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International Institute for the Unification of Private Law

WORKING GROUP FOR THE PREPARATION OF
PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS

Meeting of the Drafting Group in Bristol, 7-10 January 2002

Chapter [...]

THIRD PARTY RIGHTS

(Revised draft Chapter prepared by Professor M. Furmston in the light of the discussions of the Working Group at its 4th session held in Rome, 4-7 June 2001)

Rome, December 2001

CHAPTER [...]

THIRD PARTY RIGHTS

Article 1

Parties may by express or implied agreement confer a right in favour of a third party (the beneficiary). The existence and content of the beneficiary's right is determined by the contract of the parties and is subject to any conditions or other limitations under the contract.

COMMENT

Usually contracts are intended by the parties to create rights and obligations between the parties. In such cases only the parties will acquire rights and duties under the contract. The mere fact that a third party will benefit from the performance of the contract does not by itself give that third party any rights under the contract.

Example

Professor A makes a contract with the University of Utopia under which he agrees to give forty 1-hour lectures comparing the Utopian and Ruritanian laws of contract. Professor A only appears for twenty lectures and does not mention Ruritanian law in the lectures. T, a student who has failed the examination in this course, is aggrieved. T does not acquire rights under the contract between Professor A and the University.

All modern systems qualify this rule. The underlying principle is the autonomy of the parties, who should be free if they wish to create rights in a third party. The parties may state expressly that this is their intention but this is not essential since the intention to benefit the third party may be implicit in the contract. In cases where implied intention is alleged, the decision will turn on all the terms of the contract and the circumstances of the case.

Examples of implicit intention are:

1. A takes out a policy of insurance on the family car which is regularly driven by his wife, his two daughters and himself. The contract provides that the insurance company will cover anyone driving the car with A's consent. A's wife, T, has an accident while driving the car.
2. A sells his business to B on the terms that B will pay A £1000 a month for the rest of his life and will pay A's wife, T, £500 a month if A predeceases her. A dies. B refuses to pay T anything.

3. T, the International World University, wishes to build a new law library. For legitimate tax reasons the contract for the erection of the library is made by Denning Ltd, a company wholly owned by the University, although the contractor well knows that when completed the library will be occupied and used by T. The building has been badly done and it will cost US \$ 5,000,000 to complete it satisfactorily.

4. A instructs his lawyer, X, to prepare a will, the main effect of which will be to divide his property equally between his wife and his sister, T. By gross professional incompetence X prepares a will which is invalid. The effect is that A dies intestate and under the relevant succession law, all his property goes to his wife.

Examples where there is no such implicit intention unless the circumstances clearly indicate otherwise are:

1. A goes to an expensive furrier and selects and buys a coat. He tells the assistant (truthfully) that he is buying it for his wife T. By the side of the coat is a prominent card saying "It looks like mink, it feels like mink but is guaranteed man made." A gives the coat to his wife. In fact, owing to a mistake by the store, the coat is a real mink coat and T is ostracised by her friends.

3. A buys a new car, which is the subject of warranties both by the manufacturer and by the dealer. After he has had the car a month without any problems, he allows his wife T to drive it. Without warning the brakes fail and T is seriously injured.

4. A, a company with a large factory, makes a contract with a company operating the local sewage system. Under the contract, A is entitled to discharge its waste into the sewer but undertakes not to discharge certain types of waste. In breach of this undertaking, A discharges waste which blocks the sewer and causes damage to T, another user of the sewer.

5. A, a Japanese firm, sells materials to B, a Swiss firm. A knows that B plans to resell to T, a German pharmaceutical firm, which will use the materials for the manufacture of a new drug under a contract which will effectively limit B's liability to T to \$ US 1 million. The materials are defective and T's losses greatly exceed \$ US 1 million.

In a number of examples it is likely that there will be tort claims in some jurisdictions. This possibility is outside the scope of the Principles.

It is assumed that an express statement that the parties do not intend to create rights in a third party will be effective.

Article 2

The third party must be identifiable with adequate certainty by the contract but need not be in existence at the time the contract is made.

COMMENT

The parties may well wish to make a contract in which the identity of the third party is not known at the time the contract is made but a mechanism is provided by which it will become known by the time performance is due. This might be by providing that the parties, or one of them, can identify the beneficiary at a later date or by choosing a definition of the beneficiary which later circumstances will serve to make the identity clear.

Examples :

1. A married man with children but no grandchildren makes a contract with the XYZ insurance company under which A pays £10 a month to the insurance company and they promise to pay £10,000 to each of his grandchildren on his death.

2. Company A launches a takeover bid for company B, a public company whose shares are traded on leading Stock Exchanges. Company B engages C, a leading firm of accountants to prepare a report on Company B for distribution to shareholders. The contract between company B and C requires C produce an honest, thorough and competent report. Owing to incompetence C produces a report which is much too favourable to company B. As a result the majority of shareholders (T1) vote to reject Company A's offer. Some shareholders show copies of the report to friends (T2) who buy shares in Company B. T1 can acquire rights under the contract between B and C but T2 cannot.

Article 3

For the purposes of this chapter, the conferment of rights in the third party includes the right to rely on a clause in the contract which excludes or limits the liability of the third party.

COMMENT

Contractual provisions limiting or excluding liability of those who are not parties to the contract are very common particularly in contracts of carriage, where they often form part of a settled pattern of insurance. In general the autonomy of the parties should be respected in this area too.

Example:

A, the owner of goods, makes a contract with a sea carrier to carry them from Zenda to Xanadu. The bill of lading is subject to the Hague Rules and purports to exclude the liability of (a) the master and crew; (b) stevedores employed in loading and unloading the cargo; and (c) the owners of ships onto which the goods may be transhipped. These Exclusions will be effective.

Article 4

The promisors may assert against the beneficiary all defences which the promisors could assert if the claim was made by the promisee.

COMMENT

Under Article 1 the content of the beneficiary's right may be made subject to any conditions or limitations devised by the parties. The parties' autonomy is in principle unlimited but they may well not provide expressly for all possibilities. The normal default rule will therefore be as stated in the present Article.

Example

A takes out a policy of life insurance with B Insurance Co in favour of T. The contract provides for the payment of premiums for 25 years but after 5 years A stops paying premiums. The position of T will be modelled on that of A if the policy had been in his favour. Such policies do not usually deny all return on the premiums paid. If, however, the policy had been liable to be set aside by the insurance company, for instance because A had not made material disclosure, then B insurance company would normally be entitled to raise this defence against T.

Article 5

The contracting parties (or one of them if the contract so provides) may revoke the rights granted by the contract to the third party until the third party has accepted them or relied on them.

COMMENT

It might be the rule that the promisor and promisee were free to revoke the third party's rights at any time or, contrariwise, that the third party's rights were

immutable once the contract is complete. It appears that few systems adopt either of these extreme positions. The solution adopted is that the third party's rights become irrevocable once the third party has either accepted the rights or has relied on them. It will, of course, be open to the parties to provide for a different regime in the contract and there might be relevant usages which limited the possibility of revocation.

Article 5

It is open to the third party to renounce the benefit which the contracting parties have purported to confer upon him.

COMMENT

Although the third party will usually welcome the benefit which the parties had conferred upon him, he cannot be forced to accept it. It follows that the third party may expressly or impliedly renounce the benefit.