to prove that the promisor owes him a duty of care. The promisor can reasonably foresee that the third party will suffer losses if he breaches his duty of care. Since the performance to be rendered by the promisor is for the third party, the relationship between the promisor and third party is sufficiently proximate. However, the courts may not approve of such wide expansion of the tort of negligence as to do so will blur the distinction between contract law and tort law.¹⁰⁸ The courts are burdened

¹⁰⁷ Deane J in *Walton Stores (Interstate) Ltd v Maher* (1988) 164 CLR 387, at 454 stated that on the facts of this case (provided in this Chapter at Part IV(B)(1), Maher had a good cause of action in negligence against Waltons for the latter's deliberate failure to inform Maher that they might not wish to enter into a contract of lease with Maher. Deane J's opinion was referred to in Swanton, "Concurrent Liability in Tort and Contract: the Problem of Defining the Limits" (1996) 9 *JCL* 21-52, at 48-49.

¹⁰⁸ Treitel, Guenter, *Some Landmarks of 20th Century Contract Law*, (OUP, 2002) (hereinafter referred to as '20th Century') argues, at 89 that in *Beswick v Beswick* [1968] A.C. 58, the widow would not be able to sue the nephew for tort of negligence as to do so will amount to compensating the widow for her loss of expectation which arises from the nephew's promise alone. This will do away the distinction between contract and tort. However, the courts do have the ability to impose a duty of care in situations involving performance of contractual obligations. This has blurred the distinction between contract and tort and leads to opinions that there should not be any distinction between contract or tort or that contract law is subsumed under the law of tort or law of obligation. Yet, at present, the courts continue to maintain the distinction between contract and

with the conceptual objection that if a person is denied a cause of action in contract law, the courts should not allow him to succeed in the law of tort. By contrast, in *White v Jones*, Lord Goff held that the imposition of a duty of care on the solicitors did not amount to an ‘unacceptable circumvention of the law of contract’ due to the need to ensure ‘practical justice’.¹⁰⁹ Yet, the term ‘practical justice’ is vague. It remains unclear as to when judges will decide that the conceptual objection should not be a barrier to the imposition of a duty of care.

Thirdly, the liability of tort of negligence is based on the failure to exercise reasonable care. This is different from liability based on breach of contract where the emphasis is whether the contract is breached and not whether the promisor has exercised proper care. Thus, it may be easier to establish breach of contract rather than breach of duty of care under tort of negligence.¹¹⁰

Due to the above difficulties, particularly the second difficulty, the appropriate solution to the problems created by the privity doctrine to contracts made for the benefit of third parties lies in contract rather than in tort.¹¹¹

tort; see Burrows, Andrew and Edwin Peel, eds., *Commercial Remedies: Current Issues & Problems*, (OUP, 2003), at 8-9.

¹⁰⁹ At 268 (*White v Jones*).

¹¹⁰ Whittaker, S., “Privity of Contract and the Tort of Negligence: Future Directions” (1996) *OJLS* 191–230, at 205.

¹¹¹ Lorenz, Werner and Basil Markesinis, “Solicitors’ Liability towards Third Parties: Back into the Troubled Waters of the Contract/Tort Divide” (1993) 56 *MLR* 558-563, at 562, Fleming, John G., “Tort in a Contractual Matrix” [1995] 33 *OHLJ* 661-678, Beatson, Jack, “Reforming the Law of Contracts for the Benefit of Third Parties: A Second Bite at the Cherry” (1992) 45 *CLP* 1-28 at 25-26, Markesinis, B.S., “An Expanding Tort Law – The Price of a Rigid Contract Law” (1987) 103 *LQR* 354-397, at 396-397.

III. Mechanisms Allowing Third Party to Enforce Exclusion, Limitation and Waiver of Subrogation Clauses

Courts have displayed their ingenuity to develop the law to allow third parties to rely on an exclusion, limitation or waiver of subrogation clauses¹¹² to defend himself in a legal action brought by the promisor. This part examines the principles developed by English and Canadian courts on this matter such as (i) vicarious immunity, (ii) bailment on terms, (iii) Himalaya clauses, (iv) tortious analysis of exclusion clauses and (v) the ‘principled exception’ in *London Drugs v Kuehne & Nagel*.¹¹³ This is followed by a discussion on the Malaysian position in relation to third parties’ reliance on exclusion or limitation clauses found in a contract to which they are not privy.

A. Vicarious Immunity

The principle of vicarious immunity provides that employees, agents or sub-contractors can rely on exclusion or limitation clauses found in contracts entered into by their employers despite their lack of privity to the contract. This principle was first introduced in *Elder, Dempster & Co v Paterson, Zochonis & Co*.¹¹⁴ In this case, a company (‘the charterer’) agreed to carry palm oil belonging to the claimant from West Africa to Hull based on a contract of carriage as found in the bill of lading. A ship was chartered for this purpose. One of the terms of the contract of carriage stipulated that the bill exempted “the

¹¹² The mechanisms in Part II of this Chapter are also applicable in relation to the enforceability of exclusion clauses. However, due to the difficulties of relying on these devices to allow third parties to rely on exclusion clauses, the courts have created further mechanisms or expanded existing mechanisms to specifically apply to exclusion clauses.

¹¹³ [1993] 3 SCR 299. For convenience purposes, the ‘principled exception’ is known as the ‘*London Drugs* exception’ in Chapters 1 and 7.

¹¹⁴ [1924] A.C. 522.

shipowners” from liability for bad stowage. The oil was damaged by bad stowage. The claimant sued the shipowners and the charterers under the law of tort. The shipowners sought to rely on the exclusion clause found in the contract of carriage but they were not privy to the contract. The High Court and the Court of Appeal (by majority) decided that the shipowners could not rely on the exclusion clause. In the Court of Appeal, Scrutton LJ who dissented held that the shipowners were entitled to rely on the exclusion clause and stated that:

The real answer to the claim is in my view that the shipowner is not in possession as a bailee, but as the agent of a person, the charterer, with whom the owner of the goods has made a contract defining his liability, and that the owner as servant or agent of the charterer can claim the same protection as the charterer. Were it otherwise there would be an easy way round the bill of lading in the case of every chartered ship; the owner of the goods would simply sue the owner of the ship and ignore the bill of lading exceptions, though he had contracted with the charterer for carriage on those terms and the owner had only received the goods as agent for the charterer.¹¹⁵

On appeal, the House of Lords decided in favour of the shipowners and held that they could rely on the exclusion clause in the bill of lading. One of the grounds relied on by the House of Lords was the principle of vicarious immunity. Viscount Cave agreed with Scrutton LJ’s reasoning and stated that:

It was stipulated in the bills of lading that "the shipowners" should not be liable for any damage arising from other goods by stowage or contact with the goods shipped under the bills of lading; and it appears to me that this was intended to be a stipulation on behalf of all the persons interested in the ship - that is to say, charterers and owners alike. It may be that the owners were not directly parties to the contract; but they took possession of the goods (as SCRUTTON, LJ, says) on behalf of and as the agents of the charterers,¹¹⁶ and so can claim the same protection as their principals.¹¹⁷

¹¹⁵ [1923] 1 KB 420 (Court of Appeal), at 441-442.

¹¹⁶ Although the concept of ‘agents’ was used by Viscount Cave, his Lordship was not utilising the agency relationship to evade the doctrine of privity as here, the third parties were the agents, not the principal. Instead, the concept of agency was used to show that there was a relationship between the promisee

To apply the principle of vicarious immunity, a number of requirements have to be satisfied. Firstly, there must be a connection between the third party and the promisee. The third party must be an employee, agent or independent contractor of the promisee. Secondly, the nature of work to be performed by the third party must be necessary to perform the obligations stipulated in the contract between the contracting parties. It is debatable whether there is an additional third requirement that the contracting parties must intend to extend the benefit of the exclusion clause to the third party. Viscount Cave in *Elder* did not make it conclusive that this was an important requirement to be satisfied. In fact, his Lordship relied on agency relationship between the shipowners and the charterer to support his conclusion, thus making it more important to prove an existing relationship between the promisee and the third party. Scrutton LJ in *Elder* also did not explain the importance of the contracting parties' intention in his judgment as quoted earlier. Indeed, in the subsequent case of *Mersey Shipping & Transport Co Ltd v Rea Ltd*,¹¹⁸ Scrutton LJ explained that if there is a contract which contains an exclusion clause, the servants or agents who act under the contract are entitled to enjoy the benefit of the exclusion clause. No mention was made on the importance of the contracting parties' intention to benefit the servant or agent.

The requirement of the intention to benefit the third party will restrict the scope of the application of vicarious immunity. It may be difficult to imply an intention of the contracting parties to benefit the third party if the exclusion clause makes no express reference to the third party. In *Elder*, this did not pose a difficulty as the exclusion clause

(charterer) and the third parties (shipowners) which justified why the shipowners should be given protection of the exclusion clause.

¹¹⁷ At 534 (*Elder Demspter* (HL)).

¹¹⁸ (1925) 21 Lloyd's Rep 375, at 378.

expressly protected the shipowners. However, it can be contended that since the problem of the privity doctrine is its inability to give effect to the contracting parties' intention, it will be in line with the development of the law if the requirement of an intention to benefit the third party is imposed.

The recognition enjoyed by this principle came to an end when it was rejected by the House of Lords in *Scruttons Ltd v Midland Silicones*¹¹⁹ on the ground that it goes against the doctrine of privity. Lord Reid in *Midland Silicones* stated that:

In such circumstances I do not think that it is my duty to pursue the unrewarding task of seeking to extract a ratio decidendi from what was said in this House in *Elder, Dempster*. Nor is it my duty to seek to rationalise the decision by determining in any other way just how far the scope of the decision should extend. I must treat the decision as an anomalous and unexplained exception to the general principle that a stranger cannot rely for his protection on provisions in a contract to which he is not a party to.¹²⁰

B. Bailment on Terms

Bailment on terms is the alternative ground behind the House of Lords decision in *Elder*.

Lord Sumner decided in favour of the shipowners as he held that:

It may be that in the circumstances of this case the terms to be inferred from the reception of the cargo for carriage to the United Kingdom amount to a bailment upon terms which include the exceptions and limitations of liability stipulated in the known and contemplated form of bill of lading.¹²¹

Lord Sumner's judgment was supported by Lord Dunedin and Lord Carson.¹²² Applying the principle of bailment on terms, there was a relationship of bailment¹²³ between the

¹¹⁹ [1962] AC 446.

¹²⁰ At 479 (*Midland Silicones*)

¹²¹ At 564 (*Elder Dempster* (HL)).

shipowners and the claimant where the exclusion clause was incorporated by tacit reference.¹²⁴ The shipowners were the bailee and the claimant was the bailor. Bailment on terms does not contravene the doctrine of privity as bailment can arise from a contract or otherwise.¹²⁵ If a contract of bailment is implied, there is privity between the bailee and the bailor. If the bailment is non-contractual, there is no necessity to comply with the doctrine.

Lord Denning MR adapted bailment on terms to create the principle of sub-bailment in *Morris v CW Martin & Sons Ltd*.¹²⁶ The principle of sub-bailment deals with the passing of burden. A sub-bailee is entitled to rely on the terms of a sub-bailment to defend a claim brought by a bailor. The bailor will be bound by the terms of a sub-bailment if it has either expressly or impliedly given consent to the bailee in entering into a contract of sub-bailment on those terms. In *Morris*, the plaintiff sent a mink to a furrier to be cleaned. The plaintiff consented that the furrier could deliver the mink to the defendant for cleaning. The mink was stolen by one of the defendant's employees. The contract between the furrier and the defendant contained exclusion clauses. Relying on the principle of sub-bailment, it was held that the plaintiff was bound by the exclusion clauses. However, the clauses did not cover the plaintiff's loss. Thus, the defendant remained liable.

The requirement of consent was satisfied in *Morris* as the plaintiff expressly agreed to allow the defendant to clean her mink, thus, she must be taken to impliedly consent to the making of the sub-bailment contract on the standard terms of such contracts in practice.

¹²² At 548 and 565 respectively (*Elder Demspster* (HL)).

¹²³ This relationship is created by the bailee's voluntary undertaking into possession goods belonging to the bailor; per Lord Goff in the Privy Council decision of *The Pioneer Container* [1994] 2 AC 324.

¹²⁴ 'Law of Contract', at 666

¹²⁵ 'Law of Contract', at 666.

¹²⁶ [1966] 1 QB 716.

This shows that the requirement of consent can be satisfied easily if the bailor consents to the performance of the contract by the sub-bailee.

The sub-bailment principle was approved by the Privy Council in *The Pioneer Container*. Lord Goff in this case added a requirement that the sub-bailee must have sufficient notice that someone besides the bailee is interested in the goods.¹²⁷ After *The Pioneer Container*, question arises whether the principle of sub-bailment can be utilised to pass benefits to third parties. This was partially answered by the subsequent case of *The Mahkutai*¹²⁸ where the Privy Council impliedly approved the use of this principle in situations where the sub-bailee attempts to rely on the terms of the contract between the bailor and the bailee.¹²⁹ In *The Mahkutai*, the sub-bailee sought to rely on the exclusive jurisdiction clause found in the bill of lading. It was held that the sub-bailment principle was not applicable because the exclusive jurisdiction clause was not within the scope of the Himalaya clause¹³⁰ found in the bill of lading. This necessarily meant that the contracting parties did not intend the exclusive jurisdiction clause to cover the shipowners. Had this been their intention, it would have been made clear in the Himalaya clause.¹³¹

As a result, a third party who is not privy to a contract may rely on the sub-bailment principle to seek benefit from the contract. However, the application of this principle is

¹²⁷ At 342 (*Pioneer Container*).

¹²⁸ [1996] 3 All ER 502.

¹²⁹ Phang, Boon Leong and Toh Kian Sing, "On Himalaya Clauses, Bailments, Choice of Law and Jurisdiction – Recent Privy Council Perspectives from *The Mahkutai*" (1996) 10 *JCL* 212-230, at 227.

¹³⁰ This is another mechanism allowing third parties to rely on contractual terms which is discussed in this Chapter at Part III(C).

¹³¹ This has been criticised by MacMillan in "Elder, Dempster Sails On Privity of Contract and Bailment on Terms" (1997) *LMCLQ* 1-7, at 5-6. The terms of the bailment which are non-contractual should mirror the terms of the bill of lading. This means that the exclusive jurisdiction clause should constitute one of the terms of bailment. Arguably, the decision in *The Mahkutai* can be justified as the application of this principle depends on the promisor's consent. The scope of the consent is shown by the terms agreed to in the contract between the promisor and the promisee. The existence of the Himalaya clause showed that the contracting parties had given thought to this matter because the purpose of the Himalaya clause was to provide the list of rights and benefits intended for the third party. Accordingly, the terms of the sub-bailment should reflect their intention.

somewhat limited. It only applies to situations where bailment or sub-bailment exists.¹³²

The bailor must consent to the creation of the sub-bailment and agree that the sub-bailee (third party) is entitled to rely on the exclusion clause in the bailment contract.

C. Himalaya Clauses

This part examines the (i) development of Himalaya clauses and (ii) evaluation of its effectiveness in dealing with contracts made for the benefit of third parties.

1. Development of Himalaya Clauses

Himalaya clauses arose from Lord Reid's judgment in *Scruttons Ltd v Midland Silicones*. In this case, there was a contract of carriage to carry a drum of chemicals from US to England. This contract contained an exclusion clause limiting the liability of the carriers to \$500. Scruttons was employed as stevedores to unload the ship, and the drum was damaged due to Scruttons' negligence. An action for negligence was brought against Scruttons which sought to rely on the exclusion clause. The House of Lords held that Scruttons was not entitled to rely on the exclusion clause as it was not a party to the contract of carriage.¹³³ Nonetheless, Lord Reid laid down the conditions in which the contract of carriage can

¹³² There seems to be attempt to apply this principle to pass a burden to a non-contracting party to situations outside the context of bailments. This is illustrated in *Twins Transport Ltd v Patrick and Brocklehurst* (1986) 4 Con.LR 117 and *Rumbelows Ltd v AMK (A Firm)* (1980) Build LR 25. These two cases dealt with situations involving construction projects where the sub-contractors attempted to rely on the exclusion clauses found in the sub-contract to exclude their liability. However, such attempt to extend the application of this principle was not met with any success.

¹³³ *Law of Contract*, at 667-668 provided explanation as to the failure of the stevedores to rely on the arguments of agency, implied contract and bailment on terms.

extend the benefit of an exclusion clause to protect a third party to the contract. These conditions are:¹³⁴

- (a) The bill of lading makes it clear that the stevedore is intended to be protected by the provisions in it.
- (b) The bill of lading makes it clear that the carrier is contracting as agent for the stevedore.
- (c) The carrier has authority from the stevedore to do that, or perhaps later ratification by the stevedore would suffice.
- (d) The stevedore provides consideration for the promisor's promise to allow it to shelter behind the relevant provisions.

After *Midland Silicones*, contractual terms (which later were known as Himalaya clauses)¹³⁵ are drafted in contracts of carriage of goods by sea to ensure that the conditions stated by Lord Reid are satisfied. The validity of the Himalaya clause was tested in *New Zealand Shipping Co. Ltd. v A. M. Satterwaite; The Eurymedon*.¹³⁶ This case involved a contract of carriage for drilling machinery from England to New Zealand which contained a

¹³⁴ At 474 (*Scruttons Ltd*).

¹³⁵ This was named after the ship in *Adler v Dickson* [1955] 1 QB 158. *Adler* indicates that a third party to the contract can be protected by an exclusion clause by proper drafting of the clause. An example of a Himalaya clause reads "It is hereby expressly agreed that no servant or agent of the carrier (including every independent contractor from time to time employed by the carrier) shall in any circumstances whatsoever be under any liability whatsoever to the shipper, consignee or owner of the goods or to any holder of this Bill of Lading for any loss, damage or delay of whatsoever kind arising or resulting directly or indirectly from any act, neglect or default on his part while acting in the course of or in connection with his employment and, without prejudice to the generality of the foregoing provisions of this clause, every exemption, limitation, condition and liberty herein contained and every right, exemption from liability, defense and immunity of whatsoever nature applicable to the carrier or to which the carrier is entitled hereunder shall also be available and shall extend to protect every such servant or agent of the carrier acting as aforesaid and for the purpose of all the foregoing provisions of this clause the carrier is or shall be deemed to be acting as *agent* or *trustee* on behalf of and for the benefit of all persons who are or might be his servants or agents from time to time (including independent contractors as aforesaid) and all such persons shall to this extent be or be deemed to be parties to the contract in or evidenced by this Bill of Lading."

¹³⁶ [1975] AC 154.

Himalaya clause and a clause providing a one year time bar. The machinery was damaged by the employees of the stevedore while it was being unloaded. The issue arising was whether the stevedore was entitled to rely on the time bar found in the contract of carriage.

The Privy Council held, by a majority of three to two, that the stevedore was entitled to rely on the time bar as the four conditions laid down by Lord Reid were satisfied. The first condition was satisfied as the stevedore was expressly referred to in the bill of lading to be entitled to the protection provided in the contract. The second condition was satisfied as it was expressly stated that the carrier entered into the contract of carriage on behalf of the stevedore. The third condition was satisfied as the stevedores was the parent company of the carrier and its services had been frequently engaged by the carrier. As such, the stevedore was aware that the contract of carriage contained an exclusion clause which extended protection to them and would have authorised the carrier to enter into the contract on their behalf. The fourth condition was satisfied as the stevedore's performance of its services (unloading the goods) for the benefit of the carrier was sufficient consideration for the agreement by the shipper that the stevedore should have the benefit of the exemptions in the bill of lading. As a result, a separate contract between the stevedore and the owner of the cargo was created.¹³⁷

It is important to note that Lord Wilberforce in delivering the main judgment for the majority stated that the law should not be "more restrictive and technical as regards agency contracts."¹³⁸ His Lordship adopted a liberal approach in order to fulfill the requirements

¹³⁷ Lord Wilberforce stated that this was a unilateral contract while Barwick CJ in Australian High Court in the case of *The New York Star* [1978] 139 CLR 231 preferred to imply a bilateral contract to allow a third party to rely on the Himalaya clause.

¹³⁸ At 169 (*The Eurymedon* (PC)).

laid down by Lord Reid due to commercial considerations to give efficacy to the terms of the contract of carriage as entered into by the contracting parties.

The extent of the contractual clauses in the bill of lading which can be relied on by a third party depends on the scope of the Himalaya clause as agreed by the contracting parties. This in turn depends on the construction of the words used in the clause.¹³⁹ The Himalaya clause is only effective in protecting the third party if the accident or negligence occurs while he is performing the obligation as stipulated in the contract.¹⁴⁰ No reliance on the clause is allowed where the loss occurs before the performance of the contract begins or after the performance of the contract has been completed. This is justifiable as the contracting parties would usually intend the third party to benefit from the Himalaya clause while he is performing the duty under the contract.

The validity of the Himalaya clause received full endorsement of the Privy Council in *Port Jackson Stevedoring Pty Ltd v Salmond & Spraggon (Australia) Pty Ltd; The New York Star*.¹⁴¹ There are some similarities between this case and *The Eurymedon*. Firstly, the term sought to be relied upon by the stevedore was a one year time bar found in the bill of lading. Secondly, the stevedore company was an associated company of the carrier who was a party to the contract of carriage of a consignment of razor blades shipped from Canada to Australia. Thirdly, the main judgment was delivered by Lord Wilberforce.

¹³⁹ For eg., in *The Mahkutai*, the Privy Council held that the third party could not rely on an exclusive jurisdiction clause as it was not covered by the Himalaya clause which applied to “all exceptions, limitations, provision, conditions and liberties herein benefiting the carrier”. The characteristic of these terms are to protect the carrier and its agents or sub-contractors. It does not benefit the cargo owners. On the contrary, an exclusive jurisdiction clause applies mutually to both parties and thus, is different from the terms stated in the Himalaya clause.

¹⁴⁰ *Law of Contract*, at 673.

¹⁴¹ [1980] 3 All ER 257.

In *The New York Star*, the Privy Council held unanimously that the stevedore was entitled to rely on the time bar found in the bill of lading. The first and second conditions imposed by Lord Reid in *Midland Silicones* were satisfied due to the wordings of the Himalaya clause in the bill concerned. It was also held that although there was room in each case for evidence as to the precise relationship of carrier and stevedore and the practice at the port of discharge, it was established law that in the normal situation involving the employment of a stevedore by a carrier, commercial practice required the stevedore to enjoy the benefit of contractual provisions in the bill of lading. Shippers, carriers and stevedores knew that such immunity was intended and thus, the stevedores were taken to have authorised the making of the contract on their behalf. In this case, consideration was provided by the stevedore by loading and unloading the goods. Thus, the third and the fourth conditions were satisfied.

The liberal approach as seen in *The Eurymedon* was echoed in *The New York Star* by Lord Wilberforce who stated that:

. . . the decision does not support, and their Lordships would not encourage, a search for fine distinctions which would diminish the general applicability, in the light of established commercial practice, of the principle.¹⁴²

In *The Owners of the Ship 'Borvigilant' v The Owners of the Ship 'Romina G'*,¹⁴³ the Court of Appeal also took a broad approach in determining whether the requirements imposed by Lord Reid in *Midland Silicones* were satisfied. This case involved a maritime collision. The respondent's (Bolkan) tug Borvigilant collided with the appellant's tanker Romina G. The appellant entered into a contract with National Iranian Oil Company (NIOC) which

¹⁴² At 261 (*The New York Star* (PC)).

¹⁴³ [2003] 2 Lloyd's Rep 520.

operated the Kharg Island terminal in order to load a cargo of crude oil. The contract allowed NIOC to hire sub-contractor to perform the services of loading. One of the issues which arose was whether the respondent, a sub-contractor employed to provide a tug to berth the Romina G was entitled to the benefit of the exclusion clause found in the contract between NIOC and the appellants. This clause expressly extended the protection to the sub-contractors chosen by NIOC but did not provide that NIOC contracted on behalf of the sub-contractor.

It was held unanimously that all the four requirements of agency as stipulated by Lord Reid in *Midland Silicones* were satisfied in this case. The first condition was satisfied since the clause expressly protected the sub-contractor. The second condition was watered down by Clarke LJ who held that it was unnecessary to state expressly that NIOC was contracting on behalf of the sub-contractor as long as the circumstances of the case warranted such a conclusion.¹⁴⁴ The fact that the clause expressly provided protection to the sub-contractor was taken as an indication that the promisee entered into the contract as an agent for the former.

Clarke LJ also adopted a liberal approach in determining whether the respondent had authorised NIOC to enter into the contract on its behalf (third condition). It was found that Bolkan had authorised NIOC to enter into the contract despite the fact that there was no clear evidence that the general manager of Bolkan who had died before the trial was aware of the terms of the contract. However, it was more probable than not that the general manager who had years of experience in this area was aware of the terms of the contract. Clarke LJ went on to discuss the possible acts of ratification if there was no actual authority

¹⁴⁴ At 524–525 (*The Borgivilant*).

for NIOC to enter into the contract. The learned judge was willing to accept that a letter written before the legal action but after the collision (where the appellant had an accrued action for negligence) was within reasonable time to constitute a valid act of ratification. The learned judge was swayed by the fact that the appellant would not be prejudiced if a broad approach was taken. The appellant should be bound by the terms of the contract which it entered into willingly to arrange the allocation of risk of losses.¹⁴⁵ The fourth condition was satisfied as consideration was provided by Bolkan performing towage services as required in the performance of the contract between the appellant and NIOC.

Clarke LJ also opined that since the contract in question expressly provided protection to the third party, this was a ‘strong pointer’ to adopt a more flexible approach to find a relationship of agency.¹⁴⁶

2. Evaluation

Himalaya clauses enable judges to give effect to the legitimate commercial expectations of businessmen. Himalaya clauses are fashioned in such a way to be consistent with the privity doctrine as it results in the creation of agency and implied contract. Unfortunately, the quest for such consistency is also the source of criticism behind this agency principle. The most notable criticism is the artificiality of Himalaya clauses.¹⁴⁷ Counsel for plaintiffs

¹⁴⁵ At 534 (*The Borgivilant*).

¹⁴⁶ At 525 (*The Borgivilant*). Another possible reason behind such a liberal attitude may be due to the legislative reform of the doctrine of privity (by the enactment of Contracts (Rights of Third Parties Act 1999) which would have definitely allowed the respondent to rely on the exclusion clause but unfortunately the new Act did not apply as the contract was created before the Act came into force.

¹⁴⁷ Lord Bingham in *The Starsin* [2003] 2 WLR 711, at 725 had referred to the reasoning relied on to uphold Himalaya clause as “undoubted artificiality”. For eg., there is difficulty in squaring the implied contract created with the conventional contractual framework. See Palmer, N.E., *Bailment*, 2nd Edition, (The Law Book Company Ltd, 1991), at 1610-1625.

may raise technical points with regards to the creation of a contract or agency relationship to defeat the third party's reliance on Himalaya clause.¹⁴⁸ Accordingly, Lord Wilberforce advised future judges to ensure that the third party's argument should not be easily defeated by technical arguments. Indeed, subsequent judges have heeded his Lordship's advice. For example, to satisfy the third condition of Lord Reid's principle, there must be special circumstances which show that the third party is aware of the Himalaya clause.¹⁴⁹ In subsequent cases decided by the Privy Council, these special circumstances are not deemed to be a prerequisite for enforcement of Himalaya clause by third parties.¹⁵⁰ Besides, the condition of proving that the third party gives authority to the carrier to act on his behalf may be redundant as the former can always ratify the carrier's act. Although this is subject to the rules of ratification, a liberal approach was adopted in *The Romina G*. As such, it is submitted that the development of this agency principle has reached a point where its technicalities no longer prove a major hindrance to judges.

At the same time, the liberal approach taken by the judges also serves as the pinnacle of artificiality of this agency principle. What is important is not whether the principles of agency are satisfied. Rather, the determinant factor lies in whether allowing the third party to rely on the exclusion clause gives effect to the intention of the contracting parties. If the

¹⁴⁸ Mckendrick, Ewan, *Contract Law – Text, Cases and Materials*, 2nd Edition, (Oxford University Press, 2005) (hereinafter referred to as 'McKendrick'), at 1225 and Lord Goff in *The Makutai* [1996] A.C. 650, at 664.

¹⁴⁹ This is necessary as a contract can only arise if the parties have knowledge of its terms at the time the contract is created that is at the time the third party discharges its performance in favour of the consignee. In *The Eurymedon* and *The New York Star*, since the third party was an associated company of the carrier, they might have knowledge about the terms of the bill of lading and had authorised the carrier to enter into the contract of carriage on their behalf.

¹⁵⁰ *The Mahkutai* and *The Pioneer Container* as referred to in the *Law of Contract*, at 672.

answer is positive, the third party should be entitled to shelter behind the exclusion clause if there are no policy reasons to object to such an outcome.¹⁵¹

At present, in England, the use of Himalaya clauses is limited to contracts of carriage.¹⁵² By contrast, in Australia, in *Noosa Shire Council v Farr*,¹⁵³ the Supreme Court of Queensland applied *The Eurymedon* to a situation outside contracts of carriage. In *Noosa Shire*, employees of the promisee were allowed to rely on an exclusion clause found in the contract between the plaintiff and the employer (promisee) in relation to a design of a water augmentation scheme. Arguably, the use of Himalaya clauses can be extended to other situations. Although Lord Reid in *Midland Silicones* formulated this device in relation to contracts of carriage, there is no rationale to prevent this device from being applicable to other situations as the problems created by the privity doctrine are the same in relation to a contract of carriage or other types of contracts.

D. Tortious Analysis of Exclusion Clauses

The third party's liability to the promisor usually lies in the law of tort. The existence of exclusion and limitation clauses may be relevant to the issue of imposition of tortious

¹⁵¹ *Law of Contract*, at 671. These concerns bear a striking resemblance to the concerns taken into account by the Supreme Court of Canada in introducing the 'principled exception' to the doctrine of privity as discussed in Part III(D) of this chapter.

¹⁵² Davis, J.L.R., "Privity and Exclusion Clauses in Kincaid, Peter, ed., *Privity: Private Justice or Public Regulation*, (Ashgate Publishing Company, 2001) (hereinafter referred to as '*Privity: Private Justice*'), at 297 and Phang and Toh (1996) 10 *JCL* 212-230, at 219. An attempt to extend the application of Himalaya clauses to construction contracts failed in the case of *Southern Water Authority v Carey* [1985] 2 All ER 1076. In relation to contracts of carriage of goods by sea, the use of Himalaya clauses may be limited if the contracting parties agree to be governed by the Hague-Visby Rules and the Hamburg Rules. Nonetheless, these rules do not cover independent or sub-contractors of the carrier where Himalaya clauses are needed to extend any benefit of the contract of carriage to them. In Australia, the principle behind Himalaya clauses was applied in a contract of carriage of goods by land in *Lifesavers (Australasia) Ltd v Frigmobile Pty Ltd* [1983] 1 NSWLR 431.

¹⁵³ [2001] QSC 60.

liability. The protection intended for the third party under an exclusion clause can be indirectly given effect to by holding that the third party does not owe a duty of care to the promisor or the third party is entitled to rely on the defence of *volenti non fit injuria*. This part examines (i) rejection of duty of care, (ii) defence of *volenti non fit injuria* and (iii) evaluation of these mechanisms.

1. Rejection of Duty of Care

Lord Roskill in *Junior Books Ltd v Veitchi Co Ltd*¹⁵⁴ stated that an exclusion clause found in a main contract between a customer (promisor) and a contractor (promisee) may limit the duty of care owed by the sub-contractor to the customer. Whether the duty of care is negated depends on the manner in which the clause is phrased.¹⁵⁵ Lord Roskill's principle was applied in *Southern Water Authority v Carey*.¹⁵⁶ In this case, the plaintiffs were a water authority whose predecessor, a sewerage board, entered into a contract with the second defendants (main contractors) for the construction of sewage works. An exclusion clause was found in Clause 30(vi) of the contract.¹⁵⁷ The work done was defective. This resulted in the failure of the whole sewage scheme. The plaintiffs sued the main contractors as well as the sub-contractors (third and fourth defendant).

¹⁵⁴ [1983] 1 AC 520, at 546.

¹⁵⁵ This is seen in *British Telecommunications plc v James Thomson & Sons (Engineers) Ltd* (1999) SC(HL) 9. In this case, the domestic sub-contractor was not protected by the exclusion clause which extended its protection to nominated sub-contractors only.

¹⁵⁶ [1985] 2 All ER 1077.

¹⁵⁷ Clause 30(iv) read:

The Contractor's liability under this clause shall be in lieu of any condition or warranty implied by law as to the quality or fitness for any particular purpose of any portion of the Works taken over under Clause 28 (Taking-over) and save as in this Clause expressed neither the Contractor nor his Sub-Contractors, servants or agents shall be liable, whether in contract, tort or otherwise in respect of defects in or damage to such portion, or for any injury, damage or loss of whatsoever kind attributable to such defects or damage. For the purposes of this sub-clause the Contractor contracts on his own behalf and on behalf of and as trustee for his Sub-Contractors, servants and agents.

It was held by Judge David Smout QC that the third and the fourth defendants could not rely on Clause 30(iv) as they were not parties to the contract.¹⁵⁸ However, the sub-contractors were not liable for tort of negligence because the contractual setting and Clause 30(vi) were taken into account to deny any duty of care owed by the sub-contractors to the plaintiffs. Since the exclusion clause was clearly drafted to cover liability of sub-contractors, this showed that from the very beginning, the plaintiffs accepted that they would have to bear the loss of any damage caused to their property. Accordingly, the sub-contractors did not owe a duty of care to them.

In *Norwich City Council v Harvey*,¹⁵⁹ the plaintiff (building owners) entered into a contract for the extension of a swimming pool complex. Clause 20(C) of the contract allocated the risk of losses between the contracting parties.¹⁶⁰ The contractor sub-contracted certain roofing work to the defendant sub-contractors, one of whose employees, while using a blowtorch, set fire to both the existing buildings and the new extension. The building owners brought an action against the sub-contractors and their employee claiming damages for negligence.

The Court of Appeal held that the sub-contractors were entitled to rely on Clause 20(c) to preclude the existence of a duty of care owed to the plaintiff. Clause 20(c) did not expressly

¹⁵⁸ Despite the wordings of Clause 30(iv), the sub-contractors could not claim to be beneficiaries under a trust attaching Clause 30(iv) as to do so would extend the concept of trust far beyond its conventional limits. The learned judge also refused to infer the existence of an implied contract similar to situations involving Himalaya clause as to do so would be artificial. The sub-contractors could not rely on the principles of agency as they had not given prior authority to the main contractors to enter into the contract on their behalf. Neither could they ratify the contract as at the time the contract was signed, they were not ascertainable as principals.

¹⁵⁹ [1989] 1 All ER 1180. This device was also applied in *Pacific Associates Inc v Baxter* [1990] 1 QB 993 and *John F Hunt Demolition Ltd v ASME Engineering Ltd* [2007] All ER (D) 344 (Jun).

¹⁶⁰ Clause 20(C) read:

The existing structures . . . owned by him or for which he is responsible and the Works . . . shall be at the sole risk of the Employer (i e the building owners) as regards loss or damage by fire . . . and the Employer shall maintain adequate insurance against those risks.

state that the sub-contractors were to benefit from it. However, it indicated the plaintiff's willingness to bear the risk of loss or damage caused to the building by fire. Accordingly, if any sub-contractor had contracted with the contractor on this basis,¹⁶¹ it would not be just and reasonable to exclude the sub-contractor from the protection of Clause 20(c) if the building was damaged by fire as a result of the sub-contractor's negligence, even though there was no privity between the sub-contractor and the plaintiff.

2. Defence of *Volenti Non Fit Injuria*

The possibility of the application of the defence of *volenti non fit injuria*¹⁶² in favour of a third party was stated by Kitto J in the Australian case of *Wilson v Darling Island Stevedoring & Lighterage Co Ltd*¹⁶³ as follows:

If A in his contract with B agrees expressly or impliedly that C need take no care to avoid injuring A . . . and that B may so inform C and B does so inform C, the defence of volenti (non fit injuria) is . . .

¹⁶¹ This was satisfied on the facts of *Norwich* as the sub-contractors were invited to tender by the main contractor. The document doing so identified the form of the main contract and it attached extracts from the relevant bill of quantities where the main contractor expressly stated that the Clause 20(C) would apply. In their own additional conditions they also provided inter alia:

The work is to be carried out in accordance with the contract which exists between Bush Builders (Norwich) Ltd. (hereinafter referred to as 'Main Contractor') and the Employer, and the acceptance of this order binds the Sub-contractors and Suppliers to the same terms and conditions as those of the Main Contract. It is not however the intention of the Main Contractor to issue formal Sub-Contract Documents unless specifically required.

It seems that in order to persuade the courts to deny the existence of a duty of care, the third party must be aware of the exclusion clause before he begins work in favour of the promisor; *Precis (521) plc v William M Mercer Ltd* [2005] EWCA Civ 114, at para 25.

¹⁶² This applies where the plaintiff has voluntarily assumed the risk of the defendant's negligence. To invoke this defence, the defendant must prove that the plaintiff has agreed, expressly or impliedly to assume the risk of the defendant's negligence.

¹⁶³ (1956) 95 CLR 43. In this case, the plaintiff's (consignee) sued the defendant (stevedore) for damaging the goods after discharge from the carrier's vessel. The defendant relied on the exclusion clause found in the bill of lading between the consignee and the carrier. The High Court, by a majority of 3-2, held that the defendant could not rely on the exclusion clause as it was not a party to the contract. *Elder Dempster* was rejected. The defence of volenti did not avail to the defendant as the exclusion clause did not expressly or impliedly refer to the defendant.

clearly made out . . . The absence of privity of contract between A and C would be irrelevant. It is a question of consent or no consent.¹⁶⁴

In *Southern Water*, although the exclusion clause expressly protected the sub-contractors, Judge David Smout QC opined that the defence of *volenti* did not apply as the documents involved in this case did not indicate the existence of an agreement to assume the risk of negligence between the plaintiffs and the sub-contractors prior to the alleged breach of duty.¹⁶⁵ The fact that one of the sub-contracts had a term identical to the exclusion clause in the main contract was not taken into consideration in proving the defence of *volenti*.

By contrast, in *London Drugs v Kuehne & Nagel*, this device was used successfully by McLachlin J to limit liability of third party employees. In the learned judge's words:¹⁶⁶

The existence of a limitation on liability, whether contractual or otherwise, may affect the ambit of that duty of care. In this case, the majority of the Court of Appeal, applying these principles, concluded that the duty of care of the defendants was limited to damage under \$ 40, the plaintiff having accepted all risk of damage over that amount. I would affirm that conclusion.

As a consequence, it was held that since the claimants had agreed to limit the employer's liability, they must be taken to have done so in relation to the employees.¹⁶⁷

There are differences between the three cases discussed in the preceding paragraphs. *Wilson* seemed to place importance on whether consent is given by the promisor (plaintiff)

¹⁶⁴ At 82 (*Wilson*). Lord Denning also accepted the defence of *volenti* as a means to circumvent the privity doctrine in *Scruttons Ltd v Midland Silicones* [1962] AC 446, at 485.

¹⁶⁵ At 1085 (*Southern Water*). In Beale, H.G., ed., *Chitty on Contracts*, 29th Edition, 2 Vols, (Sweet & Maxwell, London, 2004), it was stated that an exclusion clause intended to cover a third party will not be construed as amounting to defence of *volenti*, at para 14-052.

¹⁶⁶ At 460 (*London Drugs*). The facts of this case are explored in detail later in this chapter at Part III(E).

¹⁶⁷ At 455 (*London Drugs*).

which is then communicated to the third party defendant.¹⁶⁸ Communication can be made by the promisee who hires the third party. In *Southern Water*, the standard of proving an agreement to assume the risk of loss is higher. In *London Drugs*, the existence of an agreement with the employer to exclude or limit liability is sufficient to provide protection to the employees. There is no requirement of any consent, communication of consent or agreement between the promisor and the third party.

It is submitted that McLachlin J's approach is more appropriate in dealing with third parties' reliance on exclusion clauses in raising the defence of *volenti*. The general law of *volenti* does not require consent to be communicated to the defendant. By analogy, there are situations where courts decide that an implied agreement exists between the parties where they do not discuss their liability before loss occurs.¹⁶⁹ An implied agreement should arise if the promisor (plaintiff) agrees to assume the risk for any losses suffered or agree to exclude liability of the third party defendant's employer. Express reference of the third party is preferable but it is not a necessity if the promisor is aware that the performance of the contract will be carried out by others.¹⁷⁰ The third party's negligence is not independent from the contract between the promisor and the promisee (employer). Rather negligence arises from the very act required by this contract. Thus, both the promisee and the third party should receive similar treatment.

¹⁶⁸ The imposition of the requirement of communication is criticised by Battersby in "Exemption Clauses and Third Parties" (1975) 25 *U Tor LJ* 371-405, at 378.

¹⁶⁹ See Winfield & Jolowicz, at 1068-1070.

¹⁷⁰ Macmillan also come to the same opinion in "Privity and the Third Party Beneficiary: 'The Monstrous Proposition'" [1994] *LMCLQ* 22-29, at 29.

3. Evaluation

It can be contended that the use of tort principles to analyse and give effect to exclusion clauses is sound in law. In determining the existence of a duty of care, all the relevant circumstances relating to the case will be considered. The existence of an exclusion clause is definitely a relevant circumstance as it shows the willingness of the defendant to assume responsibility over the plaintiff's well being and whether it is reasonable for the plaintiff to rely on the defendant. Similarly, the use of the defence of *volenti* in assisting the third party in defending a legal action is also valid as consent and assumption of risk destroy tortious liability. A contract is not necessarily required to prove the defence of *volenti* as long as the party who suffers the loss is aware of the exclusion or limitation clause.¹⁷¹

There is overlap between the two tort principles (negating duty of care and *volenti*). Application of these two principles may lead to the same result. However, the scope of negating duty of care may be more restrictive as compared to the defence of *volenti*. The former only applies to exclusion clauses¹⁷² whereas the scope of *volenti* is broader as it also applies to limitation clauses.¹⁷³ In addition, the former only applies in situations where the third party is sued under the tort of negligence while the defence of *volenti* applies generally to all types of torts.

¹⁷¹ Coote, Brian, *Exception Clauses*, (Sweet & Maxwell: London, 1964), at 126 relying on the case of *Ashdown v Samuel Williams* [1956] 2 QB 580 where the occupier of land was allowed to exclude liability by putting up a notice to this effect. J.L.R Davis in *Privity and Exclusion Clauses* in *Privity: Private Justice* at 284 and MacMillan [1994] *LMCLQ* 22–29, at 28 also supports the use of this concept to ameliorate the difficulties caused by the privity doctrine in this area of the law. See also Hamson, C.J., “Contract-Third Party-Benefit of Exemption Clauses” (1959) 17 *C.L.J.* 150-153; Battersby, Graham in “Exemption Clauses and Third Parties” (1975) 25 *U Tor LJ.* 371-405.

¹⁷² *Law of Contract*, at 638.

¹⁷³ This is based on McLachlin J's judgment in *London Drugs*. It is uncertain as to whether England will extend the defence of *volenti* to limitation clauses.

At present, the use of tort principles to give effect to the contracting parties' intention behind exclusion clauses is seen as an alternative rather than the general rule. Judges prefer to rely on the contractual analysis of exclusion clauses, facing the stumbling block of the privity doctrine and develop escape routes to the doctrine. In addition, the success of utilising tort principles to overcome the doctrine is not guaranteed due to the uncertainties (i) inherent in the law on imposition of duty of care and (ii) the approach to be taken in determining the application of the defence of *volenti*.

E. 'Principled Exception' to Doctrine of Privity

In Canada, the Supreme Court had launched an assault on the privity doctrine in respect of exclusion, limitation and waiver of subrogation clauses. A 'principled exception' was created to enable the third party to rely on these clauses. This part examines the (i) development of the 'principled exception' and (ii) evaluation of this exception.

The two cases responsible for the creation and development of 'principled exception' are *London Drugs v Kuehne & Nagel* and *Fraser River Pile & Dredge Ltd v Can-Drive Services Ltd*.¹⁷⁴ In *London Drugs*, London Drugs ('LD') bailed its transformer to Kuehne & Nagel ('KN'), a warehouse operation for storage. They executed a standard form contract which included a limitation of liability clause.¹⁷⁵ LD was aware of the limitation clause and had chosen to arrange its own insurance cover. LD also knew that KN's employees would

¹⁷⁴ [1999] 3 SCR 108.

¹⁷⁵ This clause read:

LIABILITY – Sec. 11(a) The responsibility of a warehouseman in the absence of written provisions is the reasonable care and diligence required by the law.

(b) The warehouseman's liability on any package is limited to \$40 unless the holder has declared in writing a valuation in excess of \$40 and paid the additional charge specified to cover warehouse liability.

be responsible for the movement and maintenance of the transformer. Subsequently, the transformer was damaged due to the negligence of KN's employees. LD sued both KN and the employees who caused the damage. The claim against KN failed due to the limitation clause. The issue was whether the employees were also entitled to rely on the limitation clause though they were not parties to the contract.

The majority of the British Columbia Court of Appeal held in favour of the employees and limited their liability to \$40. LD's appeal to the Supreme Court was dismissed. Three different approaches could be seen in the Supreme Court judgment.¹⁷⁶ Iacobucci J (L'Huereux-Dube, Sopinka, and Cory JJ concurring) held that the employees (the respondents) owed a duty of care to LD in handling the transformer. The employees were liable for the damage unless they could rely on the limitation clause. One case which stood against the employees was *Greenwood Shopping Plaza Ltd v Beattie*.¹⁷⁷ In this case, the employees of a company, a tenant of a shopping centre negligently caused a fire which destroyed part of the shopping centre. The landlord's insurer (by way of subrogation) sued the tenant and its employees for the damage caused by the fire. The Supreme Court held that the tenant was protected from the liability due to the waiver of subrogation rights found in the lease contract. However, the employees were held liable for the damage that they caused as they were not privy to the lease contract. The exception to the privity doctrine such as agency and trust were not applicable in this case.

¹⁷⁶ The other remaining judgments were that of McLachlin J which is discussed earlier in this Chapter at Part III(C)(2) and La Forest J which held that the employees did not owe a duty of care to LD.

¹⁷⁷ [1980] 2 S.C.R. 228.

Iacobucci J managed to distinguish *Greenwood* from *London Drugs* due to the following reasons:¹⁷⁸

- (a) The contract involved in *Greenwood* was a lease of premises and not a contract of storage. In *Greenwood*, the performance of the contract did not require the involvement of the employees.
- (b) The clauses subject to the dispute in *Greenwood* were clauses dealing with arrangement of insurance and the granting of subrogation rights and not general limitation clauses.
- (c) In *Greenwood*, the relevant clauses in the contract of lease did not expressly refer to the employees and there was little to infer from the contract and the surrounding circumstances that the contracting parties intended to benefit the employees.

Since *Greenwood* could be distinguished, this gave an opportunity to Iacobucci J to develop an exception to the privity doctrine. The learned judge was swayed by the difficulties created by the application of the doctrine to the facts of *London Drugs*. Firstly, to uphold the doctrine would go against commercial reality, common sense and justice. Employees such as the respondent in this case would not expect to be liable for damages incurred by LD especially where KN (their employer) had successfully limited its liability against LD.¹⁷⁹ Moreover, taking into account the amount of salary held by the employees, it is unfair to let liability to fall back on them. They had no opportunity to decide whether they want to assume the risk of loss to LD due to their own negligence. Moreover, to allow LD's claim against the employees to succeed would entitle LD to go back on its promise to

¹⁷⁸ At 431-432 (*London Drugs*).

¹⁷⁹ Ar 446 (*London Drugs*).

limit the losses suffered as stated in the contract. This would defeat the allocation of losses agreed between LD and KN. As such, strict application of the privity doctrine leads to absurd result as the law cannot accommodate the needs of commercial transactions where such contractual clauses are commonly used.

Secondly, the justifications behind the doctrine of privity did not apply to this case.¹⁸⁰ Allowing the employees to rely on the limitation clause would not lead to double recovery or floodgate of litigation. The employees would not be able to sue LD had LD breached the contract. The only benefit that the employees were entitled to was the limitation clause. It was not a case of allowing a person to sue on a contract when he cannot be sued on it like the situation found in *Tweddle v Atkinson*.¹⁸¹

Thirdly, there were special considerations arising from the relationships of employer-employee and employer-customer which justified intervention of the court. For instance, there was a clear ‘identity of interest’¹⁸² between KN and its employees in relation to the performance of the contractual obligation rendered by KN to LD. LD knew that the contractual obligation owed by KN would be performed by KN’s employees. In addition, the employees’ negligence fell within the scope of the limitation clause in this case. There was no valid reason to deny the employees from relying on the limitation clause.

¹⁸⁰ At 440 (*London Drugs*).

¹⁸¹ (1861) B&S 393.

¹⁸² At 441 (*London Drugs*). ‘Identity of interest’ arises as the obligation to be performed by the employer is performed by the employees.

Concerning the creation of a new exception to the privity doctrine, Iacobucci J opined that there was nothing in the common law which prevented judges from relaxing the doctrine.

The learned judge stated that:

. . . the common law recognizes certain exceptions to the doctrine, such as agency and trust, which enable courts, in appropriate circumstances, to arrive at results which conform with the true intentions of the contracting parties and commercial reality. However, . . . the availability of these exceptions does not always correspond with their need. Accordingly, this court should not be precluded from developing the common law so as to recognize a further exception to privity of contract merely on the ground that some exceptions already exist.¹⁸³

As such, in circumstances where the traditional exceptions to the doctrine are not applicable, courts will engage in a functional inquiry as to whether the doctrine should be relaxed. It was therefore, held that the employees should be allowed to take advantage of an exclusion clause found in the contract between his employer and customers if the following requirements are fulfilled:

- (a) The clause, either expressly or impliedly, extended to the employees, and
- (b) The employee's tortious action occurred in the course of their employment while providing the contracted services to the customer.

The above requirements were satisfied on the facts of *London Drugs*. The term 'warehouseman' in the limitation clause was given a broad interpretation to include employees. The tort of negligence was committed by the employees while performing the contractual obligation owed by KN to LD. Thus, the employees were entitled to rely on the limitation clause.

¹⁸³ At 439 (*London Drugs*).

The ‘principled exception’ was extended to allow third parties to rely on waiver of subrogation clause in *Fraser River Pile & Dredge Ltd v Can-Drive Services Ltd*. In this case, a barge owned by Fraser River sank while chartered to Can-Drive (respondent). The insurance policy of the barge created by Fraser River and its insurer included clauses waiving subrogation and extending coverage to affiliated companies and charterers.¹⁸⁴ The insurers paid Fraser River the fixed amount stipulated in the policy for the loss of the barge. The insurer made a further agreement with Fraser River to pursue a negligence action against Can-Drive and Fraser River agreed to waive any right to the waiver of subrogation clause. The insurer took a subrogated action under the law of negligence against Can-Drive. This legal action was allowed at trial, and dismissed on appeal. The insurer then appealed to the Supreme Court which had to determine whether a third-party beneficiary can rely on a waiver of subrogation clause to defend a subrogated action on the basis of a principled exception to the privity doctrine.

The Supreme Court held unanimously in favour of Can-Drive. The judgment was delivered by Iacobucci J. It was held that the general rule of the doctrine of privity continues to apply in Canada. However, this is subject to a ‘principled exception’ to the doctrine as developed in *London Drugs* which was applicable on the facts of *Fraser River*. This exception will apply if the following requirements are satisfied.¹⁸⁵

- (a) The parties to the contract must intend to extend the benefit to the third party seeking to rely on the contractual provision; and

¹⁸⁴ The relevant clause read “F.R.P.D. has agreed to waive any right it may have pursuant to the waiver of subrogation clause in the aforesaid policy with respect to Can-Dive Services Ltd....”.

¹⁸⁵ Iacobucci J modified the requirements for ‘principled exception’ as stated in *London Drugs* to cater for situations not involving reliance on exclusion clause by employees.

- (b) The activities performed by the third party must be the very activities contemplated as coming within the scope of the contract in general, or the provision in particular, as determined by reference to the intention of the contracting parties.

Besides, courts will also take into account policy reasons to justify any extension of the 'principled exception' to other situations. On the facts of *Fraser River*, all the requirements were satisfied. Fraser River and its insurer intended to extend the benefit of the waiver of subrogation clause to Can-Drive. This conclusion was reached as there was a direct reference to Can-Drive in the waiver of subrogation clause through the use of the word 'charterer(s)'. Such express reference formed a compelling reason to relax the doctrine of privity.¹⁸⁶ Moreover, the waiver of subrogation clause was not conditional on Fraser River's initiative in favour of any particular third-party beneficiary and could be enforced by Can-Drive acting independently. The activities engaged by Can-Drive at the time the barge sank were the activities anticipated in the insurance policy.

Iacobucci J was not swayed by the fact that Fraser River and its insurer had agreed to revoke the waiver of subrogation clause. A decision in favour of Can-Drive would not restrict their freedom of contract because the revocation was concluded after Can-Drive's inchoate right crystallised into an actual benefit. At that point, Can-Drive became a party to the initial contract for the limited purpose of relying on the waiver of subrogation clause. Accordingly, Fraser River and its insurers could not revoke Can-Drive's crystallised rights without the latter's consent.

¹⁸⁶ At 125 (*Fraser River*).

In reaching his decision, Iacobucci J applied the policy reasons driving the creation of the ‘principled exception’ in *London Drugs*. To uphold the doctrine of privity in this case would be inconsistent with commercial reality¹⁸⁷ as it would defeat the intention of commercial men. The creation of a new exception would not lead to double recovery by Can-Drive as the waiver of subrogation clause only entitled it to defend itself against a legal action. It could not rely on any terms in the contract of insurance to initiate another claim. Iacobucci J also supported his decision in *Fraser* on the ground that it is the role and duty of the judiciary to make incremental changes to the law where it is “necessary to address emerging needs and values in society.”¹⁸⁸

The evaluation of the ‘principled exception’ is discussed under the following issues:

1. Theoretical Justification

As seen in Chapter 2, creation of third party rights raises the issue whether these rights are consistent with contract theory. In *London Drugs*, Iacobucci J did not discuss about the consistency of the ‘principled exception’ with contract theory. Ogilvie opines that *London Drugs* and *Fraser River Pile* represents a change in the traditional understanding on the justification behind enforcement of contract based on the bargain theory.¹⁸⁹ The third party is allowed to enforce a contract as a result of the contracting parties’ intention. This is inconsistent with the bargain theory which justifies enforcement of contract on the basis that a bargain is made.

¹⁸⁷ At 131 (*Fraser River*).

¹⁸⁸ At 132 (*Fraser River*).

¹⁸⁹ “Privity of Contract in the Supreme Court of Canada: Fare Thee Well or Welcome Back?” [2002] *JBL* 163–176, at 164–166. Brock also reaches similar conclusion in his article entitled “A “Principled” Exception to Privity of Contract: *Fraser River Pile & Dredge Ltd v Can-Dive Services Ltd*” [2000] 58 *UTFLR*. 53–71, at 63.

On the contrary, Davis supports the courts' decision to uphold the benefits of an exclusion or limitation clause intended for a third party without the trouble of invoking a further mechanism such as agency, trust or implied contract.¹⁹⁰ He opines that to give effect to the exclusion clause is to give effect to the bargain entered into by the contracting parties.¹⁹¹ As stated in Chapter 2, third party rights can be accommodated by contract law via a responsive bargain theory. Hence, it can be argued that the decisions of *London Drugs* and *Fraser River* should not be marred by doctrinal difficulties.

2. Requirements Imposed by Supreme Court in *London Drugs* and *Fraser River* for 'Principled Exception'

The requirements of this exception raise a number of concerns. The first concern arises from the ability of courts to imply an intention of the contracting parties from the surrounding circumstances. The intention will be implied if courts find that there is an 'identity of interest' between the promisee and the third party¹⁹² and the promisor knows that the third party will take part in fulfilling the obligation of the contract. Looking at the cases which applied *London Drugs*, there seems to be a tendency for a liberal approach adopted by judges in determining the existence of 'identity of interest'. In *Tony and Jim's Holdings Ltd v Silva*,¹⁹³ the issue was whether the employees of a lessee were entitled to rely on the waiver of subrogation clause in the lease contract against a legal action brought by the lessor's insurer for the damage caused by fire which was attributed to the

¹⁹⁰ Davis, J.L.R., in "Privity and Exclusion Clauses" in *Privity: Private Justice*, at 284-307.

¹⁹¹ Davis, J.L.R., in "Privity and Exclusion Clauses" in *Privity: Private Justice*, at 307.

¹⁹² This applies in situations where no express reference is made to the third party in the contract or the term benefiting the third party. On the contrary, it is not necessary to find the existence of 'identity of interest' if there is an express reference to the third party in the exclusion clause; *Fraser River*, at 127.

¹⁹³ (1999) 170 DLR 193. The disputed clause provided that "Notwithstanding the foregoing, all rights of subrogation are hereby waived against any corporation, firm, individual, or other interest with respect to which insurance is provided by this policy."

employees' negligence. Charron JA held that 'identity of interest' between the promisee and the third party does not need to cover the whole contract. It is sufficient if there is such 'interest' in respect of the clause in dispute. In *Tony and Jim*, 'identity of interest' was proven as since the property was leased to a corporation, it was understood that the corporate tenant can only be negligent through the acts of its employees.¹⁹⁴

As a consequence, it appears that third party employees will most likely be entitled to rely on an exclusion clause if their employer is protected by the clause.¹⁹⁵ Strictly speaking, the situation in *Tony and Jim* may be distinguished from *London Drugs*¹⁹⁶ as the performance of the employees is not necessary for the performance of a contract of lease. However, the finding of an 'identity of interest' in *Tony and Jim* may be justified on the ground that the contractual duty of the employer under the contract of lease to inspect and maintain the property can only be carried out by its employees.

The danger of allowing implied intention is that judges may read more into the contract than the parties have intended.¹⁹⁷ Thus, the outcome of the case may be inconsistent with the intention of the contracting parties. Take for instance the case of *London Drugs* where Iacobucci J held that the term 'warehouseman' included employees as well. It can be contended that the contracting parties (LD and KN) never gave thought about this matter when they entered into the contract especially since the contract was a standard form

¹⁹⁴ At 202 (*Tony and Jim*).

¹⁹⁵ The same approach was taken in *Madison Developments Ltd v Plan Electric Co Ltd* (1997) 152 DLR 653, *Laing Property Corp v All Seasons Display Inc.* (2000) B.C.A.C. LEXIS 547 and *Harlon Canada Inc. v Lang Investment Corporation* (2008) ON.C. LEXIS 1499. In *Dryburgh v Oak Marina Bay* (1992) Ltd [2001] 4 F.C. D LEXIS 221, Nadon J of the Federal Court, at 2-3 according to the pagination provided by *Lexis.com Research System*, stated that the "rule now unless clear intention not to cover employees, Court should imply employees covered by limitation or exclusion clause."

¹⁹⁶ The facts of *Tony and Jim*, *Madison Developments* and *Laing Property* were similar to *Greenwood*.

¹⁹⁷ Macmillan [1994] *LMCLQ* 22-29, at 28.

contract.¹⁹⁸ Unpredictability may arise as judges may come to different decisions as to what is the implied intention of the contracting parties. However, the danger of implied intention or its ensuing uncertainty does not arise in relation to contracts made for the benefit of the third parties because there will be express reference to the third party in the contract. There is no need to find an implied intention of the contracting parties to benefit the third party.

Secondly, to invoke the application of the ‘principled exception’ to third party employees, at the time the loss is caused, they must be acting in the course of employment and performing the services required under the contract between their employer and the customer.¹⁹⁹ It may be queried as to how the courts decide whether this requirement is satisfied.²⁰⁰ In *London Drugs*, there was no problem in determining this issue as the employees were negligent in loading the transformer, which was the act required under the contract of storage. However, there are situations where the determination of this issue is not so straightforward. In *Tony and Jim*, it was alleged that the fire occurred due to the employee’s negligence in leaving the gas stove on “high” under a pot of butter while he went next door for a cup of coffee. It is difficult to link the employee’s act here with the performance of obligations by a tenant in relation to the lease contract. This did not deter the Ontario Court of Appeal to decide in favour of the employee. The British Columbia Court of Appeal had referred to *Tony and Jim* in *Laing Property Corp v All Seasons Display Inc.* without any disapproval. Perhaps, this could be defended on the basis that the employees in *Tony and Jim* had to ensure that they did not cause any damage to the property as this was the obligation of their employer under the lease contract. Again, there

¹⁹⁸ In fact, McLachlin J disagreed with the findings of Iacobucci J on this point at 456-457 *cf* Waddams, S.W., “Privity of Contract in the Supreme Court of Canada” [1993] 109 *LQR* 349–352, at 350 on the basis that a reasonable person would have appreciated that the performance of the contract of bailment by a company must necessarily be carried out by the employees.

¹⁹⁹ At 302 (*London Drugs*).

²⁰⁰ MacMillan [1994] *LMCLQ* 22–29, at 28.

are uncertainties as to the extent of generosity of courts in favour of third parties in determining whether the second requirement of the ‘principled exception’ is satisfied.

The second requirement of the ‘principled exception’ may also lead courts into looking at issues on whether the employee has gone on a frolic of his own and acted outside the scope of employment so as to sever the connection between an employee and employer.²⁰¹

Complexity to the law is added but arguably this is justified as the contracting parties may not have intended employees to benefit from the contract if they are not acting within the scope of employment at the time the loss is caused.

3. Crystallisation of Third Party’s Inchoate Right

The Supreme Court in *Fraser River* did not expressly discuss the events which crystallised Can-Drive’s inchoate right. Arguably, the crystallisation event is most likely the loss of the barge though this was not made clear by Iacobucci J.²⁰² This argument is reached as Fraser River and its insurer were prohibited from revoking the waiver of subrogation clause after the barge was lost. The Supreme Court was also silent as to the possibility of reliance, acceptance or consent by Can-Drive as the crystallisation events of its inchoate right. If a third party’s right crystallises when he incurs losses, in *Fraser River*, the contracting parties can revoke the waiver of subrogation clause before the barge was lost. This may cause injustice in situations where the charterer agrees to charter the owner’s barge because it comes to know that there is a waiver of subrogation clause in the contract.

²⁰¹ MacMillan [1994] *LMCLQ* 22–29, at 28.

²⁰² The crystallisation event could be at the time Fraser River was paid by its insurer or at other times; Nicholson, Lizzie, “Privity A La Canadienne: Fraser River Pile & Dredge Ltd v Can-Drive Services Ltd” (2000) *LMCLQ*. 322-327, at 324.

4. Scope of ‘Principled Exception’

The general grounds in which Iacobucci J relied on in *London Drugs* and *Fraser River* to create and extend the ‘principled exception’ are commercial efficiency, justice, common sense and sound policy reasons. Huscroft laments that these are “open-textured concepts which provide little meaningful guidance for future courts”.²⁰³ This adds to the uncertainties in determining the scope of the ‘principled exception’.

The ‘principled exception’ has won accolades from Canadian judges who have broadly interpreted Iacobucci J’s judgment in *London Drugs* and *Fraser River* and applied it to situations beyond cases involving employees.²⁰⁴ The differences drawn by Iacobucci J between *Greenwood* and *London Drugs* were ignored in subsequent cases.²⁰⁵ The ‘principled exception’ has overtaken the agency analysis in relation to Himalaya clauses. This was held by the British Columbia Supreme Court in *Valmet Paper Machinery Inc. v. Hapag-Lloyd AG*.²⁰⁶ This ensures that the law is not riddled with different legal principles applying to different cases.²⁰⁷ The court in *Valmet Paper* was of the opinion that there is no difference between a waiver of subrogation clause and a Himalaya clause. As such, there is no longer a requirement for third party to prove the four conditions imposed by Lord Reid in relation to the enforceability of Himalaya clauses.

²⁰³ Huscroft, Grant, “Bad Doctrine and Incremental Reform” (1994) 7 *JCL* 181-191, at 188.

²⁰⁴ This principle was applied in *Anchor Fence Inc. v. Polaris Realty Corp.* [1994] A.J. No. 482 (Alt. Q.B.) which involved extending protection to a ‘selling’ agent, in *Sevenoaks School Division No. 10 v. GBR Architects Ltd.* [2002] M.J. No. 512 Man. Q.B., a case involving an architect who was the principal and shareholder in a firm of architects and in *British Columbia (Workers' Compensation Board) v Neale Staniszki Doll Adams Architects* [2004] B.C.J. No. 2636, a case involving sub-contractor and consultant under a construction contract.

²⁰⁵ The ‘principled exception’ was applied in cases whose facts were similar to *Greenwood* such as *Tony and Jim and Laing*.

²⁰⁶ 2002 A.C.W.S.J. LEXIS 6444.

²⁰⁷ At 51 (*Valmet*).

The cases applying the ‘principled exception’ have dealt with commercial contracts where the types of losses suffered are property damage and/or pure economic loss. It is questionable whether judges will adopt a liberal approach in applying the ‘principled exception’ to cases where consumers are involved, particularly those suffering from physical injuries. There may be less enthusiasm to avoid the privity doctrine where this will leave consumers with no claim for the injuries suffered. McKendrick argues that the ‘principled exception’ would not apply to a situation akin to the facts in *Adler v Dickson*²⁰⁸ because *Adler* can be distinguished from *London Drugs*. In *London Drugs*, it was held that the plaintiffs intended that the employees were entitled to rely on the limitation clause as they knew that the employees were the ones who performed the contract of storage.²⁰⁹ On the contrary, in *Adler*, the Court of Appeal held that the plaintiff had no intention to allow the employees to rely on the exclusion clause. In *Adler*, the exclusion clause expressly referred to the ‘company’ (defendants’ employers) only. The Court of Appeal in *Adler* unanimously refused to imply that the benefit of the exclusion clause was extended to the employees.

It must be noted that in *London Drugs*, the term ‘warehouseman’ arguably only referred to the employer. Yet, there was an implied intention to benefit the employees as there was sufficient ‘identity of interest’ between the employees and the employers. Similarly, it may

²⁰⁸ McKendrick, at 1228. *Adler v Dickson* dealt with a situation where a consumer suffered injuries due to the defendant’s negligence. In this case, Mrs Adler was injured when mounting, the gangway of the ship (The S.S. Himalaya) at a port of call. Mrs Adler could not succeed in suing the shipping company due to the existence of an exclusion clause in the ticket issued to her which read "Passengers ... are carried at passengers' entire risk" and "The company will not be responsible for and shall be exempt from all liability in respect of any ... injury whatsoever of or to the person of any passenger ... whether the same shall arise from or be occasioned by the negligence of the company's servants ... in the discharge of their duties, or whether by the negligence of other persons directly or indirectly in the employment or service of the company ... under any circumstances whatsoever ..." As such, she sued the master of the ship and the boatswain (defendants) for tort of negligence. The defendants tried to rely on the above quoted exclusion clause to escape from liability. The Court of Appeal held that the defendants could not rely on the exclusion clause as it did not cover them. The shipping company did not enter into the contract with Mrs Adler on their behalf.

²⁰⁹ McKendrick, at 1228.

be contended that the ‘principled exception’ is applicable in *Adler*. At the time of the accident, Mrs Adler would have known that the ship would be mastered and operated by the employees of the shipping company. This creates an ‘identity of interest’ between the shipping company and its employees. Moreover, at the time of the accident, the defendants were performing the acts in fulfilling the contract of carriage entered into between Mrs Adler and the shipping company. Whether judges will give different treatment to different types of harm is still unclarified.

It is also unclear whether the ‘principled exception’ is applicable to enforcement of positive promises. Ogilvie is of the view that this exception is equally applicable to positive promises such as the situation in *Beswick*. The learned author states that:

. . . both *Fraser River* and *London Drugs* were cases where the third party beneficiary sought to rely on a contractual provision to avoid liability at the suit of the promisor. But the thrust of both decisions is that a **principle of general application in third party beneficiary cases is being established**, so that a third party who seek to enforce a positive promise in a contract should be able to do so. The criticism, although not expressly overruling the earlier Privy Council decision in *Vandepitte*, suggests as much. In *Vandepitte*, the third party beneficiary sought to enforce an insurance policy made for its benefit. The SCC criticism of it in the context of *Fraser River* about a waiver clause suggests that *Fraser River* is meant to be a principle of general third party cases. Thus, Mrs Beswick could have relied on it in her capacity as a third party beneficiary to enforce the contract against her nephew. (emphasis added)²¹⁰

It is debatable as to whether the Supreme Court intended to go beyond negative promises involving exclusion, limitation and waiver of subrogation clauses and situations where the third party is not engaged in any activities or is not required to undertake any obligation. Reliance on Iacobucci J’s criticism on the application of the privity doctrine to insurance

²¹⁰ Ogilvie [2002] *JBL* 163–176, at 174.

contracts is insufficient. Iacobucci J intended a restrictive approach for the application of the ‘principled exception’ as seen in his judgment in *Fraser River* as follows:

I am mindful, however, that the principle of freedom of contract must not be dismissed lightly. Accordingly, nothing in these reasons concerning the ability of the initial parties to amend contractual provisions **subsequently should be taken as applying other than to the limited situation of a third-party's seeking to rely on a benefit conferred by the contract to defend against an action initiated by one of the parties**, and only then in circumstances where the inchoate contractual right has crystallized prior to any purported amendment. (emphasis added)²¹¹

Thus, Iacobucci J drew a difference between positive benefits and negative benefits relating to exclusion, limitation or waiver of subrogation clauses.²¹² Therefore, the issue as to whether the ‘principled exception’ is extended to positive promises will depend on the approach taken by the Supreme Court in the future. If the Supreme Court is willing to extend this exception, it may have to refine the requirements of this exception. In situations where the third party is a purely gratuitous donee, the requirement of any performance by the third party should be rendered redundant.

²¹¹ At 128 (*Fraser River*). In fact, Iacobucci J in *Fraser River* merely reiterated his view in *London Drugs* where the learned judge warned that he was only proposing ‘a very specific and limited exception to privity’ on the facts of *London Drugs* to enable the employees to rely on the limitation clause as a shield to the legal action brought by LD, at 450 (*London Drugs*).

²¹² On the contrary, Brock [2000] 58 *UTFLR*. 53–71, at 68 questions whether the restriction on the use of “principled exception” can be maintained. In *Dryburgh v Oak Bay Marina* (1992) Ltd [2001] 1 F.C. 192, at 211, the court referred to this exception as a ‘narrow exception’. The cases of *Thunder Mountain Drilling Ltd v Denmar Equipment Rentals Ltd* (1993) CanLII 2689 (BC S.C.), *DeLeeuw v Deleeuw* (2003) BC.C. LEXIS 4333, *Sunshine Valley Developments Ltd v Hendrichs* (2006) BCSC 319 (CanLII) and *Resch v Canadian Tire Corporation* (2006) CanLII 11930 (ON S.C.) disallowed the ‘principled exception’ to be used as a sword to create a cause of action for the third party *cf Fenrich v Wawanesa Mutual Insurance* (2005) ABCA 199 (CanLII). However, in *Fenrich*, the third party’s action failed due to lacked of intention of the contracting parties to benefit him.

F. Position in Malaysia

This part examines the legal mechanisms available to third parties in Malaysia to rely on exclusion, limitation and waiver of subrogation clauses found in contracts to which they are not privy.

In *Sime Darby Ltd v Port Swettenham Authority*,²¹³ the plaintiffs claimed damages arising from the defendants' failure to deliver some cases of whisky discharged from a vessel into the custody of the defendants as bailees for reward for delivery to the plaintiff's warehouse. The goods were lost and the evidence showed they had been lost during carriage from the ship to the defendants' wharf. The defendants argued that they had accepted the goods subject to the terms and conditions of the bills of lading which included an exclusion clause. They sought to rely on the exclusion clause to escape from liability to the plaintiff. The Federal Court held that the defendants who were not party to the bill of lading could not rely on any clause in the bills of lading. Ong Hock Thye F.J. applied *Scruttons Ltd v Midland Silicones* and stated that:

As regards exemption clauses the defendants, in my opinion, are disentitled to avail themselves of any such as were contained in the bills of lading, by reason of the fact that the delivery orders to the defendant were expressed as being "subject to the terms and conditions of the bill of lading covering this cargo." . . . The defendants therefore, cannot rely on any clause in the bill of lading, not being a party to the contract.²¹⁴

In *Ramachandran a/l Mayandy v Abdul Rhaman bin Ambok*,²¹⁵ Abdul Malik Ishak J in explaining the liability of a principal for the tortious act of its agents stated that the

²¹³ [1966] MLJ 116.

²¹⁴ At 117 (*Sime Darby*).

²¹⁵ [1997] 4 MLJ 237. The facts of this case do not deal with reliance of third parties on an exclusion clause.

principal can rely on an exclusion clause in a contract entered into by the agent which limits the tortious liability of the agent as decided in *Midland Silicones*.²¹⁶

In *ABDA Airfreight Sdn Bhd v Sistem Penerbangan Malaysia Bhd*, the same judge in the addendum written in this case stated that:

Where, however, the contract contemplates that the carrier will continue to have some responsibility for the goods after the completion of the carriage, ie as bailee, any immunities from liability conferred by the contract may operate to protect him in his capacity as bailee, **and may extend to protect, in appropriate cases, his servants or agents** (*Port Jackson Stevedoring Pty Ltd v Salmond and Spraggon (Australia) Pty Ltd, The New York Star* [1980] 3 All ER 257. (emphasis added)²¹⁷

In *The Viva Ocean*,²¹⁸ a dispute arose due to the damage of a cargo. The fault was attributable to the shipowner who argued that it was not liable as it was not privy to the contract of carriage entered into by the cargo owner and the carrier. It was held by the High Court that the shipowner could be sued as the carrier entered into the contract on behalf of the shipowner.²¹⁹

In relation to the possible development of the applicability of Himalaya clauses in Malaysia, judges can opt to follow a liberal attitude taken by the Court of Appeal in *The*

²¹⁶ At 246 (*Ramachandran a/l Mayandy*).

²¹⁷ [2001] 3 MLJ 641, at 704.

²¹⁸ [2004] 2 AMR 284. This case involved the imposition of burden to a third party via the principle of agency.

²¹⁹ This was due to a clause in the contract which read:

IDENTITY OF CARRIER: If the ship is not owned by or chartered by demise to Dooyang Line Company Ltd or the line or company by or on behalf of whom this Bill of Lading is issued (as may be the case notwithstanding anything that appears to the contrary), this Bill of Lading shall take effect only as a contract with the Owner or demise Charterer as the case may be as principal made through the agency or said carrier or line, who acts as agent only and shall be under no personal liability whatsoever in respect thereof.

Romina G in determining the application of the agency device. Judges can also apply the agency device to situations outside contracts of carriage.²²⁰

Other than the agency principle, there is no reported Malaysian case which discusses or applies vicarious immunity, bailment on terms, tortious analysis of exclusion clauses or the 'principled exception'. It is submitted that it is unlikely for vicarious immunity to be adopted in Malaysia due to its rejection in England and Australia. Moreover, its utility in ameliorating the harshness of the doctrine of privity has been taken over by the tortious analysis of exclusion clauses and the 'principled exception'.

The law on bailment in Malaysia is governed by Part IX of Contracts Act 1950. There are no provisions relating to bailment on terms or sub-bailment. It is arguable that these mechanisms are applicable in Malaysia applying *JM Wotherspoon & Co Ltd v Henry Agency House*.²²¹

Malaysian judges can allow third parties to rely on an exclusion or limitation clause via the tort mechanism. The principles relating to the imposition of duty of care in the tort of negligence and the defence of volenti are similar to the English position. Accordingly, it is more probable that courts will utilise the legal principles of duty of care to indirectly give effect to the intention of the contracting parties to extend the protection of an exclusion clause to the third party. The defence of volenti may not be resorted to due to the cold reception towards its application in English law. The likelihood of adopting the tort

²²⁰ Assuming Abdul Malik J in *Ramachandran a/l Mayandy v Abdul Rhaman bin Ambok* was referring to Lord Reid's principle of agency in *Midland Silicones* which gives rise to the use of Himalaya Clause, this may indicate that this principle is of wider application in Malaysia for the learned judge referred to this principle as applicable generally and that the facts of this case did not deal with a contract of carriage.

²²¹ [1962] MLJ 86. In this case, the English law on del credere agency was applied by the trial judge as Part X of the Contracts Act 1950 which deals with the law of agency is silent on this type of agency.

mechanism is higher compared to the ‘principled exception’ as the latter requires judges to make a change to the law rather than utilising existing principles of the law to give effect to exclusion or limitation clauses.²²² Nonetheless, the ‘principled exception’ remains the most attractive device to circumvent the privity doctrine as it is designed specifically to deal with the problems created by the doctrine.

IV. New Conceptual Ideas Allowing Third Party to Enforce a Contract

Due to the inability of conventional mechanisms to deal with the problems of the doctrine of privity adequately, judges, particularly in Australia have created exceptions²²³ to the doctrine or applied other existing legal principles innovatively to escape from the doctrine. This part examines (i) ‘*Trident* exception’, (ii) promissory estoppel and (iii) restitution. Discussion on each of these mechanisms includes the (a) development and operation of the mechanism in favour of third parties, (b) position in Malaysia and (c) evaluation of the mechanism.

A. ‘Trident Exception’

For the first time, in *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd*, three of the seven judges (Mason CJ, Wilson and Toohey JJ) of the High Court of Australia introduced an exception to the doctrine of privity as a result of the need of a ‘principled

²²² In fact, MacMillan [1994] *LMCLQ* 22–29 and O’Meara, Michael, “From Elder Dempster to London Drugs: The Saga of Vicarious Immunity” 2005 *JCL LEXIS* 6 in their articles preferred the solution offered by the principle of voluntary assumption of risk in dealing with the problems created by the doctrine of privity.

²²³ The ‘principled exception’ developed in Canada as discussed in Part III(E) of this Chapter is also one of the exceptions created.

development of the law’²²⁴ (hereinafter referred to as ‘*Trident* exception’) to solve the injustices created by the doctrine. According to the judgment of Mason CJ and Wilson J, the creation of the ‘*Trident* exception’ in relation to insurance contracts was driven by the following factors:²²⁵

- (a) The contract must be intended to benefit the third party so that the intention of the contracting parties will be defeated if the third party is denied the right to enforce the contract.
- (b) Likelihood of reliance by the third party on the contract.
- (c) Other alternatives (such as trust or estoppel) do not provide adequate protection to the third party.

The contracting parties have the right to revoke or alter the benefit unless the third party has relied on the contract to his detriment.²²⁶ The promisor is entitled to defences which are applicable to him if the legal action is brought by the promisee.²²⁷

On the facts of *Trident*,²²⁸ factors (a) to (c) were present.²²⁹ The contracting parties clearly intended the sub-contractor (third party) to be able to enforce the indemnity provided in the insurance policy. The sub-contractor fell within the definition of ‘assured’ that was entitled to enforce the indemnity. Once the sub-contractor became aware of the insurance policy

²²⁴ At 124 (*Trident*). The facts are laid down in Chapter 3 Part III.

²²⁵ At 123 (*Trident*). The test formulated by Toohey J, at 172 (*Trident*), was slightly different from the test offered by Mason CJ and Wilson J as the former required reasonable reliance of the third party while the latter required likelihood of reliance by the third party.

²²⁶ At 123 (*Trident*).

²²⁷ At 123 (*Trident*).

²²⁸ If the policy insurance had been created after the Insurance Contracts Act 1984 (Cth) took effect, s.48 of the Act will entitle McNiece to enforce the insurance policy directly against the insurer.

²²⁹ At 123 (*Trident*).

created for his benefit, he would most likely order its affairs accordingly that is he would not make any arrangement to insure himself against losses. As a result of the uncertainty surrounding the application of the doctrine of estoppel,²³⁰ it did not provide an adequate response to the problem created by the doctrine of privity. The trust device was also not a good solution as it might be difficult to prove the intention to create a trust.

1. Application of ‘*Trident* Exception’ in Subsequent Cases in Australia

In *Barroora Pty Ltd v Provincial Insurance Ltd*,²³¹ the ‘*Trident* exception’ was applied in a situation dealing with property insurance intended to indemnify the insured of losses suffered if the property insured was destroyed by fire. In *Barroora*, the third party was named as an insured after extensions were made to the original insurance contract. The issue arose was whether the third party was entitled to enforce the insurance policy. Brownie J applied the ‘*Trident* exception’. The learned judge found that it would be unjust if the third party was precluded from enforcing the contract. The promisor had agreed to cover losses suffered by the third party by agreeing to the extensions made to the insurance contract. An inference was also drawn from the facts that the third party was aware of the protection provided for him in the insurance contract. Thus, it was likely that he had relied on the benefit. Accordingly, the third party was allowed to enforce the contract.

It is worthy to note that Brownie J rejected the argument that the High Court in *Trident* limited the application of the ‘*Trident* exception’ to contracts involving insurance policy.

²³⁰ These uncertainties are explained later in this Chapter at Part IV(B).

²³¹ (1992) 26 NSWLR 170.

The learned judge opined that this principle is of application to all contracts generally as follows:

Of course, both the Court of Appeal and the High Court (in *Trident*) were dealing with the case before them, and the particular submissions advanced to them so that what they said has to be read in that context, but I see no sensible basis for thinking other than that they held that an exception to the old rules, of general application, should be recognised. That finding is therefore binding, but what in my judgment is not binding is the measure of the exception, or the definition of its boundaries: that I think is a matter to be decided in the way in which the common law develops, case by case, and step by cautious step.²³²

The ‘*Trident* exception’ was discussed by the Full Court of the Western Australia Supreme Court in *Woodside Petroleum Development Pty Ltd v H & R – E & W Pty Ltd*.²³³ Ipp J in this case held that there is no requirement that a third party in relying on ‘*Trident* exception’ has to prove any ‘presumed reliance’. What is required is a clear intention of the contracting parties to benefit the third party. Thus, a third party can rely on the ‘*Trident* exception’ even if he does not know about the contract intended to benefit him at the time of the breach of contract. Ipp J reached this conclusion due to two reasons. Firstly, the headnote to Mason CJ and Wilson J’s judgment in *Trident* did not state about the requirement of reliance. Secondly, Ipp J’s interpretation of Toohey J’s judgment in *Trident* was such that Toohey J did not state that it is necessary to prove reliance before the ‘*Trident* exception’ can be invoked.

²³² At 178 (*Baroora*).

²³³ [1999] WASCA 1024. The respondents were awarded a design contract by Woodside Petroleum in relation to the construction of a drilling platform. The respondents caused losses to Woodside Petroleum as certain piles which were installed as part of the construction of the drilling platform were damaged. The insurer of Woodside Petroleum brought a subrogated action against the respondents who sought to rely on the waiver of subrogation clause found in the insurance policy to defend themselves. The respondents were the ‘other assureds’ in the insurance policy. It was held that the insurer had no right to sue the respondents as it is a general rule of the law of insurance that parties can rely on the waiver of subrogation clause if the party falls within the ambit of the clause notwithstanding the fact that the party is not privy to the insurance contract. Thus, this case was resolved without resorting to the ‘*Trident* exception’. However, Ipp J went on to discuss about the ‘*Trident* exception’. It is submitted that Ipp J’s decision to prevent the insurer from bringing the subrogated action against the respondents was at odds with the privity doctrine and had been criticised in Aikens, Richard, “Who Can Enforce a “Waiver of Subrogation” Clause in an Insurance Contract” (2000) *ITLQ* 73-83 and Brian, Berry, “Limitations of Liability and Third Parties” [2002] *JMCL* 131-158, at 152.

The case of *Hannover Life Re of Australasia Ltd v Sayseng*²³⁴ also displayed a generous application of the ‘*Trident* exception’. This case related to a group life insurance policy covering employees who suffered total and permanent disablement. However, payments would only be made by the insurer upon the Trustee (a company who held the group life insurance policy on behalf of the company) making an opinion that the insured person (employee) was incapacitated to the required extent. According to the insurance policy, payments would be made to the Trustee to be paid into the company’s retirement fund to be distributed to the disabled employee. Mr Sayseng was injured and claimed that he was entitled to compensation on the basis of the insurance policy. His claim was rejected by the Trustee. Mr Sayseng wanted to challenge the decision of the trustee and claim compensation from the insurance company. One of the issues was whether he had the locus standi to bring the legal action as he was not a party to the insurance policy.

In explaining the ‘*Trident* exception’, the Court of Appeal of New South Wales (Santow JA) agreed with Ipp J in *Woodside* that reliance does not form a requirement under the ‘*Trident* exception’.²³⁵ Nonetheless, Santow JA did place emphasis on reliance to justify the extension of the ‘*Trident* exception’. Santow JA found that although Mr Sayseng might not have been aware of the actual terms of the insurance policy, he must be taken to know of the existence of the insurance policy and thus, had arranged his affairs accordingly. He could have made contributions and agreed to work for the company due to the assurance that if he suffered total and permanent disablement, he would be compensated.²³⁶ Thus, it would be unjust to exclude Mr Sayseng from enforcing the insurance policy. Accordingly,

²³⁴ [2005] NSWCA 215. The Supreme Court also referred to previous cases where it was decided that the insured person (employees) under group life insurance policy was entitled to make a direct claim against the insurance company for compensation. These cases are *Verinder v Australian Institute of Steel Construction Ltd* [2003] NSWSC 975 and *Cigna Insurance Asia Pacific Ltd v Packer* [2000] WASCA 415.

²³⁵ At para 58 (*Hannover*).

²³⁶ At para 64 (*Hannover*).

the Court of Appeal held unanimously that Mr Sayseng had the right to bring the action by applying the ‘*Trident* exception’ even through that there were differences between *Trident* and *Hannover*. In *Trident*, the insurance policy specifically extended protection to the sub-contractor as it was intended that he could seek indemnity for his losses directly from the insurer. By contrast, in this case, Mr Sayseng only had an indirect path to the entitlement of payment from the retirement fund as the insurance policy stated that the entitlement depended on the decision of the Trustee and payment was to be made to the Trustee.

In *Smith Lloyd James v Kelly G E*,²³⁷ the parquet flooring of the plaintiff’s (third party) premises was destroyed following a flooding incident at his home. He made a claim upon his insurer for reinstatement. The defendant (tradesman) was appointed to undertake the replacement of the parquet flooring. The contract between the insurer and the defendant contained an implied term that work would be undertaken in a proper and tradesmanlike manner. Subsequently, the plaintiff claimed that the defendant’s work were defective and brought a legal action against the defendant seeking damages suffered. It was held by the Queensland Building Tribunal that although the plaintiff was not a party to the contract created between the defendant and the insurer, he was entitled to sue the defendant for breach of contract as the contract was made for his benefit. This decision was reached on the authority of *Trident* and s.55 Property Law Act.²³⁸ With due respect, there was no discussion in *Smith Lloyd* as to the reasons which justified the application of the ‘*Trident* exception’. Particularly, it is arguable whether the contracting parties intended to allow the plaintiff to enforce the contract if the work was defective as it was not shown in the judgment that there was any term of the contract to this effect.

²³⁷ [1995] QBT 110.

²³⁸ This is the exception provided by the legislature in Queensland which is discussed in Chapter 6 Part III(C)(2).

The above cases dealt with the application of *Trident* in the insurance context. There are instances where the ‘*Trident* exception’ was held to be applicable to cases not relating to insurance policies. However, in these cases, the judges’ observation of the application of the ‘*Trident* exception’ was merely obiter dicta as no third parties were seeking to enforce the contract. In *NMRSB Ltd v Commissioner of Taxation*,²³⁹ there was a merger agreement between two financial institutions. Clause 10 of agreement provided as follows:

Subject to Clause 8 a Special Interest Offer will be made to holders of Relevant Deposit Accounts. That Special Interest Offer **will confer upon Original Depositors in respect of a Relevant Deposit Account a contractual right** (which may not be mortgaged, assigned or otherwise dealt with by the Original Depositor) to be paid by the New Company or any Successor Company . . . (emphasis added)

The Federal Court of Australia stated that although the depositors were not parties to the above contract, they were likely to be entitled to enforce the promise to make the Special Interest Offer to them relying on the principles laid down in *Trident*.²⁴⁰ Similar to *Smith Lloyd*, the Federal Court did not mention expressly that the ‘*Trident* exception’ was being relied on in reaching this conclusion. Although Clause 10 expressed a clear intention of the contracting parties to allow the depositors to enforce the promise, it was not discussed by the Federal Court as to whether there is any likelihood of reliance by the depositors.

2. Position in Malaysia

There is yet to be any Malaysian case which applies the ‘*Trident* exception’ in relation to insurance cases. *Trident* was referred to in *Baharuddin Ali & Co v BPMB Urus Harta Sdn*

²³⁹ [1998] 146 FCA (4 March 1998).

²⁴⁰ In *Re Emanuel (No 14) Pty Ltd* (1997) 22 A.C.S.R. 641, it was held that a third party to a deed of forbearance and release might be entitled to enforce promises made in the deed intended to benefit him.

*Bhd*²⁴¹ but the trial judge did not adopt the ‘*Trident* exception’.²⁴² The lack of cases which discusses the ‘*Trident* exception’ in Malaysia in relation to insurance cases may be due to the fact that similar result is achieved in Malaysia without the need to resort to the ‘*Trident* exception’. As discussed earlier in this chapter at Part II(D), in relation to insurance cases, Malaysian judges infer the existence of a trust to evade the application of the doctrine.

3. Evaluation

The creation of an exception to the privity doctrine is consistent with the contract theory according to the discussion in Chapter 2. However, the ability of the ‘*Trident* exception’ to resolve the problems created by the doctrine is limited in certain aspects. Firstly, it is uncertain as to the role played by the third party’s reliance on the contract in invoking the application of the ‘*Trident* exception’. The cases which applied this exception were divided as to the need to prove reliance. If some form of reliance is required, this exception may not apply to situations where the third party is unable to prove any reasonable or likelihood of reliance. This happens if he is not aware of the contract created for his benefit before breach of contract occurs. Nonetheless, even if there is a requirement to prove reliance, from the cases discussed above, the courts can easily conjure the likelihood of reliance.

Application of the ‘*Trident* exception’ may also be limited by judicial approach towards it. At present, this principle was mostly utilised in cases dealing with insurance policy. This does not mean that it is not available beyond insurance cases. Toohey J opined in *Trident* that it is unreal to conclude that the exception created will not have “implications for privity

²⁴¹ [2000] 4 CLJ 693.

²⁴² The reasons behind the rejection of the *Trident* exception are discussed in Chapter 3 Part III.

of contract in other situations.”²⁴³ However, for cases outside the ambit of insurance policies, the success rate of the invocation of this principle by third parties is almost nil. Although the ‘*Trident* exception’ was invoked numerous times by legal counsels, it had been rejected by judges in most of the cases²⁴⁴ on the ground that the contract concerned was not made for the benefit of the third party or the elements of the ‘*Trident* exception’ were not satisfied. After *Trident*, there is no decision of the High Court of Australia which extends the application of the ‘*Trident* exception’ to situations not involving insurance policies.

A perusal of cases after *Trident* suggests that judges prefer to apply the trust mechanism to circumvent the doctrine of privity compared to the ‘*Trident* exception’.²⁴⁵ This is not surprising as the trust mechanism is a well-recognised alternative to go round the doctrine compared to the ‘*Trident* exception’ which is seen as a direct assault on the doctrine. The ‘*Trident* exception’ also did not receive unanimous support of the High Court in *Trident*.²⁴⁶

²⁴³ At 163 (*Trident*). This view was adopted by Brownie J in *Barroora*; at 177. By contrast, the New South Wales Supreme Court in *Dalton v Ellis* [2005] NSWSC 1252, at para 30, stated that the High Court in *Trident* only changed the law in relation to insurance contracts.

²⁴⁴ In *Visic v State Government Insurance Commission* (1990) 3 WAR 122, *Trident* was distinguished from the facts of *Visic* as the policy insurance created by the employer and the insurance company was only intended to indemnify the employer and not the employee. As such, it was not intended to benefit the employee. Accordingly, the employee failed to sue the insurance company. A similar result was reached in *Hickey v Australian Wire Rope Works Pty. Ltd* (1998) 4 VR 455. In *Jones v Barlett* [2000] 176 ALR 137 no extension was made to a third party to a lease. In *Neilson v Overseas Projects Corporation of Victoria* [2002] WASC 231, no extension was made in relation to a third party (the employee’s wife) to the employment contract which provided that the premises occupied by the employee and his family would be reasonably fit for use as a residence. In *Harriton v Stephens* [2006] 226 ALR 391, an infant who suffered disabilities due to the negligence of a doctor was not entitled to apply ‘*Trident* exception’ to enforce the contract entered into by his mother with the doctor. In *HIH Casualty & General Insurance Ltd v Building Insurers’ Guarantee Corporation* [2003] NSWSC 1083, no extension of the ‘*Trident* exception’ was applicable to reinsurance cases to allow the creditors of the insured to enforce the reinsurance contract. In *Morris v Hanley* [2003] NSWSC 42, the ‘*Trident* exception’ was not applicable to an outsider who sought to enforce the provisions of the articles of association of a company.

²⁴⁵ These cases are discussed in Part II(D)(2) of this chapter.

²⁴⁶ Brennan J, Deane J and Dawson J, at 134 (*Trident*) did not agree to create a new exception to the doctrine of privity. In fact, Brennan J highlighted the difficulties involved in creating such an exception as rules have to be prescribed as to the scope and limits of the applicability of the new exception.

Accordingly, judges of first instance²⁴⁷ opted not to follow the ‘*Trident* exception’ as they opined that it was not appropriate for them to do so. Such restrictive approach reduces the effectiveness of this principle to curb the problems created by the doctrine.

From the case of *Woodside*, it appears that the ‘*Trident* exception’ can be expanded to allow third parties to rely on exclusion, limitation or waiver of subrogation clauses to defend themselves from a legal action brought by a promisor.

B. Promissory Estoppel

The doctrine of promissory estoppel²⁴⁸ can assist a third party to claim a benefit intended for him²⁴⁹ by the contracting parties if the promisor has represented to him about the benefit. If the third party has relied on the representation, the doctrine of promissory estoppel will prevent the promisor from going back on his words. Thus, although the third party is not privy to the contract made between the promisor and the promisee, he is still entitled to enforce the benefit against the promisor. Before the recent developments to the promissory estoppel which are discussed below, there are limitations on the scope and

²⁴⁷ *Noosa Shire Council v. Farr* [2001] QSC 60; *JWH Pty Ltd v Kimpura Pty Ltd* [2004] WASC 39 and *Coffison v Australian Casualty & Life Limited* [2000] QDC 403 *cf Barroora*.

²⁴⁸ The doctrine of promissory estoppel states that a person (A) who has made a representation to another person (B) is not allowed to resile from his representation where B has relied on the representation to his detriment. Once A promises to forgo certain legal rights that he enjoys against B, A is not entitled to assert those legal rights against B. This refers to the doctrine of promissory estoppel as propounded by the House of Lords in *Hughes v Metropolitan Railway Co* [1877] 2 App Cas 439, which was again popularised by Denning J (as he then was) in *Central London Property Trust Ltd v High Trees House Ltd* [1947] K.B. 130.

²⁴⁹ The possibility of utilisation of the doctrine of promissory estoppel in by-passing the doctrine of privity had been stated by Mason CJ and Wilson J in *Trident*, at 140 and *Principles of Contract Law* by Paterson, J, Andrew Robertson and Peter Heffey (Australia, Lawbook Co, 2005) (hereinafter referred to as ‘Paterson, Robertson and Heffey’), at 187.

application of promissory estoppel which prevent the third party from utilising it to claim benefits intended for him in a contract. These limitations are as follows:²⁵⁰

- (a) The doctrine is intended to be relied on as a defence. It cannot be used to establish a cause of action where none existed before.
- (b) The doctrine can only be raised between parties who have a pre-existing contractual relationship between them.
- (c) There must be a clear and unequivocal promise or undertaking, either express or implied. The representation must clearly demonstrate that the legal relations between the parties would be affected and the representor is giving up his strict legal rights.
- (d) There must be detrimental reliance on the promise.²⁵¹
- (e) The effect of the doctrine is to temporarily suspend contractual rights and obligations of the parties.

It may be difficult for the third party to prove that he has a pre-existing relationship with the promisor as there may be no prior dealings between them.²⁵² In enforcing the promisor's promise, the third party will be bringing an action against the promisor, thus relying on the doctrine as a sword, to create a new cause of action. It may be difficult for the third party to prove detrimental reliance as he may not incur any detriment in relying on

²⁵⁰ These limitations arose from the cases of *Hughes v Metropolitan Railway Co* and *Central London Property Trust Ltd v High Trees House Ltd* are found in an article written by Wan Izatul Asma Wan Talaat entitled "The Boustead Case: A Departure From The Traditional Parameters of the Equitable Doctrine of Promissory Estoppel" [2003] 3 *CLJ* i–xi, at iii.

²⁵¹ This requirement can be qualified as in *High Trees*, the lessee did not suffer any detriment as he were only asked to pay the contract price agreed upon by the parties at the time the lease agreement was created. However, since the lessee had conducted his affairs on the assumption that he could pay the rent at a lower price, it was inequitable for the lessor to insist on payment of the full rent; per Goff J (as he then was) in *The Post Chaser* [1982] 1 All ER 19, at 26-27.

²⁵² It was decided in *S Pathamanathan v Amaravathi* [1979] 1 MLJ 38 that the doctrine of promissory estoppel could not be raised as the disputing parties did not have a contractual relationship between them.

the promise. The restrictive remedies of promissory estoppel is also a prohibiting factor for the third party in considering whether to rely on this doctrine to enforce the promise made for his benefit.

1. Liberalisation of Promissory Estoppel in Australia

The Australian position is discussed as the case of *Waltons Stores (Interstate) Ltd v Maher*,²⁵³ which relaxed the limitations of promissory estoppel is applicable in Malaysia. In *Waltons Stores*, Maher, the owner of a commercial property negotiated with Walton, a retailer who was interested to lease the building to be built on the land which was specially suited to Walton's need as a retailer. Maher assumed that a valid contract for the lease would be created²⁵⁴ and demolished the existing building on the land and started building operations. After a few months, Walton refused to enter into a lease agreement. Maher could not bring an action for breach of contract as no valid contract was created between them. Thus, Maher brought an action against Walton relying on the doctrine of estoppel to prevent Walton from denying that a valid contract was created. One obstacle faced by Maher was that he was relying on the doctrine to create a cause of action which did not exist in the first place.

The High Court of Australia held that Maher was entitled to succeed and granted damages to him. Three of the five judges (Mason CJ, Wilson and Brennan JJ) held that the doctrine

²⁵³ (1988) 164 CLR 387.

²⁵⁴ This assumption was based on a form of Deed of Agreement for lease which was sent by Waltons' solicitors to Maher. Maher's solicitor also sent the Deed which was duly executed by Maher stating that he would start the building operations in a few days' time in order to meet the dateline set by the agreement.

of estoppel can be relied on to create a cause of action. According to Brennan J, this would arise if:

. . . the promisor induces the promisee to assume or expect that the promise is intended to affect their legal positions and he knows or intends that the promisee will act or abstain from in reliance on the promise, and when the promisee does so act or abstain from action and the promisee would suffer detriment by his action or inaction if the promisor were not to fulfil the promise.²⁵⁵

Mason CJ and Wilson J (joint judgment) held that departure from the rule that estoppel doctrine is used as a shield is justified only if it is unconscionable to allow the representor to turn back on his promise. If this is proven, the doctrine can be used to enforce voluntary promises. To prove such unconscionability, the learned justices provided the following guideline:

As failure to fulfil a promise does not of itself amount to unconscionable conduct, mere reliance on an executory promise to do something, resulting in the promisee changing his position or suffering detriment, does not bring promissory estoppel into play. Something more is required. *Humphreys Estate* suggests that this may be found, if at all, in the creation or encouragement by the party estopped in the other party of an assumption to his detriment to the knowledge of the first party.²⁵⁶

Another importance of *Waltons* is in relation to the remedies that courts will grant if the plaintiff successfully proves an estoppel. Brennan J held that the remedy granted is to compensate any detrimental reliance suffered. The remedies may include damages, specific performance or injunction. The approach taken by Mason CJ and Wilson J differed from Brennan J. The learned judges opined that the remedies granted for estoppel doctrine extend to the protection of expectation interest of the representee. This is similar to the approach taken in compensating the plaintiff for losses suffered due to a breach of contract.

²⁵⁵ At 424 (*Waltons*).

²⁵⁶ At 406 (*Waltons*).

The application of the expectation-based approach is further strengthened by the High Court in *Giumelli v Giumelli*²⁵⁷ where this approach will be the starting point for judges in determining the remedy to be granted to the representee.²⁵⁸

2. Position in Malaysia

The doctrine of promissory estoppel is applicable in Malaysia.²⁵⁹ In *Malaysian Australian Finance* and *Tan Guat Lan*, the High Court held that a third party can enforce a contract if the promisor makes a promise to the third party that direct payment will be made to him, applying the legal position in India.²⁶⁰ The third party's right is justified in the doctrine of estoppel.²⁶¹ In *Tropical Profile Sdn Bhd v Kerajaan Malaysia (Jabatan Kerja Raya)*,²⁶² Low Hop Bing J (as he then was) held that in situations where no privity existed between the plaintiff and the defendant, the former can still sue the defendant if there are facts which raise the application of the doctrine of promissory estoppel.

The legal principles relating to the doctrine of estoppel have also been liberalised in Malaysia. This development was spearheaded by Gopal Sri Ram JCA in *Boustead Trading (1985) Sdn Bhd v Arab-Malaysian Merchant Bank Bhd*.²⁶³ In *Boustead*, the appellant (Boustead Trading) bought goods on credit from Chemitrade Sdn Bhd. The latter entered into a factoring agreement with the respondent (Arab-Malaysian Merchant Bank) where debts owed by the appellant to Chemitrade were assigned to the respondent. Notice of the

²⁵⁷ [1999] 196 C.L.R. 101.

²⁵⁸ Paterson, Robertson and Heffey, at 181-182.

²⁵⁹ As per Terrell CJ in *Motor Emporium v Arumugam* [1933-34] FMSLR 21, at 26. The application of the doctrine of promissory estoppel is also allowed by s.3 Civil Law Act 1956.

²⁶⁰ *Muddala Venkatarreddi Naidu v Dharwada Venkata Varaha Varasimharao* AIR. 1935 115; *Ramaswami v S.S. Krishnasa & Sons*, AIR 1935 Mad 905; *Mst. Kali v Ram Autar*, AIR (32) 1945 Oudh 65; *B.K. Mukherjee v Manoranjan Mitra* AIR (29) 1942 Calcutta 251.

²⁶¹ This method is labelled as 'Acknowledgement and Estoppel' in *Mulla Indian Contract & Specific Relief Acts*, 12th Edition, (Butterworths, 2001), at 129.

²⁶² [2008] 1 CLJ 513.

²⁶³ [1995] 3 MLJ 331.

assignment was given to the appellant. Copies of the invoices in respect of the sale and delivery of goods to the appellant were passed by Chemitrade to the respondent. The respondent stamped the invoices with the indorsement that any objection was to be reported to the respondent within 14 days of its receipt and sent them to the appellant. The appellant did not complain about the 14-day period nor challenge the respondent's right to impose the 14-day period by way of indorsement. The appellant made payment on several of the invoices but refused to pay on 20 invoices on the ground that the amounts due on the invoices were to be offset against the cost of stocks returned to Chemitrade. This right to offset was stated in the purchase orders. The respondent denied knowledge of the existence of the appellant's right of offset and argued that since the appellant had not protested about the validity of the indorsement, it was entitled to assume that the appellant had accepted it.

The trial judge decided in favour of the respondent. The appellant appealed to the Federal Court. One of the grounds relied on by the appellant was that the trial judge had erred in relying on the doctrine of estoppel which was not pleaded by the respondent. The appeal was dismissed by the Federal Court unanimously.²⁶⁴ The judgment was delivered by Gopal Sri Ram JCA who took the opportunity to clarify the legal principles relating to this doctrine as explained below.

(i) General Approach in relation to Application of Promissory Estoppel

Gopal Sri Ram JCA took a liberal view on the approach which a court should adopt in determining the application of this doctrine as follows:

²⁶⁴ The Federal Court held that a court may permit a litigant to argue an unpleaded estoppel if it is in the interest of justice to do so.

The time has come for this court to recognise that the doctrine of estoppel is a flexible principle by which justice is done according to the circumstances of the case. It is a doctrine of wide utility and has been resorted to in varying fact patterns to achieve justice. Indeed, the circumstances in which the doctrine may operate are endless.²⁶⁵

The limitations of the doctrine may not necessarily prevent the application of the doctrine.²⁶⁶ Gopal Sri Ram JCA's recognition that the doctrine may apply in many different situations strengthens the argument that third parties may have recourse to this doctrine to evade the doctrine of privity in Malaysia. The learned judge had reinforced the application of a liberal approach towards promissory estoppel in subsequent cases.²⁶⁷ This approach was followed in numerous cases.²⁶⁸

(ii) Plaintiff may Utilise Promissory Estoppel

Gopal Sri Ram JCA²⁶⁹ also decided that plaintiffs may have recourse to this doctrine by relying on the judgment of Lord Russell in *Nippon Menkwa Kabushiki Kaisha v Dawsons Bank* as follows:

²⁶⁵ At 344 (*Boustead*).

²⁶⁶ In reaching this conclusion, Gopal Sri Ram JCA placed reliance on Lord Denning's judgment in *Amalgamated Investment and Property Co Ltd (In liquidation) v Texas Commerce International Bank Ltd* [1982] 1 Q.B. 84, at 122 where his Lordship stated that "The doctrine of estoppel is one of the most flexible and useful in the armoury of the law." His Lordship also tried to assist the doctrine to break free from its limitations by arguing that the various limitations can be merged "into one general principle shorn of limitations." Estoppel will apply if it is unfair or unjust to allow a party to go back on the assumption made by him which leads the other to proceed on a transaction.

²⁶⁷ *Bauer (M) Sdn Bhd v Daewoo Corp* [1999] 4 MLJ 545, at 566; *Chor Phaik Har v Choong Lye Hock Estates Sdn Bhd* [1996] 4 CLJ 141, at 150; *Teh Poh Wah v Seremban Securities Sdn Bhd* [1996] 1 MLJ 701, at 706.

²⁶⁸ *UMW Toyota (M) Sdn Bhd v Chow Weng Thiem* [1996] 5 MLJ 678, at 685; *Thong Guan Co (Pte) Ltd v Lam Kong Co Ltd (No 2)* [1998] 7 MLJ 720; *KM Quarry Sdn Bhd v Ho Hup Construction Co Bhd* [2006] 7 MLJ 203, at 212; *Pan Malaysia Equities Sdn Bhd v Ang Soon Tat* [2006] MLJU 333; *Malaysia Airports (Sepang) Sdn Bhd v Malayan Banking Berhad and Agate Sdn Bhd* [2007] MLJU 108.

²⁶⁹ At 345 (*Boustead*).

Estoppel is not a cause of action. It may (if established) assist a plaintiff in enforcing cause of action by preventing a defendant from denying the existence of some fact essential to establish the cause of action, or (to put it in another way) by preventing a defendant from asserting the existence of some fact the existence of which would destroy the cause of action.²⁷⁰

The above finding of the law is consistent with the limitation stated in *Combe v Combe*²⁷¹ which held that plaintiff can rely on the doctrine to establish one of the elements to prove his cause of action. However, Gopal Sri Ram JCA also referred to *Waltons*, thereby suggesting that the learned judge accepted that the doctrine can be used to establish a new cause of action for the plaintiff. Subsequent cases have allowed plaintiffs to rely on the doctrine on the authority of *Boustead*. This is seen in *Teh Poh Wah v Seremban Securities Sdn Bhd*,²⁷² *Rakka @ Kanniah a/l Samayan v Subramaniam*²⁷³ and *Masjaya Trading Sdn Bhd v Kedah Cement Sdn Bhd*.²⁷⁴ It is submitted that in all these cases, the plaintiff was relying on the doctrine to establish the elements of the cause of action that they were entitled to take against the defendant, thereby consistent with the decision of *Combe*.²⁷⁵ The plaintiffs in these cases did not rely on promissory estoppel to create a cause of action where none existed before.

A good example where the doctrine is used to establish a cause of action where none existed before is the case of *Curvet Transport SA v Shapadu Trans-System Sdn Bhd*.²⁷⁶ In this case, the plaintiffs negotiated with the defendant to provide transportation services

²⁷⁰ [1935] Lloyd's Rep 147, at 150.

²⁷¹ [1951] 1 All ER 767.

²⁷² [1996] 1 MLJ 701. This case has been referred to in the Court of Appeal decision of *American International Assurance Co Ltd v Koh Yen Bee* [2002] 4 MLJ 301.

²⁷³ [2004] 7 MLJ 198.

²⁷⁴ [2004] 4 CLJ 18.

²⁷⁵ In *Rakka*, estoppel was used to prevent the defendant from denying the right of the plaintiff to rely on a particular document to establish the plaintiff's case. In *Teh Poh Wah*, estoppel was pleaded to prevent the defendant from denying that she had given authority to the husband to enter into transactions on her behalf. In *Masjaya*, estoppel was relied on to introduce a term into the contract between the plaintiff and the defendant.

²⁷⁶ [1999] 4 MLJ 150.

(carriage of goods by sea) to the defendant. The defendant's group manager and senior manager had accepted the plaintiffs' quotation and informed them that the contract would be awarded to them save for some formality to be fulfilled. The defendant was informed that a vessel was on its way to South Korea to be ready for loading of the first shipment. The defendant later awarded the contract to another company on the reason that the plaintiffs did not meet the pre-requisite that the successful contracting party must be a Bumiputra company to be first registered with the Ministry of Finance, Malaysia.

It was held by Kamalanathan Ratnam J that there was indeed a concluded contract between the plaintiffs and the defendant. Alternatively, if there was no concluded contract between the parties, the defendant was clearly estopped and precluded from denying that there was a valid and concluded binding contract between the parties. The learned judge arrived at his decision by relying on *Waltons* (which bore similar facts to the present case) and observed that:

The *Waltons Stores* case was cited by our Federal Court in the case of *Boustead* wherein Gopal Sri Ram JCA stated that the doctrine of estoppel had been applied in the *Waltons Stores* case to prevent a litigant from asserting that there was no valid and binding contract between him and his opponent and **to create binding obligations where none previously existed.** (emphasis added)²⁷⁷

(iii) No Need to Establish Pre-Contractual Relationship

Gopal Sri Ram JCA in *Boustead* did not deal directly with the issue whether the representee is required to establish pre-contractual relationship with representor. However, it can be

²⁷⁷ At 161 (*Curvet*).

argued that the learned judge's liberal approach had indirectly loosened this requirement. In addition, the learned judge referred to *Waltons* without disapproval.²⁷⁸

(iv) Detrimental Reliance is not Part of Promissory Estoppel

In dismissing the need to prove detrimental reliance to raise an estoppel, Gopal Sri Ram JCA in *Boustead* stated that:

We take this opportunity to declare that the detriment element does not form part of the doctrine of estoppel. In other words, it is not an essential ingredient requiring proof before the doctrine may be invoked. All that need be shown is that in the particular circumstances of a case, **it would be unjust to permit the representor or encourager to insist upon his strict legal rights.** In the resolution of this issue, a judicial arbiter would, when making his assessment of where the justice of the case lies, be entitled to have regard to the conduct of the litigant raising the estoppel. **This may, but need not in all cases, include the determination of the question as to whether the particular litigant had altered his position, although such alteration need not be to his detriment.** (emphasis added)²⁷⁹

The representee only needs to prove that it is unjust and unconscionable for the representor to resile from his promise.²⁸⁰ It is not compulsory to prove alteration of the representee's position. In addition, Gopal Sri Ram JCA stated that in proving that the representee is being induced by the representor's actions or promise, all the representee needs to do "is to place sufficient material before the court from which an inference may fairly be drawn that he was influenced by his opponent's actings."²⁸¹ The promise or encouragement of the representor need not be the sole factor influencing the representee. The learned judge had

²⁷⁸ Wan Izatul [2003] 3 *CLJ* i–xi, at vii.

²⁷⁹ At 348 (*Boustead*).

²⁸⁰ In Australia, the basis of estoppel was held to be the prevention of unconscionable conduct but inequity or unconscionability is tied to the proving of detriment suffered by the representee. This approach can be found in cases such as *Waltons*, at 404, 419 and *Commonwealth of Australia v Verwayen* (1990) 170 CLR 394, at 407, per Mason CJ. As such, the Malaysian position in relation to the rejection of the element of detriment as stated by Gopal Sri Ram JCA in *Boustead* may go further than the Australian cases.

²⁸¹ At 347 (*Boustead*).

provided guideline for subsequent judges in determining when estoppel should apply in *Lai Yoke Ngan v Chin Teck Kwee* where it was stated that:

Accordingly, the global question which a court must ask itself if this: is it just and equitable that the particular litigant (against whom the estoppel is raised) should succeed, given the totality of the facts and circumstances of the case? If the answer to that question is in the affirmative, estoppel does not bite: if the answer is in the negative, then it does.²⁸²

The cases above do not provide a definitive answer as to the scope of ‘just and equitable’. The commonest and easiest ground to prove inequity is still detriment in monetary form. Detriment can also be in non-financial form²⁸³ though the strength of such claim may vary according to the facts. In addition, in determining whether it is inequitable for the representor to resile from his promise, the reasonableness of the representee’s reliance on the promise is also assessed. Judges will determine whether the representee deserves equity’s protection.²⁸⁴

What remains uncertain are the types of situations which would attract the application of the doctrine if the representee does not suffer any detriment though its position has been altered or where there is no alteration of position.²⁸⁵ This will be of interest to third parties in contracts made for their benefit who may not have suffered any detriment in expecting the benefit to be provided.

²⁸² [1997] 3 CLJ 305, at 328. This guideline was also found in *Chor Phaik Har v Choong Lye Hock Estates Sdn Bhd* [1996] 4 CLJ 141, at 149.

²⁸³ In *Vermayen*, both Deane and Dawson JJ, at 448– 449 and 462 respectively, stated that increased and prolonged period of stress, anxiety, ill-health and inconvenience amounted to detriment suffered by the claimant.

²⁸⁴ Paterson, Robertson and Heffey, at 173–174.

²⁸⁵ Matta, A.M., “Promissory Estoppel: The Unchained Doctrine” [1999] 2 *MLJ* lxviii-cii, at lxxxix.

It is submitted that following Gopal Sri Ram JCA's guideline, if circumstances surrounding the making of the promise are taken into account, the fact that the promise arises from a contract made for the benefit of a third party should be considered. If this fact is taken into account, it can be contended that it is unfair to allow the promisor (representor) to renege on his promise as he has received consideration from the promisee to perform his promise. Despite the fact that the promisee may be able to sue the promisor for breach of contract, the remedies obtained for breach of contract are either inadequate²⁸⁶ or do not address the fact that the contracting parties may have intended to allow the third party to enforce the contract. It remains to be seen whether judges will adopt such approach as the unfairness seems to relate more to the promisee rather than the third party (representee).

(v) Remedies

Gopal Sri Ram JCA in *Boustead* did not discuss the remedies granted to a party who successfully raise an estoppel. At present, the remedies obtainable include damages, specific performance and injunction.²⁸⁷ The availability of these remedies is consistent with the purpose of this doctrine to redress any injustice caused by the promisor for breaching his promise. Courts should have the discretion to determine the most appropriate remedy in a given situation.²⁸⁸ The current debate in relation to remedies is the approach used to assess the quantum of damages awarded to the representee. The debate is between two different types of approach, reliance-based approach and expectation-based approach. Third parties would prefer expectation-based approach as they may prefer to protect their

²⁸⁶ This is highlighted in Chapter 4 Part IV.

²⁸⁷ As per Brennan J, at 423–424, 427 and Mason CJ and Wilson J, at 405 (*Waltons*).

²⁸⁸ This is also supported by Matta [1999] 2 *MLJ* lxviii-cii, at xci.

expectation that the contract will be performed rather than to claim for losses sustained due to his detrimental reliance on the promise.

In Malaysia, in *Cheng Hang Guan v Perumahan Farlim (Penang) Sdn Bhd*,²⁸⁹ Edgar Joseph Jr SCJ stated that if a plea of promissory estoppel is successful, “what the court will have to consider is the extent of the equity and how best to satisfy it”. As such, the remedy chosen by the courts will be the most appropriate remedy to redress the unconscionability of the representor. As such, arguably, the reliance-based and expectation-based approaches are equally applicable in Malaysia. In *Curvet Transport SA v Shapadu Trans-System Sdn Bhd*, the approach taken by Kamalanathan Ratnam J in awarding damages to compensate for the plaintiff’s expectation loss mirrored the expectation-based approach.²⁹⁰

3. Evaluation

There are a number of difficulties faced by third parties in seeking to rely on the doctrine of promissory estoppel to enforce promises made by the promisor in relation to contracts made for their benefit. Firstly, third parties may not be able to prove that the promisor makes a promise to them. Thus, promissory estoppel is not applicable where the third party does not know that a contract has been made for his benefit or where the third party knows the existence of such contract but no promise is made to him. Knowledge about the existence of the contract may come from the promisee who may even makes a promise to the third party that a contract is created for his benefit. This is likely as usually there is

²⁸⁹ [1993] 3 MLJ 353, at 403.

²⁹⁰ Kamalanathan Ratnam J relied on promissory estoppel as an alternative argument to decide in favour of the plaintiffs. Damages granted to the first plaintiff comprised of the loss of profits which the plaintiff would obtain if the defendant performed the contractual obligation. Damages awarded to the second plaintiff comprised of the loss of commission which would be earned if there was no breach of contract by the defendant.

connection between the promisee and the third party which justifies the making of the contract for the latter's benefit. Here, the third party has no cause of action as the promisee is not the party who breaches the promise. The promisor cannot be made liable through the doctrine as he has made no promise to the third party unless it could be argued that the promisee is acting as his agent, which is unlikely in most of the situations. Secondly, there are uncertainties as to the scope of unconscionability protected by promissory estoppel. Particularly, it is questionable whether the courts will decide that the promisor (representor) has acted unconscionably if the third party does not suffer any detriment or that there is no change of position by the third party as a result of the promise.

C. Restitution / Unjust Enrichment

The requirements to be proven in order to invoke the assistance of unjust enrichment are as follows:²⁹¹

- (a) Enrichment of the defendant²⁹²
- (b) Enrichment must be gained at the plaintiff's expense²⁹³
- (c) It would be unjust to allow the defendant to retain the enrichment²⁹⁴

The right to recover an unjust enrichment is subject to limitations²⁹⁵ and defences.²⁹⁶

Gaudron J in *Trident* relied on the principle of restitution to enable the sub-contractor (third

²⁹¹ Goff & Jones, at 14.

²⁹² This is where the defendant receives money, property, services, enjoy improvements to his property or saved expenses or loss which would have otherwise been incurred.

²⁹³ This is where the plaintiff has provided goods, money, rendered services or saved expenses to the defendant.

²⁹⁴ Although the word 'unjust' carries a broad meaning, its application to this principle is generally limited to situations where benefit is conferred involuntarily, failure of consideration, benefit conferred on the expectation that payment will be made or the defendant benefits from his own wrongdoing.

party) to enforce the insurance policy. In *Trident*, Gaudron J, found it necessary to extend to application of this principle to cover the rights of a third party to enforce a contract made for his benefit.²⁹⁷ In Gaudron J's view:

. . . it should be recognised that a promisor who has accepted agreed consideration for a promise to benefit a third party is unjustly enriched at the expense of the third party to the extent that the promise is unfulfilled and the non-fulfillment does not attract proportional legal consequences.

...

The possibility of unjust enrichment is obviated by recognition that a promisor who has accepted agreed consideration for a promise to benefit a third party owes an obligation to the third party to fulfil that promise and that the third party has a corresponding right to bring an action to secure the benefit of the promise.²⁹⁸

The scope of duty owed to the third party will correspond with the content and duration of the contract and is subject to changes made by the contracting parties.²⁹⁹ However, Gaudron J accepted that there may be circumstances where there is "some intervening circumstance" which renders the duty to the third party to be unalterable.³⁰⁰ The learned judge did not elaborate further on this point. Applying the principle of unjust enrichment, Gaudron J held that McNiece was entitled to make a claim against Trident as the facts

²⁹⁵ These are listed down in Goff & Jones, at 50. These include situations where the defendant cannot be restored to his original position or where public policy precludes restitution.

²⁹⁶ These include of change of position, estoppel, provision of consideration and limitation of actions.

²⁹⁷ In extending restitution to apply to a contract made for the benefit of a third party, Gaudron J relied on Deane J's judgment in *Pavey & Matthews Pty Ltd v Paul* (1987) 162 CLR 221, at 256–257, with whom Mason and Wilson JJ agreed with. Deane J in *Pavey* stated that:

Unjust enrichment . . . constitutes a unifying legal concept which explains why the law recognises, in a variety of distinct categories of case, an obligation on the part of a defendant to make fair and just restitution for a benefit derived at the expense of a plaintiff and which assists in the determination, by the ordinary processes of legal reasoning, of the question whether the law should, in justice, recognise such an obligation in a new or developing case.

However, in *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 185 ALR 335, Gummow J held that the basis of restitution is unconscionability rather than unjust enrichment. By contrast, in England, the basis of restitution remains to be unjust enrichment; *Sempra Metals Ltd v Her Majesty's Commissioners of Inland Revenue* [2007] UKHL 34. Nicholls V.C. (as he then was) in *CTN Cash Ltd v Gallaher Ltd* [1994] 4 All ER 714, at 720 opined that ". . . the categories of unjust enrichment are not closed." Lord Woolf also opined that "restitution is an area of the law which is still in the process of being evolved by the courts" in *Westdeutsche Landesbank Girozentrale v Islington L.B.C.* [1996] AC 669, at 723.

²⁹⁸ At 176 (*Trident*).

²⁹⁹ At 177 (*Trident*).

³⁰⁰ At 177 (*Trident*).

clearly showed that the insurance policy was made for the benefit of third parties such as McNiece. Trident was enriched through the savings it made by rejecting McNiece's claim for indemnity under the contract of insurance. Trident's enrichment was gained at McNiece's expense as the latter's expectation to be indemnified was defeated. The enrichment was unjust as Trident who had accepted consideration turned back on its promise. This unfairness was exacerbated by the fact that Trident's breach of contract did not attract any proportional legal consequences.

There were three reasons which persuaded Gaudron J to adopt a flexible application of the principle of unjust enrichment. Firstly, the existing alternative avenues to evade the doctrine of privity are insufficient. This conclusion was reached as the protection offered by the trust mechanism or the doctrine of promissory estoppel is not secured depending on the ability of third party to prove the necessary requirements. Secondly, the existing remedies for breach of contract are insufficient to deal with the inherent unfairness created by the doctrine of privity. Thirdly, since unjust enrichment is separated from the law of contract,³⁰¹ there will be no inconsistency with the privity doctrine by allowing the third party to succeed on this ground.

It must be noted that Deane J in *Trident* also referred to the possibility of relying on the principle of unjust enrichment to allow the third party to claim indemnity of a policy insurance made for his benefit.³⁰² However, unlike Gaudron J, Deane J did not appear to allow this principle to be used as a general rule to defeat the application of the doctrine of privity. It will only apply in specific situations. Unfortunately, the learned judge did not

³⁰¹ As per Lord Wright in *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* [1947] 1 All ER 522, at 61.

³⁰² At 145–146 (*Trident*).

elaborate further on this point as he held that the circumstances of the case did not warrant a claim to be made on unjust enrichment.

1. Application of Restitution Principle in Subsequent Australian Cases

In *Winterton Constructions Pty Ltd v Hambros Australia Ltd*,³⁰³ the first respondent (H) and the second respondent (P) entered into a finance agreement which provided for a loan facility for use by P for the purpose of the acquisition of a property and the construction of an office block on the property. The property was used as security for the loan. Subsequently, P and the applicant (W) entered into an agreement for the construction of the office block. P failed to make two progress payments to W. W commenced proceedings against H seeking to recover the two progress payments. One of the grounds relied by W was unjust enrichment. W argued that the construction work it had done on the property improved the value of the property, thus improving the value of the security to H, causing an unjust enrichment to H.

The Federal Court of Australia refused to strike out W's claim on unjust enrichment as following the decision of *Trident*, there was sufficient support for the existence of a claim of unjust enrichment in Australia. Accordingly, it was inappropriate to strike out the claim on the ground that there was no such cause of action. Gummow J in *Winterton* accepted Gaudron's J proposition on extending the principle of unjust enrichment to situations where the promisor received an unjust benefit at the expense of the third party.³⁰⁴

³⁰³ [1991] ALR 363.

³⁰⁴ At 375-376 (*Winterton*).

Similar acceptance of Gaudron J's proposition was also found in *Hannover* where Santow JA relied on it as one of his alternative arguments in deciding in favour of the third party.

The learned judge stated that:

Were the *Trident* outcome to be based on the principle of unjust enrichment in the manner articulated by Gaudron J, the obligation of good faith and fair dealing would operate independently of the insurance contract, so avoiding the unjust enrichment that would otherwise be enjoyed by the insurer where a legitimate claim under the insurance policy was not able to be pressed against the insurer to the detriment of the employee third party. (emphasis added)³⁰⁵

In *Marriott Industries Pty Ltd v Mercantile Credits Ltd*,³⁰⁶ the Supreme Court of South Australia was divided as to the extension of unjust enrichment as a general cause of action to abrogate the doctrine of privity. King CJ took the view that Australian law does not recognise unjust enrichment as a general source of obligation.³⁰⁷ There was no reference to Gaudron J's judgment in *Trident*. On the contrary, Olsson J with whom Mohr J agreed was prepared to accept Gaudron J's proposition though he admitted this "that marks the furthest distance to which the courts have been prepared to go."³⁰⁸ In sum, there seem to be no outright rejection of Gaudron J's proposition by the Australian judges.

³⁰⁵ At para 71 (*Hannover*).

³⁰⁶ [1991] SASC 2874.

³⁰⁷ At para 34 (*Marriot*). Since the plaintiff's claim did not fall within any of the established categories of restitution, the learned judge rejected the claim of unjust enrichment in this case.

³⁰⁸ At para 116 (*Marriot*). However, the claim of unjust enrichment was rejected as it could not be proven that the defendant obtained a benefit from the services rendered by the plaintiff and one of the limitations of unjust enrichment was applicable. The limitation applicable in this case was that the plaintiff confers an alleged benefit whilst performing an obligation which he owes to another or otherwise whilst acting voluntarily in his own self-interest.

2. Position in Malaysia

It has been accepted by Malaysian courts that restitution rests on the principle of unjust enrichment. The requirements to prove unjust enrichment are those stated by Goff and Jones.³⁰⁹ However, there is no reported case which applies Gaudron J's proposition in *Trident* in Malaysia.

3. Evaluation

A number of concerns have been raised in relation to the validity of the reliance on unjust enrichment to allow third parties to enforce a contract made for his benefit. Firstly, the utilisation of unjust enrichment to assist the third party to enforce the contract seems to be beyond its scope. At present, this principle is used to explain the various claims found in the law to seek recovery of money paid, services rendered or saved expenses which do not fall within the law of contract. Any development of unjust enrichment to cater to new situations is made sparingly. Although Deane J in *Pavey* had allowed for such development, this should not be taken as a tool to achieve justice whenever a judge deems appropriate to do so.³¹⁰ It must be remembered that the same judge in *Trident* did not extend the use of unjust enrichment to cater to contracts made for the benefit of third parties generally.

³⁰⁹ *Chong Thian Fook v Sarawak Shell Bhd* [2004] 7 MLJ 53, at 90–91 and *Seascope Sdn Bhd v Syed Izhar bin Syed Syed Salleh* [2006] 3 MLJ 756, at 771. See Cheong, May Fong, *Civil Remedies in Malaysia*, (Sweet & Maxwell Asia, 2007), Chapter 7.

³¹⁰ Rossiter, CJ and Margaret Stone, “The Chancellor’s New Shoe” (1988) 11 *UNSWLJ* 11–47, at 39, Jackman, IM, “Contract – Rights and liabilities of third parties – Indemnity insurance – Unjust enrichment and privity of contract” (1989) *ALJ* 368–370, at 368 and Soh, KB, “Privity of Contract and Restitution”, (1989) 105 *LQR* 4–6, at 5. In fact, Deane J in *Pavey*, at 256–257, specifically stated that the principle of restitution did not amount to “a judicial discretion to do whatever idiosyncratic notions of what is fair and just may dictate”.

The objective of allowing third parties to enforce contracts made for their benefit is to give effect to the bargain made by the contracting parties. In *Trident*, Gaudron J relied on this doctrine to give effect to the bargain made by the contracting parties by compelling Trident to indemnify McNiece as per the policy insurance. By contrast, the objective of restitution is to return any unjust enrichment obtained by the defendant to the plaintiff. Thus, the use of restitution to overcome the privity doctrine is contrary to the objective of restitution.

Secondly, even if unjust enrichment can form an independent cause of action for the third party to enforce a contract made for his benefit, it is questionable whether the defendant obtains any unjust enrichment at the third party's expense.³¹¹ In relation to a contract made for the benefit of a third party, it is the promisee who provides consideration to the promisor. As such, any enrichment of the promisor as a result of the breach of contract will be at the promisee's expense. There may be situations where the enrichment is made at the third party's expense, but this will be in "extremely indirect manner".³¹² Hence, to accommodate a third party's claim will result in a too liberal definition and scope of the requirement 'at the plaintiff's expense'. Gaudron J tried to overcome this difficulty by stating that the plaintiff who relies on unjust enrichment does not need to prove any actual impoverishment.³¹³ The third party's loss of expectation of the benefit amounts to a loss that he suffers as a result of the defendant's breach of contract. This ensures that unjust enrichment can be applied generally to third parties. It remains to be seen whether this

³¹¹ Usually, there will be no problem in proving that the defendant has obtained enrichment. Arguably, it can also be proven that the retention of the enrichment is unjust as the defendant deliberately refuses to perform his obligation as promised.

³¹² For eg., a third party sub-contractor agreed to accept the work at a lower price because the contractor (promisee) paid for the premium of the insurance policy covering the sub-contractor; Soh (1989) 105 *LQR* 4-6, at 5.

³¹³ At 175 (*Trident*). Gaudron J reached this conclusion by relying on the judgment of Winderyer J in *Mason v New South Wales* (1959) 102 CLR 108, at 146 where the latter held that unjust enrichment may arise in situations where there is no actual impoverishment. Gaudron J's finding on this matter is criticised by Detmold, M.J., "Australian Law: Freedom and Identity" (1990) 12 *Syd L Rev* 482-568, at 548.

approach is acceptable to judges as it is inconsistent with the law of unjust enrichment generally.

There are some old cases which allow the plaintiff to succeed where the benefit obtained by the defendant comes from another person other than the plaintiff.³¹⁴ To extend this category to include contracts made for the benefit of third parties requires judicial approval which may be hard to obtain as these cases seem to be the exception rather than the general rule.

Subsequent cases accepting Gaudron J's utilisation of unjust enrichment to grant third party rights did not elaborate further on the requirement 'at the plaintiff's expense'. In *Winterton*, there is no problem in satisfying this requirement as the plaintiff had provided building work. On the contrary, in *Hannover*, loss of expectation of the benefit under the insurance policy was sufficient. If a stricter view as to the definition of 'at plaintiff's expense' is taken, many situations involving contracts made for the benefits of third parties will be excluded.

In relation to the scope of unjust enrichment, Gaudron J did not limit its application to insurance contracts.³¹⁵ As such, it is available to different types of contract. But it does not provide a comprehensive coverage of all contracts made for the benefit of third parties. It only applies to situations of unfulfilled performance. Thus, it may not apply to a situation where performance is rendered but is defective or to situations where the third party seeks to shelter behind an exclusion clause.

³¹⁴ Goff & Jones, at 42-43. These include cases on usurpation of the plaintiff's office, the law of secret trusts and where fiduciary receives bribe.

³¹⁵ Edgell, Colin, "Privity of Contract in Australia: The Beginning of the End?" [1989] *LMCLQ* 139-142, at 141.

The remedies obtainable by the third party are limited to monetary compensation only. Compensation is assessed on the amount of unjust enrichment received by the defendant rather than on losses suffered by the third party. Hence, restitution is not an attractive cause of action to a third party who wants to recover losses that he suffers as a result of the promisor's breach of contract.

Furthermore, in granting third party rights, one of the fundamental issues is on the power of the contracting parties to vary or revoke the contract. At present, the law on unjust enrichment does not provide principles in dealing with this issue.

As a consequence of the uncertainties and difficulties discussed above, judges may prefer to rely on the more established methods to evade the doctrine of privity rather than to place reliance on unjust enrichment. In sum, the third party may bring a claim of restitution provided the unjust enrichment is obtained at his expense without stretching the definition of 'at the plaintiff's expense'. But it is not suitable to be used as another alternative argument to supplant the doctrine of privity generally. This principle is not originally intended to deal with the problems created by the doctrine of privity. Hence, there will be difficulty in fitting the rules of unjust enrichment to solve the problems of the doctrine.³¹⁶

³¹⁶ Cf Proksch, Louis, "Restitution and Privity" (1994) 68 *ALJ* 188-192.

V. Conclusion

The existence of the various mechanisms deployed by judges to evade the doctrine of privity exemplifies the need of modification to be made to the doctrine if justice and logic are to be upheld.³¹⁷ Judicial efforts in this area of the law are commendable. This shows that whenever a dispute about a contract made for the benefit of third party arises, there is definitely one mechanism which will be applicable if judges are willing to utilise it. This ensures that the problems created by the doctrine are minimised but this is achieved at a price. Guesswork is necessary as to firstly, the generosity of judges and secondly, the particular device which will be deployed.

Furthermore, each of the alternative mechanisms does have its own setbacks. The third party may face difficulties in satisfying the requirements laid down by the particular mechanism or it does not apply to all contracts made for the benefit of third parties. In sum, the protection offered by the various mechanisms is inadequate. What is required is a general exception applicable to all these contracts. Although the 'principled exception' and '*Trident* exception' were introduced to apply to contracts made for the benefit of third parties, at present, the scope of these exceptions is unduly restrictive.

In relation to the legal position in Malaysia, there are not many cases which give opportunity to the courts to discuss about the various mechanisms, particularly, the new conceptual ideas.³¹⁸ As a whole, although the number of cases involving contracts made for

³¹⁷ For eg., in relation to exclusion clauses, although vicarious immunity has been so vehemently criticised and rejected in *Scruttons Ltd v Midland Silicones*, yet it is in the same case that Lord Reid innovatively applied agency principles to assist a third party's reliance on exclusion clauses.

³¹⁸ It is submitted that the lack of development of the law relating to the development of common law mechanisms to evade the privity doctrine may also be due to the lack of creativity of lawyers and judges.

the benefit of the third parties is small, it can be contended that Malaysian courts give a benevolent treatment to these contracts. This conclusion is reached from the discussion on the utilisation of the trust mechanism in relation to insurance contracts. They do attempt to give effect to the bargain of the contracting parties and offer protection to deserving third parties whenever possible. However, the present state of the law in Malaysia is still unsatisfactory for a number of reasons. Reliance on the legal mechanisms does sometimes lead to artificiality as judges overstretch the scope of the mechanism to extend its coverage to the case before them. These difficulties are unavoidable as the origins of these mechanisms (unless the exception is created specifically to deal with the problems created by the privity doctrine) are not intended to solve the problems created by the doctrine. This is especially true in relation to reliance on the trust mechanism by Malaysian judges to avoid the doctrine.

Uncertainty and unpredictability exist in Malaysian law because the scope of the various common law mechanisms has not been clearly spelt out in the cases. It is difficult to predict which mechanism will be utilised by judges in a given case. It is also unsure as to whether Malaysian judges will adopt the exceptions developed in England, Australia and Canada. Judges may be reluctant to play a more active role in this area of the law due to the doctrine of separation of powers. The role to make legislative changes to the law belongs to the Parliament. As a consequence, there is a need to assess another method in dealing with the problems created by the doctrine, which is through a statutory reform of the doctrine. This is discussed in the following chapter.