



The Law Reform Commission and the Report on Privity of Contract

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The law surrounding the area of privity of contract is one of the most antiquated and complicated areas of Irish contract law. As a system of exclusion, to prevent among other things a floodgate of cases coming before the courts, it has little to recommend it. A doctrine for which there are so many exceptions that it no longer holds any real meaning is in urgent need of reform; the realisation of this need by the Law Reform Commission lead to the 2008 Report, '*Privity of Contract and Third Party Rights*'¹ (hereinafter, 'the Report'). This recommended new legislation that would streamline and elevate some of the inefficiencies and unfairness that permeates through the present law.

This article is useful in obtaining a more detailed understanding of the law in this area. Privity of Contract is examinable at Formation 1; please see Section 4 of the Business Laws syllabus. While the Report is not in itself examinable, it will give readers greater insight into this area of law, its limitations, and indeed the development of law.

Before examining the Report's recommendations it is important to examine the law as it stands. The law on privity of contract states that rights arising out of a contract can be enforced or relied upon only by parties to that contract. Therefore third parties cannot enforce any rights nor have any rights imposed upon under the contract, even if that contract was for the benefit of that same third party. The law has developed in this way for a number of reasons, and these reasons must be kept in mind when discussing any possible set of reforms. These include: the lack of consideration, this means that a third party has only assumed any liabilities and accrued any benefits on a voluntary basis and as such these can only be considered personal rights; it permits parties to a contract, at any time, to amend or end the contract without consultation with third parties; and probably the most often cited reason, the possibility of open

¹ Law Reform Commission, '*Privity of Contract and Third Party Rights*' LRC 88 -2008.

floodgates which could potentially lead to any person suing on the basis of a contract to which they bare no relation and from which they do not benefit.

Privity of Contract and its Exceptions

One of the most important Irish cases on law of privity is that of *Murphy v Brower*.² Here the court clearly stated that, 'no stranger to the consideration can take advantage of a contract, although made for his benefit'.³ This is the clear position of Irish law, though most EU countries, including the United Kingdom, have since reformed their law in this area.

The need for change to the positive rule of privity is only part of the reason for reform. It is the plethora of exceptions to that rule that has led the Law Reform Commission to seek to overhaul the law. There are several exceptions to the rule including among others: agency, trusts, assignment, tort (including professional negligence and pure economic loss), and contracts for the benefit of a spouse or a child, consumer law,⁴ negotiable instruments, employment law, company law⁵ and covenants running with the land.⁶ Some of these exceptions need to be examined in more detail to understand the possible reforms being suggested by the Law Reform Commission.

According to Treitel, 'where an agent is authorised by a principal to enter into a contract on the principal's behalf with a third party and does so then a contract is created between principal and the third party.'⁷ There must be intention to create the agency relationship as per *Sheppard v Murphy*⁸ and *Pattison v Institute for Industry, Research and Standards*.⁹ The Report states that it does not intend to propose any legislative changes to the law of agency in regard to the law of privity.

² *Murphy v Brower* (1868) 2 IRCL 506

³ Ibid

⁴ *Inter alia* Sections 13, 14 and 80 of the *Sale of Goods and Supply of Services Act, 1980* and Section 2 of the *Package Holidays and Travel Trade Act 1995*

⁵ *Inter alia* Sections 25 and 37 of the *Companies Act 1963*

⁶ The *Land and Conveyancing Law Reform Bill 2006* proposes to expand this exception.

⁷ G.H. Treitel, *The Law of Contract* (11th Ed. Thomson, Sweet & Maxwell, London, 2003)

⁸ *Sheppard v Murphy* (1867) 1 Ir R Eq 490

⁹ *Pattison v Institute for Industry, Research and Standards* Unrep. High Court May 31st 1979

Equity intervenes to create the trust exception. According to *Drimmie v Davis*,¹⁰ '[t]he equitable rule was that the party to whose use or for whose benefit the contract has been entered into has a remedy in equity against the person with whom it was expressed to be made. The Court will deem the latter a trustee for the former, and would compel him to execute his trust according to the apparent intention of the contracting parties.' Though as Barrington J pointed out in *Cadbury Ireland Ltd v Kerry Co-Op Creameries Ltd*¹¹ the Court will not enforce a trust as an exception to the law of privity where it is no more than a commitment to enter into honest negotiations and not a commitment to create a trust in favour of the third party. The Law Reform Commission pointed out in its report that this trust exception has been much criticised as a 'cumbrous fiction' and that increasingly courts are reluctant to use the trust as an exemption from the rule except when it is the very clear intention of the parties. The creation of the trust creates much broader duties than would otherwise be available under the contract but which are enforceable under the law of trusts, this includes *inter alia* the creation of special duties for the trustee and the inability to rescind or vary the contract without first consulting with the third party beneficiaries. The need to change the law to allow parties to a contract to benefit third parties without the creation of a trust is clear.

Under the tort of negligence if the duty of care is breached third parties who stood to benefit would be able to sue under the original contract. Though the law is unclear as to whether this exists in the case of pure economic loss¹² in other areas such as professional negligence it is granted. A good example of this is *Ward v McMaster* where a negligent builder was held liable to the subsequent purchasers of a house.¹³

The Report follows on from the Law Reform Commission's Consultation Paper which was published in 2006.¹⁴ In the Report the Law Reform Commission discussed a number of the difficulties that result from the law as it now stands.

¹⁰ *Drimmie v Davis* (1899) IR 176

¹¹ *Cadbury Ireland Ltd v Kerry Co-Op Creameries Ltd* [1982] 1 ILRM 77

¹² See *Glencar Exploration plc v Mayo County Council* [2002] 1 IR 84

¹³ *Ward v McMaster* [1985] IR 29. See also *Wall v Hegarty* [1989] ILRM 124 in the case of a solicitor held liable to the beneficiaries of a will.

¹⁴ Law Reform Commission, 'Consultation Paper Privity of Contract: Third Party Rights' Law Commission No. 242, 1996. For some commentary on the consultation paper see C. Kelly, 'Reform of Privity of Contract and Third Party Rights' (2007) 1 *Commercial Law Practitioner* 8 and M. Enright, 'Principals of Irish Contract Law' (Clarus Press, Dublin, 2007) 119-121

One of the most important of which is the intentions of the parties. The intention of the parties is one of the most crucial aspects of the law of contract. The Report argues that the law as it stands can take away from freedom of contract and that the contractual intention of the parties should be enforced in the most effective way possible.

Another important point which the Report makes is with such a surfeit of exceptions it can be unclear whether the court will enforce the privity rule or one of the exceptions to it. In *Glow Heating Ltd. v Eastern Health Board*¹⁵ Costello J noted that the Court should not be prevented from granting relief due to the application of the doctrine of privity, this is particularly clear where none of the exceptions apply to the situation. The application of the doctrine also can lead to injustice and hardship for the third parties; it leads to commercial inconvenience and expense and probably most importantly for the development of the law it has led to incoherence in the law which sometimes result in an illogical applications of both privity and its exceptions. As the Report notes, the development of the exceptions in such a piecemeal fashion has led to various difficulties which could be avoided if a more general rule in favour of third party rights was put in place in legislation.¹⁶

The Commission considered several issues when deciding what format what reform should take. The first point was when a third party should be able to enforce rights under a contract. The Commission considered that third parties should be able to enforce their rights in the following situations. When the terms of the contracts expressly benefits a third party there should be a presumption in favour of third party enforcement. When the contract expressly states that the third party has a right of enforcement under the contract. Finally when the contract excludes or limits the liability of third parties. The Report also considered several other issues such as identification of a third party beneficiary, the requirement of consideration, whether it would exclude or limit the liabilities of third parties, as well as the right of contracting parties to vary or cancel the contract.¹⁷

¹⁵ *Glow Heating Ltd. v Eastern Health Board* [1988] IR 110

¹⁶ The proposed Bill, the *Draft Contract Law (Privity of Contract and Third Party Rights) Bill 2008* is Appendix A to the Report

¹⁷ The Report stipulates that certain areas will not come under their proposed legislation. This includes contracts of employment, where the promisor is an employee, company law, contracts

The proposed new legislation would stipulate that

‘3. - (1) Subject to the provisions of this Act, a third party may enforce a term of a contract in his or her own right if –

(a) The contract expressly provides that he or she may, or

(b) Subject to subsection (2)¹⁸, the term expressly confers a benefit on him or her’

In section (4) provision is made to allow for the variation and termination of the contract between parties to the contract. The proposed legislation always expressly lists the type of contract that the legislation would not apply to as well as possible defences and remedies available to the promissory.

While this Report is both comprehensive and does suggest a reform which would be of great benefit to Irish contract law, it is unclear whether the Irish Government will take the impetus to reform the law. Whether or not the Government chooses to follow the Law Reform Commissions suggestions for reform some form of change is definitely required. As the law stands it is convoluted and leads to both confusion and unnecessary delay and expense. Ireland has lagged behind most other countries in this area for far too long and reform is necessary for Irish contract law to suffice.

for the international carriage of good by air, rail or road and contracts for the carriage of goods by sea, negotiable instruments and letters of credit.

¹⁸ This section states that if on proper construction of the contract, interpreted in light of the surrounding circumstances the parties did not intend it to be enforceable by third parties.