

Legal Value of Third Party Right over a Valid Contract

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ABSTRACT

The sanctity of the contract is protected by keeping third party away from the right to sue on contract. No doubt, it is essential to protect contracting parties from unnecessary litigations but at the same time the third party must be provided with his due claim over the contract. The circumstances may vary case to case and the right of third party could be claimed as the matter of right. However, the doctrine is not meant to be exercised according to personal whims of parties to the contract rather to be exercised by the application of judicial mind. In Pakistan, like other countries, the same rules of privity are in practice. Current research aims at exploration of third party rights with special reference to Pakistan. The researcher will explore nature and scope of third party to contract and will discuss, with the help of the case laws, the circumstances whereby a stranger to the contract may bring an action to the contract.

KEYWORDS: Pakistani Laws, Third Party Right, Law Associate,

INTRODUCTION

1. HISTORICAL OVERVIEW OF THIRD PARTY RIGHT

It has been traditionally believed that a contract between two parties will not allow a third party to initiate any proceedings for or against the same contract. A third person to the contract is considered to be a stranger to the contract as no liability fall on him so no benefits, those arising from the contract, can be shared with him and such person is not allowed to sue to any party in this situation.¹ In short, it can be said that with formulation of any contract the question of third party rises. Jurists, scholars and practitioners take this issue in different ways so it remained a debatable issue and no consensus has ever been formulated. The third party rights have initiated a debate that is not easy to conclude. A question in relation to privity and consideration has further complicated the debate. It is difficult to determine whether doctrine of privity is a distinct approach to resolve contract issues or it is a mere part of consideration. In Pakistan and India, rule of consideration is applicable that excludes third person rights in any contract to which he is not a party in direct manner but at the same time it gives rights to third party about enforcement of his claim over the contract in exceptional circumstances.

Moreover, one can not exactly trace out the historical point from where this doctrine began. Historically, various rulings of jurists were in practice as no particular view point ever been established and it remained fluctuating from consideration to doctrine of privity. To overcome this confusion and achieve proper understanding, it is necessary to investigate the same thoroughly. Theoretically, the historical development may be categorized into three formative phases, i.e., first phase 1500-1680, second phase 1680-1800 and third phase constitutes of nineteenth century². In earlier common law, this doctrine of privity was not accepted in its entirety but with the passage of time the rights of third person get restricted and finally the rule prevailed and third party rights totally curtailed³. Historical perspective is a key to comprehend this research problem along with cultural perspective as doctrine of privity has been discussed and applied differently in the UK, the USA, India and Pakistan.

The Common law Doctrine of Privity prohibits a stranger from benefits or liabilities arising out of a contract, nevertheless, there are certain exceptional circumstances whereby a third party can sue upon a contract, as a matter of right, to execute its terms. Exceptions to doctrine of privity includes trust, charge, marriage settlements, partition and other family arrangements, acknowledgement, covenants running with land, collateral contract, agency and assignments. In *Drugs Ltd v. Kuehne & Nagel*⁴, the Canadian Supreme Court held that introduction to the reforms against the doctrine of privity is necessary as third party cannot be restricted to enforce his due claim over the contract.

¹ Jesse W. Lilienthal, Privity of Contract, Harvard Law Review, Vol. 1, No.5 (Dec.15,1887), pub. By The Harvard Law Association

² Ibid, 5,6

³Coulls v. Bagot's Executor and Trustee Co Ltd 1967 ALR 385, 407-409

⁴London Drugs Ltd v. Kuehne & Nagel [1992] 3 S.C.R.

2. CONCEPTUALIZATION OF THIRD PARTY RIGHT

The doctrine of privity is a wider and fundamental rule of English Law that clearly states that only parties to contract can sue and can be sued for its breach. It rigorously refutes the possibility of third party to interfere with the contract⁵. It also hampers third party to use any clause of contract for defense. When a passenger on a ship is misbehaved or received any injury from any member of the crew then the passenger cannot sue the shipping company but a specific member of crew. Similarly, that employee cannot escape by invoking any exemption clause provided in the contract between passenger and company as crew member have their responsibility towards passenger that have been neglected. The basic notion of the doctrine is based on the traditional concept of contract in which there is no place for third person who is not a party to contract. With inclusion of third party, so many issues can be generated that results in violations of certain rules. Likewise, same problem may be faced in establishing the rights of third person in any contract which has been made for his benefit.⁶

Involvement of third party brings many fundamental questions and complexities which may be further increased in maintaining the right of third party when no explicit consideration is available in the contract. The doctrine of privity, however, is subject to certain exceptions whereby a third party to the contract may sue for the relief, i.e., trust, charge, marriage settlement, partition or other family arrangements, covenants running with land, collateral contract, agency, assignment and novation. The doctrine of privity is justified in terms of privacy as contracting parties have the right to venture into any agreement without involvement of third person. The phenomenon of autonomy gives right to parties that all rights and duties will be personal affair of the people who are involved in contract; no such right can be given to third person to violate the privacy of contracting parties. Similarly, it would also be unfair to grant rights to the contracting party to sue a person who is not a party to the contract. The doctrine of privity was justified on certain grounds on the basis of theory and some critics declare it successful to settle commercial disputes. Yet, in practice, it caused many difficulties and remained a prevalent cause for injustice to third persons those have definitive benefits. In strict sense, the doctrine of privity was not in existence prior to 1670. It has emerged gradually and before that benefits were given generously to third parties having considerations in contracts. Reliefs were provided as the two fundamental principles of privity were not controlled at that time, i.e., parties to contract can only sue each other and also consideration exclusively depends upon the promise that have been made explicitly keeping in view the third person which is not a party to contract.⁷

In *Vernon v. Palmer*⁸, the court laid down four conditions in which relief can be granted to the beneficiary: interest, benefit, agency and consideration. Interest theory is quite easy to comprehend as the name suggests that only who have interest in the promise can seek benefit from it and no one else can be entitled to any such benefits. The interest theory remained prevalent in 17th century. The benefit theory advocates that action can be brought by the one who is or may be benefitted from the promise. In agency cases, it has been considered that legal persona of agent is merged with that of principal so no objection of privity can be raised⁹. The consideration theory, last but not least, absorbs benefit and interest theories and provides a complex test for beneficiary. These four theories fully comprehend the historical discourse of privity doctrine and make this historical venture easy to understand.¹⁰

3. POSITION IN PAKISTAN

Strictly speaking, the doctrine of privity has no roots in Pakistani law of Contract, normally Pakistani law enables third party to take benefits from the contract if consideration to the contract is moved on the desire of promisee himself. Law enables stranger to sue on contract for enforcing his right and law also grants power to the parties of contract to impose liabilities over strangers if contract so orders. Jurisprudence which evolved through Pakistani courts gave no definite position to the doctrine of privity resultantly a diverging jurisprudence is developed. The concept used in Pakistani law to enforce right of third person against the contract is of consideration. It may move from the desire of promisor or promisee and thus third person gets the right easily but sometimes there arises certain situation where doctrine of privity applies by court and third person loses its right to enforce the contract. It can be further elaborated with the help of illustration, i.e., A, advanced money to B over the guarantee of B's father and take Pronote from B. Later on, B failed to pay and action against B was dismissed by the court on the

⁵ Bourne v. Mason, 1669 K.B 1 vent 6 86 E.R 5

⁶ A.M. Finlay, Contracts for the Benefit of Third Persons, 1939, Sweet & Maxwell, Limited

⁷ Clypsam v. Morris ,1669 2 Keb. 401

⁸ Verner V. Palmer, The American Journal of Legal History, Vol.33, No.1(Jan.,1989), Pub. By Temple University

⁹ Mahesh Chandra Basu v. Radha Kishore Bhattacharjee, 1908, 12 Cal WN

¹⁰ Verner V. Palmer, The American Journal of Legal History, Vol.33, No.1(Jan.,1989), Pub. By Temple University

ground that advances were made on request of B's father and not of B. Therefore, suit cannot be entertained against B.¹¹

A recent authority regarding law of property has totally neglected the right of third person to sue on contract. In **Fazal Dad(deceased) through L.R & Others V. Adnan Ali**¹², the Supreme Court enunciated that only a party to the contract or a party directly effected through any decision of the court has right to come to the court to seek relief. Any third party or a stranger to contract who has not suffered any loss or injury or who is not an aggrieved party cannot seek justice from the court as they have no locus standi. In Pakistan, doctrine of privity was not established in its entirety yet decisions of superior courts considered it a lot. Opinion about doctrine of privity by Pakistani court kept on fluctuating by varying decisions of higher judiciary. In another case where the owner transferred his property to his brother, his son filed suit against the new owner of the property but the court rejected the claim and held that the son is stranger to contract and according to privity rule no stranger to contract can take unnecessary advantage over the contract.¹³

Like Common Law, the doctrine of privity is not well established in Pakistan but the superior courts observed this on several occasions while dealing with the rights of contracting parties. In Pakistan, the basic emphasis is on consideration, rights of contracting party and third party to contract solely depends on it.¹⁴ The consideration includes interest, benefits and sometimes obligation which a party undertakes to fulfill on desire of other party. This entitles third party to enforce their right over the contract.¹⁵ In several cases, the rule of privity is recognized by the superior courts. In, **Muhammad Raza v. Haji Abdul Ghaffar and 6 others**¹⁶, the plaintiff was a constructor who constructed two plots. Only for one plot he had an agreement for work and for the second he had nothing. The superior court dismissed the application and held that the plaintiff has no *prima facie* right to claim compensation or perpetual injunction from restriction of work on the other plot. In the present case, the plaintiff is a stranger to the contract and cannot be allowed to sue on the contract. In the case of **Fazal Dad (deceased) through L.R & Others v. Adnan Ali**¹⁷, the court upheld the doctrine of privity and rejected the claim of stranger over the contract. The Court held that only contracting parties can take benefits arising under the contract. In another case, titled as, **M/s Arrow Trading Company v. Hyosung Corporation, Seoul, Korea and two others**¹⁸, the court dismissed the application and held that there is no privity of contract between plaintiff and defendant number one, therefore he is not entitled to suit for attachment of two L.C.'s.

The section 41 of Contract Act, 1872 clearly depicts by its text that if a contracting party has received obligation from third party then that contracting party cannot enforce his claim against the other contracting party.

The section 126 of Contract Act, 1872 tells about third party rights in case of guarantee contract. In this section the legislature stated that the contract of guarantee is a contract to perform the promise, or discharge the liability, of a third person in case of his default.

The section 136 of Contract Act, 1872 describes about the situation where a contract to give time to principal debtor is made by the creditor with a third person, and not with the principal debtor. It is clearly stated by the text that in above mentioned circumstances surety will not be discharged from his liabilities.

The third party rights are also available in bailment cases. The section 167 of The Contract Act states that if a person, other than the bailor, claims goods bailed, he may apply to the court to stop delivery of the goods to the bailor, and to decide the title to the goods.

In cases where a third person wrongfully deprives the bailee of the use or possession of the goods bailed, the bailee is entitled under section 180 of the Contract act 1872 to use such remedies as the owner might have used in the like cases if no bailment had been made. The bailor or the bailee may bring a suit against a third person for such deprivation or injury.

The rigidity of the doctrine of privity diminished with the passage of time and the courts in the UK, India and Pakistan deliberately gave rights to third party so that to protect the contracting party from unnecessary litigations. Case law study made it clear that the recognition of the doctrine of privity was above board but efforts are being made to protect the rights of third parties. Some fundamental exceptions to the doctrine are also introduced in these countries which entitled third party to sue on contract as the matter of right. These exceptional circumstances restricted the doctrine from flourishing and made contracting parties conscious about their rights.

¹¹ AIR 1948 P.C.150

¹² PLJ 2014 SC (AJ&K) 64

¹³ Pak American Commercial (Pvt.) Ltd through Director v. Humayoun Latif and 7 others, PLJ 2008 Karachi HC 138.

¹⁴ Shoukat Mahmood, The Contract Act(IX of 1872), 1969, Pakistan law times publications, 1 urdu bazar, Lahore.

¹⁵ PLD 1967 Dacca 152

¹⁶ PLJ 1992 Karachi High Court 71

¹⁷ PLJ 2014 SC (AJ&K) 64

¹⁸ PLJ 1996

Since the inception of the doctrine of privity, the court declared certain exceptional circumstances whereby the privity rules were not acceptable and held third party liable to take benefits arising under the contract. These exceptional circumstances include contract of agency, charge on certain immovable property, marriage settlement, family arrangements, acknowledgment of right, assignment of contract, trust related contracts, rule of estoppel, covenants running with land, collateral contract, unjust enrichment and certain other similar contracts. The courts had deliberately held third party liable for conferring benefits by acknowledging the exceptional circumstances and their role on the doctrine of privity. Both, the judge made law and statutory laws favoured the idea to provide third party with the right to sue on contract in which his direct interest is involved.

To recapitulate, reforms in the field of law of contract were essential for providing third party rights to enforce their claim. These reforms were neither meant to put down the doctrine of privity nor to diminish scope of the doctrine rather these were meant to give third party right to enforce the contract. The strangers to contract are facilitated with the help of either express or implied provision, made in the contract, and such right can also be revoked if the contract allows the same by including implied terms in the contract. Similarly, it needs further reforms that to what extent a stranger to the contract can assign his right to someone else, and what is the liability of such person to whom a stranger has assigned his rights, towards the principal parties to the contract? To give strangers their due share in the contract, it must be expressly or impliedly stipulated by the contract otherwise they will not be able to acquire the right to sue on the contract. The third party to the contract must be the real beneficiary of the contract and his rights should be of the kind which can be easily inferred from the contract.

The rigidity of the common law doctrine vanished with the passage of time and reforms were introduced in the common law which deliberately gave rights to third party to contract in circumstances where their rights were involved. To protect the contracting parties from unnecessary litigations, various initiatives have been taken. The rights of third party to sue on contract was conditional on circumstances where from the language of the contract it could be inferred that contract had some provisions, express or implied, for enforcement of third party right to sue on the contract. It was settled in the Reforms that the parties to the contract can also make express provisions for enforcement of third party rights over their contract. In like circumstances third party will enjoy the same rights over the contract as the contracting parties. The rights and liabilities of the contracting parties and third party were mentioned and it was agreed that third party will be entitled to the benefits of contract if he has assented to the contract. As the third party is provided with the right to enforce his due benefits, this was also concluded that he can also be liable for any liabilities arising under contract.

4. DISCUSSION AND CONCLUSION

To sum up, the third party rights over a contract are not easily accessible in Pakistan because consideration is considered as the determining factor of the rights and liabilities of contracting parties and the third party to the contract. In Pakistan, substantial reforms are required for commercial type of contract to overcome the problems like uncertainty, injustice, inconvenience and unnecessary litigations. Through direct and specific legislation, these issues can be addressed. Moreover, rules and policies may be formulated to elucidate the rights and liabilities of the third party to the contract. Respect to the intention of the contracting parties must be given where they want to confer benefits or impose liabilities upon a stranger and the latter is agreed with their terms and conditions then they must be allowed for that. The extent of third party rights and liabilities need further clarification that whether or not a third party can assign his rights and liabilities to another person. The government should design just and fair policies to secure the ends of justice by protecting the rights and liabilities of deserving parties to the contract. To safeguard right of third party to sue on the contract, the government should devise a mechanism whereby a third party is not only facilitated in terms of compensation rather there should be a tool to ensure specific performance of the contract where the monetary compensation would not be an appropriate remedy.

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