

## **Privity of Contract Revisited: A Case for Third Party Rights to Enforce Contracts**

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The privity rule holds that only a party to a contract can sue upon it. As such, strangers to a contract cannot enforce the same or be bestowed with rights or obligations occurring from it. However, in certain circumstances, third party beneficiaries have been allowed to sue upon a contract, in view of equity. Such a principle is firmly rooted in common law and is regarded as the doctrine of privity of contract.

### **The Common-Law Background**

In one of the early English cases of *Dutton v. Poole*<sup>1</sup>, a third-party beneficiary was permitted to enforce a contract entered by her father, although she was not privy to it. The court observed the close relationship between the two and held on grounds of equity, that the consideration promised to the father, would extend to his daughter. However, starkly different views have been taken as well.

In *Tweddle v. Atkinson*<sup>2</sup>, Crompton J remarked that love and affection would not constitute adequate consideration, when bringing about an action of assumpsit. The court opined that a stranger to the consideration cannot sue upon the contract, despite being a beneficiary under it. A similar approach was taken in *Dunlop Pneumatic Tyre Co v. Selfridge & Co Ltd.*<sup>3</sup> wherein the court noted that only a party to a contract can enforce the same. As such, the rights of third-party beneficiaries remain a contentious issue.

### **Privity of Contract in India**

At the outset, it must be noted that the Indian Contract Act does not explicitly provide for (or against) privity of contract. The Privy Council, nevertheless, extended that principle to India in *Jamna Das v. Ram Autar Pande*.<sup>4</sup> Along similar lines, in *Krishna Lal Sadhu v. Promila Bala Dasi*,<sup>5</sup> the Contract Act was memorably interpreted by Rankin CJ to provide for the privity rule. According to him, “the idea that contracts can be enforced by a person who is not a party to the contract...is rigidly excluded by the definition of “promisor” and “promisee”. This statement was endorsed—and the privity rule upheld—by the Supreme Court in *M.C. Chacko v. State Bank of Travancore*.<sup>6</sup> This case definitively established privity of contract in India. However, a catena of subsequent judgements have established circumstances involving beneficiaries under a trust or charge, family or marriage settlements, estoppel, or covenants shall be excluded from this general rule.<sup>7</sup>

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<sup>1</sup> *Dutton v. Poole*, (1677) 2 Levinz 210.

<sup>2</sup> *Tweddle v. Atkinson*, (1861) 1 B&S 393.

<sup>3</sup> *Dunlop Pneumatic Tyre Co v. Selfridge & Co Ltd.*, [1915] AC 847.

<sup>4</sup> *Jamna Das v. Pandit Ram Autar Pande* [1911] 39 IA 7.

<sup>5</sup> *Krishna Lal Sadhu v. Promila Bala Dasi*, [1928] 55 Cal 1315.

<sup>6</sup> *M.C. Chacko v. State Bank of Travancore*, [1969] 2 SCC 343.

<sup>7</sup> AVATAR SINGH, CONTRACT AND SPECIFIC RELIEF 120, (Eastern Book Company 2017).

However, prior to *M.C. Chacko*, there was another line of thinking on this topic. The *ratio* of the Privy Council in *Khwaja Muhammad Khan v. Hussaini Begum*<sup>8</sup> has been variously interpreted to mean that the privity rule was in-applicable in India. Subsequently, the Madras<sup>9</sup> and Calcutta High Court<sup>10</sup> held that *Tweddle v. Atkinson* was not a law in India.

### **Changes in the Privity Rule in Other Jurisdictions**

Over time, the doctrine of privity of contract has been relaxed in several countries. In the United States, *Lawrence v. Fox*<sup>11</sup> was the first instance wherein a third-party beneficiary was able to enforce the contract. Thereafter, The First Restatement of the Law of Contracts restricted the said right of third parties to only creditor and donee beneficiaries.<sup>12</sup>

However, Section 302 of The Second Restatement of Law of Contract<sup>13</sup> in 1981, widened its scope and embraced the intention to benefit test. As per the same, if the contracting parties intended to provide a third party with benefit and the circumstances imply that the performance of the promise would benefit the same,<sup>14</sup> then such a third party would constitute an intended beneficiary and may sue upon the contract. In situations wherein the performance must be provided directly to the promisee, a third party that might benefit too, would only be an incidental beneficiary and will have no right to enforce the contract.<sup>15</sup> Such a test has gained prominence in the US, letting third party beneficiaries to sue upon a contract, despite being strangers to it.

In the UK, third party beneficiaries, save for some exceptions, were not permitted to enforce the contract. However, the Contracts (Right of Third Parties) Act, 1999 diluted the privity rule significantly. Under Section 1(1) of the Act,<sup>16</sup> a third party can sue upon a contract if its terms expressly say so or purport to provide him with some benefit. For such purposes, Section 1(3) stipulates that the contract must explicitly identify the third party, as part of a specific class or description. Further, Section 1(5) provides a third party with such remedies to enforce a contract, as he would have upon breach, if he were a party to the contract. Consequently, with the new Act, the UK too has watered down the doctrine of privity of contract, in a bid to empower third-party beneficiaries.

### **A Case for Extension to India of Contractual Rights of Third Party Beneficiaries**

Arguments for the privity rule rest on numerous limbs. Such limbs shall now be briefly listed and critiqued. Firstly, it is argued, that enabling third parties to enforce contracts may limit the rights of contracting parties to vary or terminate the contract. However, as Contracts (Right of Third Parties) Act, 1999 shows, a seemingly acceptable compromise is possible whereby the

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<sup>8</sup> *Nawab Khwaja Muhammad Khan v. Nawab Hussaini Begum*, [1909] 37 IA 152.

<sup>9</sup> *Munisami Naicker v. Vedachala Naicker*, [1928] AIR Mad 23.

<sup>10</sup> *Debnarayan Dutt v. Chunilal Ghose*, [1914] 41 Cal 137.

<sup>11</sup> *Lawrence v. Fox*, 20 N.Y. 268 (N.Y. 1859).

<sup>12</sup> Sital Kalantry, *The Intent-to-Benefit: Individually Enforceable Rights Under International Treaties*, 44 Stanford Journal of International Law 63, 76 (2008).

<sup>13</sup> *Restatement (Second) of Contracts* § 302 (1981).

<sup>14</sup> Sital, *supra* note 12, at 74.

<sup>15</sup> *Contracts for the Benefit of Third Parties in the Construction Industry*, 40 Fordham Law Review 315, 319 (1971).

<sup>16</sup> Contracts (Right of Third Parties) Act, 1999, §1, Acts of Parliament, 1999 (UK).

contracting parties may—without limits—vary the terms of the original contract (to the extent of extinguishing the benefits and entitlements of the third party), provided that the concerned third party has not assented to, or relied upon the benefits formerly granted.<sup>17</sup> It has been observed that such a compromise is considerably more equitable.<sup>18</sup>

Secondly, if privity rule were to be struck down, the promisor would likely face two actions—from the promisee and the third party. However, it is submitted that the effects of such a scenario can be considerably mitigated by requiring that third parties necessarily join the promisee as a plaintiff, and in case the promisee refuses to be joined—then as a defendant.<sup>19</sup> Moreover, in case separate decrees are passed in favour of third party and promisee, equity may be easily maintained by balancing the remedies granted in each decree (so as to ensure a zero-sum game).<sup>20</sup>

Lastly, in support of the privity rule, it is often argued that since the third party may not have provided the consideration, it would be unjust if such a party could enforce the contract. While this contention remains important, however in practice, the rule of privity leads to highly inequitable outcomes because it creates an absolute bar against third party beneficiaries (from enforcing the contract). Granting rights to third party beneficiaries to enforce the contract only mediates against this initial bar. The power always remains with the Court to decide whether in *particular* cases, the third party of concern *ought* to be entitled to remedies.

Additionally, there are abundant arguments *for* granting rights and protections to third-party beneficiaries: firstly, a rule to the contrary prevents effect being given to the intentions of the contracting parties. If remedy is denied to the third party even when the contracting parties intended that it be provided so, the same frustrates their intentions.<sup>21</sup> Secondly, the privity rule is deeply inequitable for a third party who may have relied on the benefits granted under the contract to regulate his affairs,<sup>22</sup> and thus upsets the reasonable expectations of the third party to the benefit under the contract.<sup>23</sup> Thirdly, it is un-intuitive that a (third) party who may have suffered losses cannot sue, but the promisee who has suffered no loss can. Moreover, even if the promisee were of an intention to sue—in order to protect the third party's benefits—such a promisee may only receive nominal damages because no damage was caused to his interests. Lastly, the third party rule causes difficulties in commercial life, particularly where transactions and projects involve a 'network' of contracts allocating risks, responsibilities and liabilities between the parties.<sup>24</sup>

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<sup>17</sup> Contracts (Right of Third Parties) Act, 1999, §2(1), Acts of Parliament, 1999 (UK); Contracts (Right of Third Parties) Act, 1999, §2(2), Acts of Parliament, 1999 (UK).

<sup>18</sup> Neil Andrews, *Strangers to Justice No Longer: The Reversal of the Privity Rule under the Contracts (Rights of Third Parties) Act 1999*, 60 Cambridge Law Journal 353 [2001].

<sup>19</sup> A similar procedure was contemplated in *Beswick v. Beswick* [1967] 2 All ER 1197 (HL).

<sup>20</sup> Stephen A Smith, *Contracts for the Benefit of Third Parties: In Defence of the Third-Party Rule*, 17 Oxford Journal of Legal Studies 643 [1997].

<sup>21</sup> POLLOCK AND MULLA, THE INDIAN CONTRACT ACT, 1872 29 (15<sup>th</sup> ed. Lexis Nexis 2018); See also *Dunlop Pneumatic Tyre Co v. Selfridge & Co Ltd.*, [1915] AC 847.

<sup>22</sup> JACK BEATSON ET. AL., ANSON'S LAW OF CONTRACT 38 (30<sup>th</sup> ed. Oxford University Press 2020).

<sup>23</sup> POLLOCK, *supra* note 21 at 30.

<sup>24</sup> *Id.*

Lastly, it is pertinent to note that the provisions of Indian Contract Act relating to privity (in general) stand on a different footing than the traditional Common Law principles. Nevertheless, initial cases of the Privy Council sought to transport the Common-law privity of contract into an Indian context; the statutory backing of which was provided by referencing the use of “promisor” and “promisee” in Section 2(d) of the Contract Act. It is respectfully submitted that such an argument is not exceedingly persuasive. It is at least indisputable that the Contract Act does not explicitly provide for the rule of privity of contract. Then, given that England itself<sup>25</sup>—the originator of the privity rule—has sought to grant protections and rights to beneficiary strangers even in contracts to which they are not a party, it is perhaps time that India may jump on that wagon. Lastly, it must be noted that conferring rights and benefits upon third parties is not a new concept in India—the same has already been provided under numerous statutes.<sup>26</sup> What is required is that such rights also be granted under the Indian Contract Act.

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<sup>25</sup> Other jurisdiction having Common-Law genealogies (for e.g., Western Australia, Queensland, and New Zealand) have recently relaxed or abrogated laws relating to Privity of Contract.

<sup>26</sup> POLLOCK, *supra* note 21 at 40.