

# Contracts (Rights of Third Parties) Ordinance

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**Mr. Simon Wong**

*Christine M. Koo & Ip, Solicitors & Notaries*

Room 601, 6/F, Admiralty Centre,  
18 Harcourt Road, Hong Kong

Tel: (852) 2524 8996

Fax: (852) 2523 6922

Email: [simonwong@cmkoo.com.hk](mailto:simonwong@cmkoo.com.hk)



# Background

- The Bill was introduced to Legco in March 2014 and passed on 26<sup>th</sup> November 2014,
- The Ordinance will come into operation on 1<sup>st</sup> January 2016.



# The General Principal

## ■ Privity of Contract

- A person who is not party to a Contract cannot be made liable under it
- A person cannot acquire and enforce rights under a Contract to which he or she is not a party.
  - This legal principle cannot give effect to the intention of the contracting parties to benefit a 3<sup>rd</sup> party.



# The Old Situation

- Third party may only enforce his contractual rights in trust, agency and collateral contract.
- Yet, they are limited and uncertain in scope.



# Third Party's Protection under the New Ordinance

## ■ Enforcement by Non-party

### – The Requirements

- The contract expressly provide that 3<sup>rd</sup> party may do so; or
- The term ( as opposed to the whole contract )purports to confer a benefit on the 3<sup>rd</sup> party, if on a proper construction of the contract, it is so intended to be enforceable by the 3<sup>rd</sup> party
  - In this regard, the benefit must be a direct benefit, not just a consequential or incidental benefit (Dolphin Maritime [2009] EWHC 716 (Comm))
- For proper construction, the Court will look into the surrounding circumstances to decide whether the contract has conferred benefit to 3<sup>rd</sup> party.



# Contracting Out

- Under S4(3) of the Ordinance, contracting parties can expressly contracted out of the application of the Ordinance by an express provision in the contract between the parties.
  - Sample clause
    - “The contracts (Rights of Third Parties) Ordinance shall not apply to this contract and unless specifically provided no person other than the parties to the contract shall have any rights under it nor shall be enforceable by any person other than the parties to it.”



# Rights by Rescission or Variation of Contract

- Under Section 6 of the Ordinance, if a third party may enforce a term of contract under Section 4 of the Ordinance, the contracting parties, without the third party's consent, cannot rescind or vary the term of the contract so that 3<sup>rd</sup> party's right under the term is altered or extinguished.
- Yet, it can be done if the 3<sup>rd</sup> party has assented to the term and the promisor ( a party to the contract against whom a third party may enforce the contract has received notice of the assent; or relied on the term, and the promisor is aware of or can reasonably be expected to have foreseen such reliance.



# Rights by Rescission or Variation of Contract

- It is permissible for the parties to specify in a term of the contract that the parties may rescind or vary the contract without the 3<sup>rd</sup> party consent; the term of which will only be effective if rights before accrual of such rights. In addition, the 3<sup>rd</sup> party is aware of the term or the parties to the contract have taken reasonable steps to make the third party ware of the term.
- Acceptance Test or Reliance Test plus Crystallization Test



# Remedy available to 3<sup>rd</sup> Party

- Under Section 5, 3<sup>rd</sup> Party can enforce a term of a contract that would have been available to 3<sup>rd</sup> party in an action for breach of contract, including remedy under the rules of equity.
- Under Section 8, the Ordinance provides for Defence, setoffs and counterclaim for promisor in court proceedings.
- The promisor is only liable for single liability for the same loss and damages. No double liability for the promise and the third party when they all together enforce the same term of contract under Section 11 of the Ordinance



# Application

- No effect to contract made before 1<sup>st</sup> Jan 2016.
- Non application to bill of exchange, promissory note or any other negotiable instruments, deed of mutual covenant, a covenant relating to land, a contract of carriage within the meaning of the Bills of Lading and Analogous Shipping Documents Ordinance and Carriage by Air Ordinance , Company's Articles, as well.
- It appears that the Ordinance does not prevent a 3<sup>rd</sup> party from enforcing a term against the employer despite it does not confer a right on a third party to enforce a term of a contract of employment against an employee.



# Impact to Various Contracts

## ■ Arbitration

- Under Section 12 (1) to (3), 3<sup>rd</sup> party's right to enforce a term of the contract is subject to a procedural condition to enforce by way of arbitration. He is treated as a party to arbitration agreement subject to contrary intention of contracting parties.
- Under Section 12(4) to (6), 3<sup>rd</sup> party given a procedural right to require that disputes between him and the promisor be submitted to arbitration if (1) 3<sup>rd</sup> party may enforce a term, (2) the term provides that disputes be submitted to arbitration and the term constitutes an arb. Agr.
- If so, he will be treated as a party to the arbitration agreement when choosing to exercise the right to arbitrate



# Construction Contracts

- Construction projects may involve contracts benefiting 3<sup>rd</sup> parties but it may be difficult for the parties to identify them, who may have potential rights against the parties and the nature of such rights.
- Under the current system, the contracting parties know with certainty that only the third parties who have been granted collateral warranties would have enforceable rights.
- Possibilities that an enforceable 3<sup>rd</sup> party interest may be unknown up until the point of enforcement.
- It is necessary to insert clauses, limiting the scope of application of the Ordinance such as the clause as follows



# Construction Contracts

“ Subject to the form of the conditions set out in clause XX of this Agreement], [3<sup>rd</sup> party] shall be entitled to enforce the benefit conferred on him by clause XX of this Agreement [and for that purpose shall be entitled to the benefit of clause XX of this Agreement [i.e. jurisdiction and/ or arbitration clauses] but otherwise no party other than the parties to this Agreement [or their respective assigns] or persons becoming party to this Agreement by novation shall have any right to enforce any terms of this Agreement.”



# Insurance Contract

- It always confer benefit upon the 3<sup>rd</sup> parties, such as direct indemnity payment to a nominated 3<sup>rd</sup> party in life insurance policy.
- There may have unforeseen third party rights in insurance. It may create an unfair position where the insurer is expected to confer benefit upon 3<sup>rd</sup> parties who have not satisfied the duty of disclosure required under insurance contracts.
- Defence can be given to insurer. If the insured had breached its duty of disclosure, or indeed any other contractual terms under the policy, the insurer would be entitled to raise the breach as a defence against a 3<sup>rd</sup> party's claim.
- Insurer may contract out the policies under the new law.

## **PLEASE NOTE**

The law and procedure on this subject are very specialised. This article is a general explanation for your reference only and should not be relied on as legal advice for any specific case. If legal advice is needed, please contact our solicitors.

## **請注意**

本題目之法律及程序十分專門。此文章只屬一般性之解釋，供你參考，而不應被依賴為關於任何特定事件之法律意見。如需法律意見，請與我所律師聯絡。

**Christine M. Koo & Ip, Solicitors & Notaries LLP**  
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