CONTRACTS FOR THE BENEFIT OF THIRD PERSONS

THE LAW REVISION COMMITTEE'S RECOMMENDATIONS AND THE CIVIL LAW

In its Sixth Interim Report issued in May 1937 The Law Revision Committee in London recommended a most far-reaching limitation on the doctrine of consideration. The main recommendation of the Committee referring to this matter reads as follows :

> That an agreement shall be enforceable if the promise or offer has been made in writing by the promisor or his agent or if it be supported by valuable consideration past or present.[1]

The Committee also adopted certain other recommendations further limiting the doctrine of consideration—a doctrine peculiar only to the Common Law, and one which does not exist in any other legal system. The Law Revision Committee was evidently acting on the opinions expressed by courts and egal scientists as to the value and practicality of this doctrine. It considered but did not adopt the abolition of this doctrine because it was so deeply embedded in English Law that they believed its total abolition would arouse suspicion and hostility. It would seem that but for this reason the Committee was prepared to favour such an abolition in principle. "Many of us," the Report reads "would like to see the doctrine abolished root and branch."[2]

One of the special aspects of this doctrine which the Committee had to consider was the advisability of introducing into the Common Law contracts for the benefit of third parties, enforceable by the third party.

PRESENT STATE OF THE LAW[3]

To begin with the Sixth Interim Report gives a clear exposition of the law regarding these contracts. It has been expressed by Lord Haldane in *Dunlop Pneumatic Tyre Co.* v. *Selfridge & Co.*[4] as follows :

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[1] Law Revision Committee. Sixth Interim Report. Cmd. 5449. par. 29 and 32 and page 31.

[2] *Ibid.*, p. 17.

[3] A thorough study on Contracts for the Benefit of Third Persons has recently been published by Dr. A. M. Finlay. (See a Book Review in 18 Can. Bar Rev. 235). This seems to be the only exhaustive monograph on this subject. It deals not only with the history and the present state of the law but also with the recommendations of the Law Revision Committee. An article on the same subject has been published by Professor A. L. Corbin in (1930) 46 L.Q.R. 12.

[4] [1915] A.C. 847.

"My Lords, in the law of England certain principles are fundamental. One is that only a person who is a party to a contract can sue on it. Our law knows nothing of a jus quaesitum tertio arising by way of a contract. Such a right may be conferred by way of property, as for example, under a trust, but it cannot be conferred on a stranger to a contract as a right to enforce the contract in personam. A second principle is that if a person with whom a contract not under seal has been made is to be able to enforce it, consideration must have been given by him to the promisor or to some other person at the promisors request. These two principles are not recognized in the same fashion by the jurisprudence of certain Continental countries or Scotland, but here they are well established."

This statement of Lord Haldane is based on the rules laid down in older cases such as *Tweddle* v. *Atkinson*,[5] and refers to the cases where the courts were forced to have recourse to the legal fiction of a trust, the promisee being considered the trustee for the third party who was the beneficiary, as in *Tomlinson* v. *Gill*,[6] or *Les Affréteurs Réunis Société Anonyme* v. *Leopold Waldorf (London) Ltd.*[7]

The present state of the law has been very severely criticised both by the courts and by legal writers. Lord Dunedin expressed this criticism very strongly in *Dunlop Pneumatic Tyre Co.* v. *Selfridge & Co.*[8] as follows:—

"My Lords, I confess that this case is to my mind apt to nip any budding affection which one might have had for the doctrine of consideration. For the effect of that doctrine in the present case is to make it possible for a person to snap his fingers at a bargain deliberately made, a bargain not in itself unfair and which the person seeking to enforce it has a legitimate interest to enforce."

A. M. Finlay[9] also expresses the opinion that the present state of the law is not satisfactory. After a searching analysis he states "that the law on this point is confused and doubtful, which . . . . is deplorable. Here and there it is possible to point to cases and say that equity has prevented an injustice that would undoubtedly have resulted from the application of com-

[5] (1861), 1 B. & S. 393.
[6] (1756), Ambler 330.
[7] [1919] A.C. 801.
[8] [1915] A.C. 855.
[9] A. M. Finlay, Contracts for the Benefit of Third Persons, p. 122.

mon law principles, but it cannot be denied that the conflict between the two systems has left in its trail a wholly undesirable element of uncertainty." As to authorities on jurisprudence suffice it to refer to Salmond[10] and to Pound[11] whose criticisms are not less severe.

The Report of the Committee adopts this criticism. First it states that "the Common Law of England stands alone among modern systems of law in its rigid adherence to the view that a contract should not confer any rights on a stranger to the contract, even though the sole object may be to benefit him."[12] Then the Report cites the leading cases on this subject and proceeds: "We feel that this summary of cases . . . . will at least have made one point clear, and that is that the law on this point is uncertain and confused. For the ordinary lawyer it is difficult to determine when a contract right 'may be conferred by way of property' in Viscount Haldane's phrase, and when it may not."[13] "There is an important practical reason for taking this step (*i.e.* legislation on the subject) at the present time. Bankers commercial credits[14] are now playing a leading part in the business world . . . . so that it is highly desirable that no legal doubt should be cast on their validity. It is, to say the least, doubtful whether the third party, namely the seller of the goods, is entitled to sue the banker issuing the credit in the event of a refusal by the latter to honour it."[15]

Jura Quaesita Tertio in the Civil Law

Contracts for the benefit of third parties are familiar to the civil law systems which have never recognized the doctrine of consideration. They knew, however, in earlier statges the rule that only a party to a contract can sue on it. This rule has been abolished only in this century and it is remarkable that the process by which this has been achieved was one very similar to the analogous process of the Common Law. First some statutory exceptions were provided, then the courts granted other exceptions *per analogiam*, sometimes having recourse to similarly inadequate fictions as the trust concept in the Common

[10] Salmond, Jurisprudence, 9th ed., p. 493 *et seq.*
[11] Pound, An Introduction to the Philosophy of Law, 4th ed. p. 236 *et seq.*
[12] Report, p. 25.
[13] *Ibid.*, p. 28.
[14] Finlay, p. 126, points out that the problem which arises for bankers confirmed credits, will not be solved by the Law Revision Committee's recommendations.
[15] Report, p. 28.

Law, finally, legal science recommended the abolition of the rule and the great codifications of this century followed this advice. Some older codes have been amended accordingly, *e.g.*, the rule of the Austrian Code of 1811 against jura quaesita tertio was changed only in 1916.

The Civil Code of Quebec corresponding in this matter with the Code Napoléon stipulates :

C. C. Art. 1029: A Party . . . . . may stipulate for the benefit of a third person, when such is the condition of a contract which he makes for himself, or of a gift which he makes to another; and he who makes the stipulation cannot revoke it, if the third person have signified his assent to it.

C. C. Art. 1030: A person is deemed to have stipulated for himself, his heirs and legal representatives, unless the contrary is expressed, or result from the nature of the contract.

The German Civil Code has created the following rules :

Sections 328: An act of performance in favour of a third party may by contract be stipulated for in such manner that the third party acquires a direct right to demand the performance.

In the absence of express stipulation it is to be inferred from the circumstances, especially from the object of the contract, whether the third party shall acquire the right, whether the right of the third party shall arise forthwith or only under certain conditions, and whether any right shall be reserved to the contracting parties to take away or modify the right of the third party without his consent.

Sections 329–333 contain details referring to third party contracts.

Section 334: Defences arising from the contract are available to the promisor even as against the third party.

Section 335: The promisee may unless a contrary intention of the contracting parties is to be presumed, demand performance in favour of the third party, even though the right to performance is in the latter.

The corresponding sections of the Austrian Civil Code (revised in 1916) provide another version, as follows :—

Section 881: If a person has accepted a promise that something will be performed for a third party the promisee has the right to enforce its performance. Whether and when the third party also acquires the right to compel the performance from the promisor should be determined according to the con-

tract and according to the nature and purpose of the contract. In dubio the third party acquires this right if the performance should accrue to his advantage . . . .

Section 882: If the third party refuses the right acquired by the contract the right is considered as not having been acquired.

The promisor has all the defences arising out of the contract against the third party.

The Recommendations of the Committee

In this article we are concerned only with two of the recommendations made by the Committee, namely :

(1) "That a promise shall be enforceable by the promisee though the consideration is given by or to a third party."

(2) "That where a contract by its express terms purports to confer a benefit directly on a third party, it shall be enforceable by the third party in his own name subject to any defences that would have been valid between the contracting parties. Unless the contract otherwise provides, it may be cancelled by the mutual consent of the contracting parties at any time before the third party has adopted it either expressly or by conduct."

The first of these two recommendations purports to regulate the cases where a person who is a party to the contract but not to the consideration cannot enforce the contract because the consideration has not moved from him. The Report gives this example :

"A, B and C are all parties to a contract. A promises B and C to pay £100 if B will do a certain piece of work desired by A. A declines to pay the £100 and C cannot compel him to do so. C is a third party to the consideration but not to the contract." The Report "sees no reason either of logic or of public policy why A who has got what he wanted from B in exchange for his promise should not be compelled by C to carry out that promise merely because C, a party to contract, did not furnish the consideration." Therefore the abolition of this rule is recommended.

It is perfectly clear from this illustration what the first recommendation above cited means. But it seems that this is not so clear from the text of the recommendation itself without the commentary given by the Report. The term "third party" is used there as "third party to the consideration" or rather

as "a person who is a party to the contract but not to the consideration." If we consider the same term "third party" as used in the second recommendation in the sense of "third party to the contract and to the consideration" it might be advisable —should there be legislation—to amend the first recommendation of the Committee by adding at the end the words "to the consideration who is a party to the contract" or in some similar way.

The example cited by the Report is a case where the consideration is given "by a third party". The recommendation mentions also the case when the consideration is given "to a third party". For example: A, B and C are all parties to contract. A promises B and C to pay a sum of money to C if C will do a certain work for B. It would seem that this case is covered already by the rule in *Dunlop Pneumatic Tyre Co.* v. *Selfridge & Co.*[16] which reads: "A second principle is that if a person with whom a contract not under seal has been made is to be able to enforce it, consideration must have been given by him to the promisor *or to some other person at the promisor's request*". But in *Vandepitte* v. *Preferred Accident Insurance Corporation of New York*,[17] Lord Wright has stated: "No doubt at common law no one can sue on a contract except those who are contracting parties and—if the contract is not under seal—from *and between* whom consideration proceeds. This rule is stated by Lord Haldane in *Dunlop Pneumatic Tyres Co.* v. *Selfridge & Co.*" There is a contradiction. Lord Wright refers expressly to the rule stated by Lord Haldane in *Dunlop Pneumatic Tyre Co.* v. *Selfridge & Co.* But there Lord Haldane has stated that the consideration may move from the promisee to the promisor *or to some other person at the promisor's request*, while Lord Wright in *Vandepitte* v. *Preferred Accident Insurance Corporation of New York* states that the consideration has to move from *and between* the promisor and the plaintiff, *i.e.* the promisee. It may have been this uncertainty of language which induced the Law Revision Committee to include in their recommendation the case when the consideration is moving "to a third party."

As F. A. Vallat[18] points out, the first recommendation would be unnecessary if the doctrine of consideration were abolished. According to the Committee's general recommendation on the

[16] [1915] A.C. 847.
[17] [1933] A.C. 79.
[18] *Law Reform in England*, 2 University of Toronto Law Journal, at p. 252.

doctrine of consideration, it (*i.e.*, consideration) would be necessary only if neither the promise nor the offer has been made in writing by the promisor or his agent. Should the second recommendation of the committee be enacted the common law would be enriched by the subject of contracts for the benefit of a third party.

This recommendation requires that the benefit for the third party should be conferred by the "express terms" of the contract. This requirement seems to indicate that the third party should acquire the right to sue in his own name only where there is no doubt that the intention of the contracting parties was to confer this right upon the third party. The requirement stipulated by the Committee plays the same role as do rules of evidence or presumptions which we can find in some codes in connection with jura quaesita tertio *e.g.*, Art. 1030 of the Civil Code of Quebec, corresponding to sec. 1122 of the Code Napoleon as above cited. This presumption of the French law that *in dubio* it should be deemed that the parties wanted to stipulate for themselves and not for the benefit of a third party is introduced by the Committee not in the form of a presumption but by the requirement of a certain form, *i.e.*, that the benefit for the third party should be conferred by the express terms of the contract. It seems that this formulation is very efficient, in any case much better than the presumption of sec. 881 of the Austrian Code above cited which seems to favour the existence of a contract for the benefit of a third party. This does not fill the needs of practice, as Ehrenzweig[19] shows, because in the ordinary case a party will usually contract for his own benefit, and contracting for the benefit of a third party is an exception from the normal case. On the other hand Ehrenzweig states very clearly that the intention of parties contracting for the benefit of a third person usually is to secure *the performance* for the third person without considering whether this third person should or should not acquire the irrevocable right to ask performance in his own name. The contracting parties usually are not interested in this question. This was the concern of the Austrian legislators in setting such a wide presumption for the existence of a contract for the benefit of a third party and also of the German Civil Code whose stipulation is more careful.

[19] EHRENZWEIG: SYSTEM DES ÖSTERREICHISCHEN ALLGEMEINEN PRIVATRECHTES, 7th ed., para. 319.

The most important question as to the right acquired by the third party is *at what time* the third party should acquire his irrevocable right to claim performance of the contract concluded for his benefit. There are several possible solutions for this problem.

The third party may acquire this right as soon as the contract has been concluded. If we consider that the acquisition of this right also means that the contracting parties—from this moment—cannot change the contract and cancel the right acquired by the third person, it is obvious that this solution would not always satisfy the contracting parties, especially the promisee, who might wish to reserve for himself the right to change the contract (with the consent of the promisor) *e.g.*, to change it into a contract for the benefit of the promisee himself. Actually—as far as we know—no legal system stipulates that the third party acquires his right at once, *i.e.*, at the conclusion of the contract.

There are, however, in all legal systems provisions made by statute for special cases where for very important reasons the third party acquires this right at once, *e.g.*, in the law of insurance.

Another solution is the solution of the Austrian law. It does not state a definite rule but makes the judge decide this question "according to the contract and to the nature and the purpose of the contract". This solution has proved unsatisfactory as has also another solution adopted by the Hungarian (Custom) civil law, *i.e.*, the acquisition of the right by the third party on the giving of notice by him.

The Law Revision Committee has adopted the rule laid down by the Code Napoleon and the Swiss Code. The contracting parties may cancel the contract or the right of the third party by mutual consent at any time before the third party has adopted it. This adoption of the right by the third party certainly is the suitable moment for the acquisition of the irrevocable right by the third party. There is no reason why this right should be acquired at an earlier moment, but it should not be acquired at a later moment because that would lead to uncertainty as to the position of the third party. If the contracting parties wish to make special arrangements as to the time or as to special conditions for the acquisition of the right by the third party they must do it in the contract itself or before the third party has adopted the right, otherwise the general rule applies. In practice the promisor will usually not be

interested in the question as to whether he has to perform to the third party or to the promisee. As a matter of fact it has become quite usual in civil law countries for the contracting parties to agree in the contract that the promisee himself should have the right to stipulate (without any further consent of the promisor) whether and when the promisor should perform to the third party. In other words the promisee remains by this contractual agreement the "dominus" of the contract. This is economically quite understandable because he is usually the person who pays the promisor for his promise. The same thing can be done under the recommendation of the Committee, because the stated general rule applies only "unless the contract otherwise provides".

As the promisor has against the third party all defences that would have been valid between the contracting parties, he could, of course, raise against the third party's claim the objection that there has been no consideration given by the promisee to the promisor for the latter's promise to do something for the third party. If there were not such consideration the right of the third party against the promisor would not be enforceable, because there is no special stipulation as to the relationship between the contracting parties and the general rule, therefore, applies. According to the Committee's recommendations as to the requirement of consideration in general such a consideration would not be necessary if the promise or the offer had been made in writing by the promisor or his agent.

This leads to two other problems. The first is a very wide one and cannot be dealt with here, but can only be indicated. The recommendation of the Committee referring to consideration will create—if made law—a new class of enforceable contracts without consideration. As F. A. Vallat[20] points out the Committee have not recommended in any case that a bare promise should be enforceable. In the normal case the element of agreement is still to be required to constitute an enforceable obligation. That means that no bare written promises but only promises in the form of an agreement between the contracting parties can create an enforceable obligation, even if there is no consideration. Where is the boundary line between the non-enforceable promise on the one hand and the promise made in the form of an agreement without any consideration moving from the promisee to the promisor—on the other hand? Will it be possible to make any promise enforceable by putting it in

[20] *Supra*, note 18.

the form of a written agreement? Or will the Common law be forced—if simple contracts without consideration are to be enforceable—to adopt at least the civil law theory of *causa*.[21] This is a complicated problem which will have to be dealt with by the courts if the recommended legislation is enacted.

The second problem arising in this connection is but a reflection of the first problem projected upon contracts for the benefit of a third party. The question arises: Can any promise which is intended to be made to A. be put in the form of a contract (without consideration) concluded with B. for the benefit of A? Will it become possible to conclude a contract for the benefit of a third party with a strawman in order to make a bare promise (to the third party) enforceable? This is a question which cannot be easily answered. There is such a risk in the recommended legislation. But it is also quite possible that the Common Law would adopt a similar view as to this question as did the courts of civil law countries, namely, that only a person, who is economically interested in the contract may conclude a contract for the benefit of a third party.[22] It is obvious that usually the promisee pays for the acquisition of the right for the benefit of the third party and that this payment is the legitimation for his acceptance of the promisor's promise.[23] As far as the Common Law is concerned it might become a little difficult to stipulate such requirements, when *simultaneously* the requirement of consideration under certain precautions is abolished; contracts for the benefit of third parties recognized; and the recommended amendments say nothing at all about the question. This problem will have to be solved either by the legislation itself or by the courts by developing or interpreting the new legislation proposed by the Committee. The formulation by statute of a rule to avoid the described danger might be very difficult, perhaps even undesirable.

We may be permitted to point out that the dangers of abuse indicated above cannot detract from the value of the recommendations made by the Law Revision Committee. The recommended legislation as to the partial abolition of consideration and as to contracts in *favorem tertii* show how difficult it

[21] The Report on p. 17 points out: "The French Civil Code recognizes "cause" as an element in a contract, but this requirement, which seems to refer either to the motive underlying the making of the contract or to the purpose of which it is made, appears to be largely academic in character." See as to "cause" SALMOND ON JURISPRUDENCE, 9th ed., p. 495.

[22] *Supra*, note 19, para. 319, p. 200.

[23] *Ibid.*

is to introduce into the Common Law conceptions of the Civil Law, even if it is—as in the present case—both desirable and necessary to do so.

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