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The Contracts (Rights of Third Parties) Act 2001

The Contracts (Rights of Third Parties) Act 2001 (“the Act”) came into operation on 1 January 2002. This Act changes fundamentally the common law rule of privity of contract and is expected to radically affect the accepted notion that unless one is a party to the contract, he does not have any rights to enforce the terms of the contract against the contracting parties.

Under the privity of contract rule, only parties to the contract can enforce the terms of the contract. Third parties who are not parties to the contract have no rights to enforce the terms of the contract even if the terms of the contract purport to confer such third parties certain rights or benefits.

Privity of contract rule displaced:

An example of the operation of the privity of contract rule is evident in the construction industry where it has been generally accepted that nominated sub contractors have no rights under the Main Contract made between the Employer and the Main Contractor to claim against the Employer or the Main Contractor for breaches of the terms in the Main Contract which confer benefits on the nominated sub contractor.

Six months post commencement period

It is noted that the Act shall apply to contracts entered into more than six months after its commencement. As such it will apply to contracts entered on or after 1st July 2002. However the Act will apply to contracts made within six months of its commencement if the contract expressly provides for its application.

Scope of the Act:

Sections 2 (1) (a) and (b) of the Act provide that a third party, who is not a party to the contract may enforce a term of the contract under two situations:

- a. where the contract expressly provides that he may; or
- b. where the term purports to confer a benefit on him,

Section 2 (2) of the Act provides that notwithstanding the situation in (b) above, if on a proper construction of the contract, the contracting parties did not intend that term in the contract to be enforceable by the third party, then the third party will not be able to enforce that term against either of them.

Who is a Third Party under the Act ?

Section 2 (3) of the Act provides that the third party should be expressly identified in the contract by name, as a member of a class or as answering to a particular description. This allows

for a very wide category of persons who would qualify as third parties under the Act although the category is not unlimited. Further, the third party need not be in existence at the time when the contract was made between the parties.

What are the rights available to the Third Party?

The Act further provides under Section 2(5) that for the purpose of exercising his right to enforce a term of the contract, the third party may avail himself of any remedy that would have been available to him in an action for breach of contract if he had been a party to the contract. As such, the common law rules relating to damages, injunctions, specific performance and other remedies would be available to him. Such remedies will not be refused on the ground that, as against the person conferring the benefit (“the promisor”), the third party is a volunteer.

Availability of contractual rights to the Third Party

Section 2 (6) provides that the third party may take advantage of any exclusion or limitation provision in the contract which excludes or limits the liability of a contracting party. Accordingly where a term of a contract excludes or limits the liability of a contracting party, references in the Act to the third party enforcing that term shall be construed as references to his availing himself of that exclusion or limitation clause.

Can the rights of the Third Party be excluded ?

Section 2 (2) of the Act in effect allows the contracting parties to exclude the application of the Act to the contract concerned by expressly providing in the contract itself that the parties do not intend the terms in the contract to be enforced by the third party. The parties can achieve this including a clause in the contract stating that they do not intend that any term of the Contract shall be enforceable by the third party pursuant to section 2 (2) of the Act. Care would have to be taken to identify the third party which the parties intend to exclude.

Can the rights of the Third Party be restricted when the contract confers or purport to confer such rights ?

The answer is no unless certain preconditions are satisfied. This is because of Section 3 (1) of the Act which provides that where a third party has a right under Section 2 to enforce a term of the contract, the contracting parties will not be able by agreement, rescind or vary the contract in such a way as to extinguish or alter the third party’s entitlement under that right, without his consent if:

- the third party has communicated his assent to the term to the promisor;
- the promisor is aware that the third party has relied on the term (whether or not the third party has knowledge of its precise terms); or

- the promisor can reasonably be expected to have foreseen that the third party would rely on the term and the third party has in fact relied on it (whether or not the third party has knowledge of its precise terms).

However, this restriction against variation and rescission is subject to an express term of the contract that the parties may by agreement rescind or vary the contract without the third party's consent or that the third party's consent is to be required in specified circumstances different to those which are set out in the Act. This is provided under Section 3(3) of the Act. As such, if the parties wish to restrict the rights of third parties under the contract, they should in the contract itself expressly reserve this right to do so. This reservation clause should expressly provide that the Parties may by agreement vary or rescind any of the terms of the Contract without the consent of the third party concerned.

Protection of promisor from double liability

Where a party to the Contract manages to recover damages from the other in respect of either the third party's loss or his expense in making good that loss, the court or arbitral tribunal will reduce any award to the third party enforcing a term under the Act to take account of the sum already recovered by that party. This will prevent the defaulting party from having to compensate the innocent party as well as the third party thereby incurring a double liability.

Existing rights of the Third Party

The Act does not affect the existing rights or remedies of a third party. The Act applies the standard limitation periods for

actions for breach of contract under the Limitation Act (Cap 163) to actions by third parties under the Act. Further, Section 8 (4) of the Act provides that a third party shall not, by virtue of the Act be treated as a party to the contract for the purposes of any other written law.

Excepted contracts

The Act will not apply to the following types of contracts:

- negotiable instruments;
- a contract under s 39(1) of the Companies Act (Cap 50) (pertaining to the contract between a company and its members by virtue of the memorandum and articles of the company);
- the enforcement of any term of a contract of employment against an employee; and
- (a) a contract for the carriage of goods by sea, or (b) a contract for the carriage of goods by rail or road or for the carriage of cargo by air, which is subject to the rules of the appropriate international transport convention.

Arbitration provisions

Section 9 of the Act provides that where a third party has a right to enforce a term of the contract and that term is subject to an arbitration clause requiring the contracting parties to submit their dispute to arbitration, then the third party will be bound by the arbitration clause as well should he wish to enforce his rights under the contract against the promisor. To put it briefly, the arbitration clause in the contract will apply to the third party as well and he would have to refer his claims to arbitration in accordance with the procedure if any set out in arbitration provisions in the contract.

Editorial Comments:

As the Act has just been introduced, there are to date no reported local court decisions on the scope of the Act or of the efficacy of exclusion clauses purporting to exclude the application of the Act. In relation to building contracts, the Act will certainly have a great impact on nominated sub contractors (as third parties) in relation to Main Contracts entered into between the Main Contractor and the Employer where the rights of the nominated sub contractors are usually set out.

The potential for the application of the Act of course goes beyond the usual parties to a building contract. It is envisaged that third parties in relation to building contracts may include the Management Corporations of building developments and the individual purchasers and occupiers of units in these developments. Further, the Act may also confer rights on third parties in relation to design

consultancy agreements made between the Employer and their design consultants exposing the design consultants to claims by third parties under the Act.

With the increased application of the Act, the need for collateral warranties to be provided by specialist sub contractors/suppliers to the Employers may be reconsidered if the provisions of the Act serve a similar function. It is expected that the scope of the application of the Act and the exclusion provisions in the Contract may be challenged in the Courts. It will be interesting to see the Courts' interpretation of the various provisions in the Act and the effectiveness of the exclusion provisions. In the meantime, to avoid the unintended consequence of having third parties claiming against you under the contract, you should ensure that your contract contains the relevant opting out or exclusion clause.