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Reforming the Doctrine of Privity of Contract

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The doctrine of privity rule of the contract is a long-standing rule originated from the English law principle which essentially prohibits the third parties from filing a suit against the original parties. It emphasizes the fact that “a stranger to the contract cannot sue”. But it is quite evident that this principle paves the way for injustice and inequity. Although the English parliament brought in a new enactment named, it proved to be inefficient in dealing with third-party rights. Similarly, the exceptions to the privity rule in India do not actually help to mitigate the issue wholly. However, under the court's unconventional attitude towards privacy doctrine and the revised provisions, a reimbursement mechanism is on the wheel right now for parties who are duly harmed by the deprivation of rights due to the strict adherence to the doctrine of privity rule. Since it is high time to eradicate the injustice and inequity caused by the privity rule, this paper will closely look at the doctrine of privity and the harm it causes, thus stating the need for reformation of the rule.

Keywords: contract, reform, privity.

INTRODUCTION

The doctrine of privity rule of the contract is a long-standing rule originated from the English law principle which essentially prohibits the third parties from filing a suit against the original parties. It emphasizes the fact that “a stranger to the contract cannot sue”. But it is quite evident that this principle paves the way for injustice and inequity. Although the English parliament

brought in a new enactment named The Contract (Right of third parties) Act, 1999, it proved to be inefficient in dealing with third-party rights. Similarly, the exceptions to the privity rule in India do not actually help to mitigate the issue wholly. However, under the court's unconventional attitude towards privacy doctrine and the revised provisions, a reimbursement mechanism is on the wheel right now for parties who are duly harmed by the deprivation of rights due to the strict adherence to the doctrine of privity rule. Since it is high time to eradicate the injustice and inequity caused by the privity rule, this paper will closely look at the doctrine of privity and the harm it causes, thus stating the need for reformation of the rule.

PRIVITY OF CONTRACT RULE IN ENGLISH LAW

The English law established privity of contract as well as the doctrine of consideration by the Mid of 19th century. *Tweddle v Atkinson*¹ (1861) was the first case in which the provision of the privity rule of the contract was introduced. In that case, both Atkinson's and his wife's fathers made a contract to pay a sum of money to the couple. But Atkinson's father-in-law died before the performance of his part in the contract and subsequently, Atkinson filed a suit for claiming money. However, the court rejected stating that there was no consideration between Atkinson and his father-in-law. Also, the court deemed Atkinson as a stranger to the contract even though he was a beneficiary, which means the contract was made for his benefit. Hence court came up with the law that no legal right is conferred on third parties to an agreement. Later on, the rule got altered and developed through numerous cases. In the Dunlop case, the court further emphasized the fact that a third party cannot file a suit as he is not a party to the contract and lacks consideration.

Further, the English law observed the inadequacy of the doctrine of privity when it comes to third-party rights and proposed the Sixth Interim Report. The British courts denounced the obdurate nature of contract law which discriminates against the third party. Accordingly, it got further discussed in the case such as *Beswick v Beswick*², *White v Jones*³ and the Woodar case.

¹ *Tweddle v Atkinson* [1881] 121 ER 762

² *Beswick v Beswick* [1967] UKHL 2

³ *White v Jones* [1195] 1 All ER 691

The Law Commission of the United Kingdom later carried out changes within the privity rule not bringing any alterations in the doctrine of consideration in 1996. Subsequently, they recognized the necessity for a legislative reform to observe third-party rights as they must be able to enforce third-party rights according to the terms and conditions of the contract.

The Contract (Rights of Third Parties) Act, 1999

The timeworn rule of “only the party of a contract could enforce the contract terms” was altered by the new enactment of the English parliament, which contract (Rights of third parties) Act, 1999, which in turn made third parties eligible to work out the terms and obligations of the contract. This Act applies to all contracts except contracts such as negotiable instruments, articles of association of a company, and carriage of goods contracts.

Limitations of the contract (Right of third parties) Act, 1999

- Section 1⁴ of (rights of third parties) Act, 1999, which is a provision related to the right of third parties to enforce contractual terms must be satisfied.
- The Act is silent on the rights of the promisee to seek remedy and claim damages for the sake of a third party.
- The Act doesn't provide an exception for the parties who are not the original parties to the contract, that they must not be a burden according to the terms and conditions of the contract.
- The act does not provide any right to the third parties to file a suit to get damages when the original parties include an “opt-out” clause in the contract denying the right of third parties.

PRIVITY OF CONTRACT RULE UNDER INDIAN LAW

It was in the case of *Jamna das v Ram Autar*⁵ where the council noticed the rule of privity for the first time in India in which the council held that the plaintiff (purchaser) has not entered into any contract with the original party and therefore he must not be made liable to pay the debt.

⁴ Contract (Right of third parties) Act, 1999, s 1

⁵ *Jamna Das v Ram Autar Pande* (1916) ILR 38 All 209

But this is not a constant theory. Various and varying circumstances and facts of the case would bring changes as in the famous case *Donoghue v Stevenson*⁶ (1932). In this case, the court held that even a stranger to the contract can sue in such a situation where the manufacturer must have taken well care of things and has some sense of commitment toward his customers. Thus Donoghue (a stranger to the contract) can file a suit seeking damages on behalf of her friend.

PROVISIONS RELATED TO THE RULE

Section 2(h)⁷ of the Indian Contract Act, 1872: "An agreement enforceable by law is a contract" ie, a valid agreement between two parties that is enforceable by law is called a contract.

Section 2(e)⁸ of ICA: "Every promise and every set of promises, forming the consideration for each other, is an agreement"

Section 2(d)⁹ of ICA: "When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise"

"any other person" in Section 2(d) implies that the presence of a proper consideration in the contract is mandatory and the party who provided consideration is not of no importance.

In the *Chinnaya v Ramayya*¹⁰ case, the Court held that the consideration can move from any person who may be a stranger to the contract. Also, the cases like *Dutton v Poole*¹¹, *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd*¹², and *Tweddle v Atkinson*¹³, explain the concept of consideration.

Comparison

⁶ *Donoghue v Stevenson* [1932] UKHL 100

⁷ Indian Contract Act, 1872, s 2(h)

⁸ Indian Contract Act, 1872, s 2(e)

⁹ Indian Contract Act, 1872, s 2(d)

¹⁰ *Chinnaya Rau v Ramaya* (1882) ILR 4 Mad. 137

¹¹ *Dutton v Poole* [1678] 2 Lev 211

¹² *Dunlop Pneumatic Tyre Co. Ltd. v Selfridge & Co. Ltd.*, [1915] UKHL 1

¹³ *Tweddle (n 1)*

There are various similarities and differences between both laws. Both in English and Indian law only the contractual parties can claim damages. However, the doctrine of privity of contract rule is much wider in the Indian context when compared to English law. As stated in *Babu ram Budhu mal and Ors. v Dhan Singh Bishan Singh*¹⁴ case, the significance of consideration in Indian law is wide. ie, unlike British law, Indian law restricts seeking damages or enforcing the contract by a third party, if a contracting party didn't promise the third party consideration.

EXCEPTIONS TO THE PRIVITY RULE

There are certain exceptions to the rule that is accepted in India. They are the contracts which are:

Built on trust:

The third party can file suit against the original party if he could prove the presence of the element of trust in the contract. But it is mandatory to show that there is a certain benefit to the third party. In the cases like *Lloyds v Harper*¹⁵ and *M.C. Chacko*, it was stated that the strangers to the contract can file for a remedy against the contractual parties in case of any breach of trust.

Acknowledgment, Admission, or Estoppel:

A third party may file a suit if the original party fails to perform their part after the acknowledgment of the same. As per the rule of estoppel, the contractual parties would be made liable in case of failure. This is mentioned in the *Waltons Stores Ltd v Maher*¹⁶ case.

Contract through an agent:

Consistent with ICA1872, an "agent" is "someone who acts on behalf of the principal and deals with the parties who are not considered as an element of the contract". According to ICA, the agent is supposed to fulfill all the terms and conditions if he sets up a contract with a third party.

¹⁴ *Babu ram Budhu mal and Ors. v Dhan Singh Bishan Singh* AIR 1957, PH 169

¹⁵ *Lloyds v Harper* [1880] 16 Ch. D 290

¹⁶ *Waltons Stores Ltd v Maher* [1988] 164 CLR 387

Family Arrangements or marriage expenses:

In the case *Sundara Raja v Lakshmiammal*¹⁷ (1914), the court stated that the third party can seek remedy with his right as a beneficiary of the contract it's made as per family arrangements or marriage settlement in order to benefit a stranger. Also, Section 15(c)¹⁸ of the Specific Relief Act, 1963 states that a party can seek relief if "the contract is a settlement on marriage, or a compromise of doubtful rights between members of the same family, any person beneficially entitled thereunder".

The necessity for reformation:

It is quite necessary to redesign the doctrine of privity as it demands a serious reformation due to plenty of issues raised against it. First and foremost, the rule is indeed an injustice towards the third party as it allows the contractual parties to claim damages whereas not the third parties. Secondly, numerous common law and statutory exceptions make room for confusion and make things much more complex. The following contexts will address certain of the drawbacks of the privity rule.

Insurance contract:

Here, the employee can't file a suit when there is a breach of contract by the insurer, even if his employer collects insurance from the insurer on behalf of the employee.

Construction contract:

The third party in construction cases like tenants, purchasers, and property financiers are denied the right to sue or to seek remedy. In the case *D & F Estates Ltd v Church Commissioners for England*¹⁹, the court stated that the builder cannot be made liable for tort as the claim of the purchases is not valid as per the privity rule.

¹⁷ *Lakshmiammal v Sundararaja Aiyangar and Anr.* (1915) ILR 38 Mad 788

¹⁸ Specific Relief Act, 1963, s 15(c)

¹⁹ *D&F Estates Ltd. v Church Commissioners for England and Wales* [1988] 2 All ER 992

Contract to pay the third parties

*Beswick v Beswick*²⁰ is an ideal case that shows how much injustice is caused to the third parties due to the privity rule of the contract. Here, the uncle agreed to sell his business to his nephew for the consideration that the nephew would pay a certain amount to his aunt every week, which he failed to do after the death of the uncle. Subsequently, their aunt filed a suit claiming damages and unfortunately, the court rejected her claim as she was not a party to the contract.

ANALYSIS AND SUGGESTIONS

If two contracting parties make a contract benefitting a third party, it simply highlights that these parties must be able to uphold their right in the contract in their own capacity and hold over that contract. Or else, the said third parties would suffer if the contractual parties decide to invalidate its term. The 87th Report of the Law Commission of India put forward certain recommendations namely when a specific contract is made by two parties that clearly imparts a benefit to a party other than the original parties and is acknowledged by that third party, then the original parties are not supposed to bring changes to the terms such as terminating, replacing or amending the contract which would cost the interests of a third party.

However, the recommendation is not been adopted yet as if the implementation would endanger the fundamental essence of the contract, along with the intentions of the original parties and their right to alter or terminate the terms of the contract as per their convenience. Consequently, in *Kedar Das Mohta v Nand Lal Poddar*²¹ case accentuates the point that unless and until the parties are doing it with mutual consent, they should not be allowed to alter the terms and conditions of the original contract if there exists reciprocity in the above-said terms which activates the contract between the actual party and the third party as well. That is, the binding character of the agreement must be reciprocal between the contractual parties and the party against whom the contract is supposed to be enforced. Hence, strong obedience or fidelity to this rule would undoubtedly be a challenge in no time since it is essentially unclear and unsuited for the contemporary ethos.

²⁰ *Beswick (n 2)*

²¹ *Kedar Das Mohta and Ors. v Nand Lal Poddar and Ors.*, AIR 1971, Pat 253

The 13th Law Commission Report, 1958, has recommended that the privity rule must be abated so as to give rights to the third party to legally enforce the contract which is made for his benefit. The most effective method to eradicate this issue would be to adopt a generic exception to get devoid of circumstances where the third party suffers due to this doctrine. In accordance with the 13th Indian Law Commission Report, 1958, the rights of both contractual parties and the third party should be formulated along with a distinct statutory clause. Also, an act that parallels the Contracts (Rights of Third Parties) Act, 1999 should be formulated and passed in India under certain qualifying conditions in order to recognize third-party rights. Moreover, brand-new legislation on this matter should be enacted which acknowledges the challenging situation prevalent in the country when privity of contract is concerned. Subsequently, there should be a proper provision made by legislation so as to ensure that the law doesn't deny the rights of third parties citing the privity rule whenever there is an express statement by the original parties about the rights of the third party over their contract.

Under the court's unconventional attitude towards privacy doctrine and the revised provisions, a reimbursement mechanism is on the wheel right now for parties who are duly harmed by the deprivation of rights due to the strict adherence to the doctrine of privity rule. Hence, the stranger might be entitled to damages if a legitimate violation is caused to him under the rule. However, the stranger should be within the intended beneficiaries' reach. Whereas it would be difficult to find out who the intended beneficiaries are when dealing with complex agreements.

CONCLUSION

The Doctrine of Privity rule continues to be evolving in character. It is highly ambiguous and inappropriate in the present Indian scenario. It is undoubtedly that this doctrine had troubled people enormously and caused inequity. Bringing in brand-new legislation and acting according to the suggestions put forward by the 13th report of the Law Commission would be of relief to the third parties as it might eradicate the injustice and inequity caused by the privity rule. Moreover, to fulfill this objective, a new provision called Section 37A should be included in the Indian contract act which is comparable to the Contracts (Rights of Third Parties) Act, 1999 to acknowledge the right of third parties.

This would benefit the third party in different ways. Firstly, it will be mandatory to acknowledge and address the rights of strangers to the contract if the contract directly mentions the same in the contract. Secondly, the actual parties cannot terminate, renovate or alter the basic structure and essence of the contract if the contract enunciates the advantages upon a third party as it has got the high possibility to affect the right of the third party. The countries like Australia, Canada, New Zealand, Singapore, and England have already repudiated this doctrine as it causes great injustice. Nonetheless, in the Indian context, merely revoking or dispersing the doctrine of privity rule would not address the core issue rather would it constitute a severe challenge to the system. Hence, it must be reformed with immediate effect.