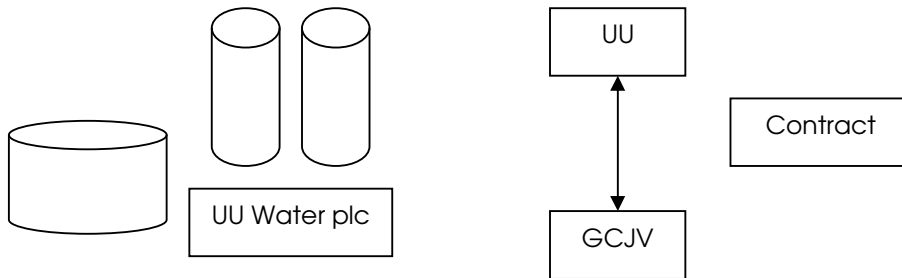


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## Contracts (Rights of Third Parties) Act 1999

### Introduction

For the purposes of this factset, we will be using the following example. Underground Utilities (UU) have entered into a Contract with GC Contracting Joint Venture (GCJV) who are building a Wastewater Treatment Works. On completion of the Contract the treatment Works will be handed over to United Utilities Water PLC, who will operate the plant.



### Third Party Rule / Privity of Contract

Under the rule of 'Privity of Contract' a person can only enforce a contract if he is party to it. The rule means that, even if a contract is made with the purposes of conferring a benefit on someone who is not a party to it, that person (a 'third party') has no right to sue for breach of contract.

### Disputes under a contract

If a dispute were to arise on the contract, for example in the form of a defect, between UU & GCJV, then under the framework agreement.....

If after Final Acceptance of the contract when the plant has been handed over to Underground Utilities Water PLC (UU Water PLC), the plant stops working as a defect has occurred. Under Contract Law, as UU Water PLC has no contract with anyone, they cannot sue for damages under a breach of contract. UU PLC cannot be included in the original contract, as the contract is between two parties (Client – UndergroundUtilities and Contractor – GCJV). As UU Water PLC was not party to the original contract, the only remedy available to them would be to sue under the law of Tort, specifically Negligence.

### Law of Tort - Negligence

Tort law serves to protect a person's interest in his or her bodily security, tangible property, financial resources, or reputation. Interference with one of these interests is redressable by an action for compensation, usually in the form of unliquidated damages. The law of torts therefore aims to restore the injured person to the position he or she was in before the tort was committed.

In an action for negligence, the plaintiff must show: (1) that the defendant owed him a duty of care; (2) that there was a breach of that duty; and (3) that recoverable damages was thereby caused. Considering the first of these elements, it is necessary to decide whether in the particular circumstances one person (the defendant) owed a duty of care to the other (the plaintiff). The classic test as to when a duty of care might arise was stated in the leading case of *Donoghue v Stevenson*. The manufacturer of ginger beer was held to owe a duty to the ultimate consumer, who found a decomposing snail in the empty bottle. The consumer could not sue in contract because the ginger beer had been purchased by a friend, and in any event the default was that of the manufacturer not the seller. In the Judgement from this case the neighbour principle was established:

*'The rule that you are to love your neighbour becomes in law; you must not injure your neighbour; and the lawyer's question who is my neighbour? Receives a restricted reply. You must take reasonable care to avoid acts or omissions, which you can reasonably foresee, would be likely to injure your neighbour. Who, then, in law is my neighbour? The answer seems to be- persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions which are called into question.'*

The law of tort remained comparatively dormant for some time after *Donoghue's* case and it was not until *Dutton v Bognor Regis UDC* that the courts began to grapple with the question which subsequently came to dominate this area of law, namely the circumstances in which a duty would arise and the inter-relationship between such duties and the type of damage suffered. In *Dutton's* case the plaintiff, a second purchaser of a house built on a rubbish tip, was unable to sue in contract. Proceedings were brought in tort against the original builder and against the local authority who had approved the plans and inspected the work on site. The case against the builder was settled but Mrs. Dutton proceeded against the local authority. In the Court of Appeal it was argued that the council owed no duty of care and that there was no physical damage to found an action in tort.

It was further pointed out that the council should not be held liable because the builder was not liable in tort. These claims were rejected, and it was held that not only was the council liable but, incidentally, the builder would also have been liable in tort. *Dutton's* case had two important consequences. First, claims in tort were potentially available against parties not hitherto thought liable; and, secondly, claims in tort could be brought as an alternative to claims in contract. This development led to yet another series of cases on the question when the cause of action in tort arose. In regard to latent (undetected) defects in buildings, the doctrine was developed that the cause of action arose when the plaintiff ought reasonably to have become aware of the existence of the damage.

In *Anns v MB Merton* the House of Lords, for the first time, considered the principles arising from *Dutton's* case. *Anns'* case concerned allegations of negligence against the local authority's building inspectors, the primary issue being whether the claim was statute-barred. The House of Lords approved, with some modification, the decision in *Dutton*. The judgement of the House of Lords in *Anns* restated the circumstances in which a duty of care would arise:

*'First, one has to ask whether as between the alleged wrongdoer and the person who has suffered damage there is a constant relationship or proximity or neighbourhood such that, in the reasonable contemplation of the former, carelessness on his part may be likely to cause damage to the latter-in which case a prima facie duty of care arises. Secondly, if the first question is answered affirmatively, it is necessary to consider whether there are any considerations which ought to negate or reduce or limit the scope of the duty or the class of person to whom it is owed or the damages to which a breach of it may give rise.'*

## Key sources of information:

Contracts (Rights of Third Parties) Act 1999

Explanatory Notes to Contracts (Rights of Third Parties) Act 1999

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## Contracts (Rights of Third Parties) Act 1999

The principle laid down in *Ann v LB Merton*, which gave the courts severe problems in distinguishing between 'defect' and 'dangerous defects', soon began to provoke criticism from the courts. In the event, the protection that had been given to subsequent owners of defective buildings lasted less than ten years, before it was removed by two important decisions of the House of Lords.

The first of these cases, *D & F Estates Ltd v Church Commissioners for England*, concerned a block of flats built by Wates in a joint development venture with the church commissioners. Some 15 years after the flats were completed, a tenant discovered that, due to the negligence of sub-contractors (who were described as 'not worth suing'), the walls and ceilings of his flat needed to be completely replastered. The tenant thereupon sued Wates in tort, claiming the cost of remedial work already carried out, the estimated cost of future work (some £50,000) and prospective loss of rent.

In rejecting the claimants' claims, the House of Lords held that a builder's liability in tort is limited to defects which cause either injury to persons or physical damage to property other than the building itself (for example if part of the treatment works falls onto a vehicle owned by UU Water PLC). Damage to the building item itself is regarded as pure economic loss and therefore irrecoverable.

Although the House of Lords in *D & F Estates* was highly critical of *Ann v Merton*, it did not specifically declare the earlier case to have been wrongly decided. Two years later, however, that final step was taken. This was in *Murphy v Brentwood DC*, which concerned a house owner's action against a local authority for having negligently approved what turned out to be inadequate foundations. The House of Lords by now had clearly decided that the time had come for a thorough reform of the law. Their lordships acknowledged that the House's power to reverse its own previous rulings should be used sparingly (to avoid creating too much uncertainty in the law). However, the unanimous view was that this was an appropriate occasion for its use. *Ann* was declared wrong, and the local authority's appeal against liability was successful.

The House of Lords in *Murphy* emphasized that the loss suffered by the owner of a building who discovers defects in it is pure economic loss, which is not normally recoverable in the tort of negligence.

In our example, UU Water PLC will struggle to obtain damages from the contractor for defects after completion. This is because that if the plant has a defect such as concrete spalling in a tank, then this will be seen as 'pure economic loss' and is irrecoverable under the law of tort.

### Collateral Warranties

Before 1999, a solution for UU Water PLC would be found under the use of a Collateral Warranty. Collateral Warranties have seen a large increase in their use over the last ten years or so, as attempts are made to bring remote owners into direct contractual relationships with those against whom they would once have been able to claim in the tort of negligence. The contents of Collateral Warranties vary considerably, the effect of one is that the subsequent / ultimate owner of a building is given contractual rights similar to those that would have been enjoyed by the client if the building had not changed hands. In our case UU Water PLC would obtain a Collateral Warranty from GCJV. Although it is important to note that GCJV is under no obligation to give a Collateral Warranty to UU Water PLC, although this should be addressed at the outset of the contract.

### Rights of Third Parties Act 1999

As we have seen it was a fundamental principle of English contract law that rights and obligations created by a contract were only enforceable by and against the parties to that contract. This principle called 'Privity of contract' has been subjected to heavy criticism over the years. This culminated in 1996 in the form of a Law Commission report, which proposed that it should be substantially overturned. This has now been done by the Contracts (Rights of Third Parties) Act 1999. The central purpose of the Act is to give the right to a Third Party to enforce a term of a contract to which that Third Party is not a party. A Third Party may only enforce a term of a contract if:

- (a) the contract expressly provides that the Third Party may do so; or
- (b) the terms of the contract purports to confer a benefit on that Third Party.

The Act came into existence in November 1999 and after May 2000 the Act applies to all contracts. It is possible for the parties to opt out of the Act, although this needs to be done in the form of express terms in the contract.

The Third Party is only given the right to enforce the specified terms of the contract. For example, the parties to the contract could place a specific limit on the third party's rights, as is commonly done in Collateral Warranties. These could include net contribution clauses or financial limitations on liability.

In our case, UU Water PLC would have had to be included as a Third Party in the original contract and for them to have communicated their assent to the terms for it to have any rights to sue against the contractor. Under the Act, once the third party (in our case UU Water PLC) has notified the Promisor (UU) of their assent to the terms, the contracting parties (UU & GCJV) are no longer allowed, either to rescind the contract, or to vary it so as to affect UU Water's rights, without first obtaining their consent.

As in a standard building contract there is still a limit on time within which claims for damages must be brought. The limitation period for a standard contract is six years and twelve years if the contract is executed as a deed. The duration will usually run from practical completion.

## Key sources of information:

Contracts (Rights of Third Parties)  
Act 1999

Explanatory Notes to Contracts  
(Rights of Third Parties) Act 1999