

A Brief Discussion on Privity of contract

Bhavana Chandran

Assistant Professor, Department of Law, Presidency University, Bangalore, India,
Email Id-bhavana.chandran@presidencyuniversity.in

ABSTRACT:

A key premise of contract law that establishes the rights and responsibilities of parties to a contract is the idea of privity of contract. It describes the legal connection that solely exists between the parties to the contract, i.e., none of the parties' third parties. Even though a contract may directly impact a third party, the theory of privity of contract limits that party's capacity to enforce or assert rights under the agreement. Privity of contract was tightly upheld in the past, prohibiting other parties from taking advantage of or enforcing contractual duties. To lessen the severity of the concept and provide for specific circumstances when third parties may have a genuine interest in the contract, exceptions and revisions have been put in place throughout time. The idea of "privity of estate," which enables a person who develops an interest in the contract's subject matter to enforce the contract, was introduced as an exception to privity of contract. Additionally, a number of laws and legal precepts have been implemented to provide rights and safeguards for specific third parties, including contracts for the benefit of third parties, rights transfers, and beneficiaries of trusts. There are several uses for the privity of contract notion. By enabling parties to choose the parameters of their contractual relationships without intervention by unaffiliated third parties, it supports the freedom of contract. By reducing the number of possible parties who may enforce a contract or be held accountable under it, it also offers some degree of clarity and predictability.

KEYWORDS:

Collateral Contracts, Legislative Exceptions, Predictability, Privity Rules.

I. INTRODUCTION

A key idea in contract law known as privity of contract regulates the rights and duties resulting from a contractual agreement. In order to enforce a contract's terms and take advantage of its provisions, all parties must be included in the contract. This is referred to as the legal connection between the parties to a contract. The concept of privity of contract states that an agreement's rights and obligations belong only to the parties who entered into it and are not automatically extended to third parties. Because it specifies the parameters of contractual responsibilities, the privity of contract notion is crucial. It makes sure that the parties have control over how the contract is enforced and carried out and that their rights and remedies are safeguarded. Privity of contract precludes other parties from interfering with or depending on the terms of a contract to which they are not a party, which adds a level of clarity and predictability to contractual interactions [1], [2].

However, in certain circumstances, privity of contract may also impose restrictions and pose difficulties. Even if individuals have a genuine interest in the execution of the contract, it may limit their capacity to enforce the agreement or seek compensation for breaches. Due to this restriction, some mechanisms and exceptions have been created, allowing for a limited amount of third parties' participation in contractual concerns. Examples of these mechanisms and exceptions include assignment and the theory of promissory estoppel. The legal connection between the parties to a contract is determined by the basic contract law concept known as privity of contract. It offers a framework for carrying out contractual responsibilities and assures that contractual rights and obligations are solely owned by those who have entered into the agreement. Although privity of contract may result in restrictions, processes and exceptions have been created to accommodate instances when third parties are involved. For parties to fully understand their rights, duties, and the scope of their contractual relationships, they must have a clear understanding of privity of contract [3], [4].

II. DISCUSSION

The privity rules

Remembering that a contract is fundamentally an agreement between two parties, check Chapter 2's definition of a contract for further information. Viscount Haldane articulated the basic rule regarding claims against parties in *Dunlop Pneumatic Tyre v. Selfridge* (1915). If we take a scenario in which a contract is established between two parties, A and B, it is simple to see the reasoning behind this. It would be quite unjust for A or B to be permitted to sue C if the contract's terms required him to fulfil obligations, and he didn't. Principle unquestionably dictates that a burden should not be placed on a third person without his permission, according to Steyn LJ. This is simple to accept since none of us would want to carry a load without first consenting to it. Therefore, if the contract put advantages on C rather than responsibilities, he could not sue A or B if they violate it, according to the same rationale (albeit possibly a bit more difficult to accept). This is seen in Figure 1.

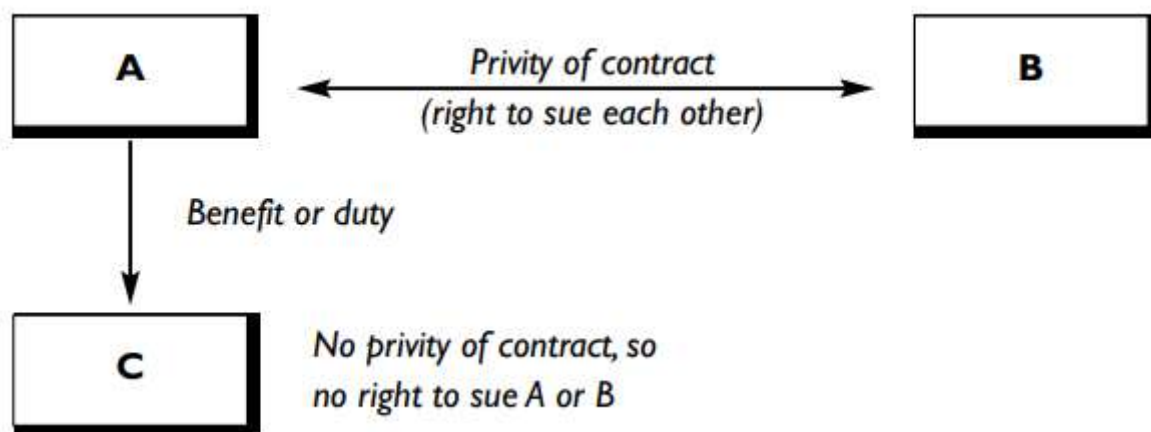


Figure 1: Benefit or duty [hzu.edu.in].

In contrast to A and C or B and C, we remark that there is no privity of contract between A and B. C is considered a "stranger" to the contract since she hasn't contributed anything to it. This supports the notion that a contract is a transaction in which both parties stand to win. The theory was upheld by the House of Lords in the case of *Dunlop Pneumatic Tyre v. Selfridge* (1915), and it is very closely related to the idea of consideration shifting away from the promisee (see *Tweddle v. Atkinson*, p. 149). This legislation makes sense and, in theory, promotes fairness. The bigger issue is the legal philosophy. The law at the time was not what Lord Denning had in mind; rather, it was what he believed the law ought to be. As expected, the House of Lords did not like his adopting this stance since it did not follow tradition, and they brought up this issue's discussion in the next case [5], [6].

Similar to *Tweddle v. Atkinson*, if a same circumstance occurred today after the passage of a laws, the law may be different. In reality, there has been a shift towards recognising claims that theoretically fell under the theory of privity even before the current amendment to the law by legislation, if to deny them would be unfair. This was the case in *Linden Gardens Trust v. Lenesta Sludge Disposals* (1994), where the first owners of a construction site were permitted to sue the builders for damages after a breach, even if the real injury was experienced by the buildings' subsequent owners. Undoubtedly, the new owners need a solution, and it was only fair that the claim's original creators be given the opportunity to do so. A lot of exceptions have been made to the law of privity since there were so many issues with it. These have developed because legislation is obviously needed, and they demonstrate that the concept itself was not entirely sufficient.

Established exclusions from the privity of contract doctrine

Legislative exceptions

There are many of them, for instance:

1. The Married Women's Property Act of 1882 enables a spouse or children to profit from a life insurance policy that is established in their behalf.

2. They now have the authority to enforce a contract to which they were not the original parties as a result.
3. The Law of Property Act of 1925 permits the assignment of contractually derived property rights.
4. The Road Traffic Act of 1988 holds whomever issues insurance to a driver accountable for paying not just the driver but also others insured by the policy, such as a third party whose automobile the driver damages, in the case of an accident.

This last exemption is evidently necessary because, in the case of the Road Traffic Act, unwary members of the public would be left unprotected against traffic in a congested area if the contracts of insurance were not enforceable.

Agency

A common law exception to the idea of privity is agency, which occurs when one person acts as another's agent (typically for convenience in business). The principle (person A) authorises the agent (person B) to represent him in dealings with person C. Typically, the principal has the right to sue the third party. In actuality, the principal and his agent, A and B, are regarded as a single entity for the purposes of forming contracts, with third party C serving as the other party. This is explained in Figure 2.

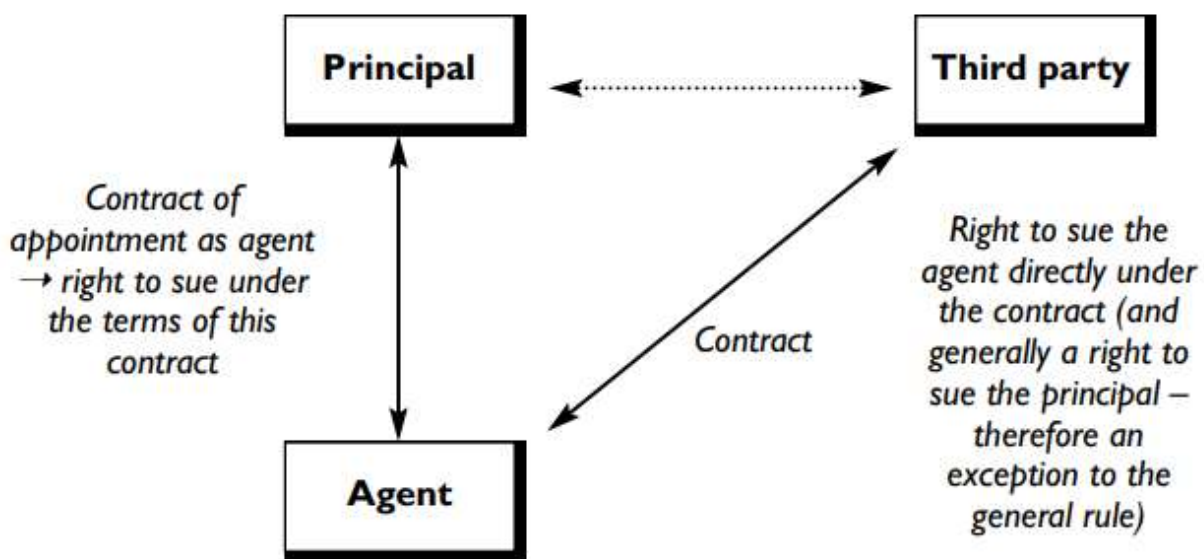


Figure 2: Principal may sue the third party [hzu.edu.in].

Collateral contracts

Additional contracts that exist in addition to the main or major contract are referred to as collateral contracts, collateral agreements, or side agreements. They are additional contracts between one of the original parties to the primary contract and a third party, and they have the potential to change the rights and duties of those parties [7], [8]. Following are some crucial ideas about collateral contracts:

1. **Independence:** Collateral agreements stand alone as distinct legal agreements and are independent of the primary agreement. They are often entered into to provide one party in the primary contract extra guarantees or inducements.
2. **Contract formation:** Collateral agreements may be made verbally or in writing. Both the person making the collateral promise and the party receiving the benefit of that promise must agree to them and take them into account [9], [10].
3. **Relationship to the primary Contract:** A collateral contract's conditions and commitments are related to and reliant upon the provisions of the primary contract. Additional promises, assurances, warranties, or guarantees pertaining to the performance or conditions of the primary contract are often included in the collateral contract.
4. **Privity of transaction:** Even though the third party is not directly engaged in the primary transaction, collateral contracts establish a distinct contractual connection between the person making the

commitment and the third party. This indicates that the promise-making party may be subject to the third party's power to enforce the provisions of the collateral contract [11], [12].

5. **Breach and Remedies:** The third party beneficiary may be entitled to legal recourse if a party breaks a collateral contract. In addition to any other remedies provided under the primary contract, they may demand monetary compensation or specific performance for the violation of the collateral contract.
6. **Importance of Clear Communication:** The terms and circumstances of collateral contracts must be communicated and documented accurately in order to prevent misunderstanding or disagreements. The provisions of the collateral agreement should be compatible with the terms of the primary contract, and the parties should make sure that everyone involved has a clear understanding of it.

The parties to the original contract may get extra security and guarantees via collateral contracts. They provide one party the opportunity to make certain commitments or assurances to others that may not be covered by the primary contract. For the purpose of managing contractual relationships and making sure that the rights and duties of all parties concerned are appropriately handled, it is crucial to comprehend the nature and consequences of collateral contracts.

Covenants which run with the land

Covenants that run with the land are legal stipulations or assurances affixable to the ownership or possession of a particular piece of property. Both the present owner of the property and any potential future owners or tenants are bound by these covenants. They "run with the land" in the sense that they are enforceable against succeeding owners and have the potential to affect how the property is used, enjoyed, or maintained. In relation to covenants that run with the land, keep in mind the following:

1. **Privity of Estate:** In order for a covenant to run with the land, the parties must have a privity of estate connection. The relationship between a property's subsequent owners or tenants is referred to as privity of estate. In spite of the fact that they were not original covenant parties, it permits the covenant to be enforced against succeeding owners or occupiers.
2. **Touch and Concern the Land:** A covenant must "touch and concern" the actual land in order for it to be considered binding. As a result, the covenant must be directly applicable to the property and have an impact on how it is used, enjoyed, or valued. The covenant shouldn't have a solely private focus.
3. **Intention and Language:** Language used in the initial contract or deed should reflect the parties' purpose to establish a covenant that runs with the property, and this aim must be evident. The text should clearly express the parties' aim for the covenant to bind and hold the future owners accountable.
4. **Notice:** To be enforceable against future owners or tenants of the land, the covenant must be made known to them in advance. Depending on whether the covenant is documented in public records or is clearly visible on the land, this may either constitute actual notice (knowing of the covenant) or constructive notice.
5. **Enforceability:** Covenants that attach to the land may be upheld by legal proceedings or remedies like injunctions, compensation, or specific performance. The party requesting the enforcement of the covenant must show that the covenant is valid and that the accused violation has broken its conditions.

Examples: Restrictions on property use, such as "residential or commercial use only," maintenance duties, such as "maintaining a fence or landscaping," and prerequisites for paying dues or fees to a homeowners' association are a few examples of covenants that run with the land.

It's vital to keep in mind that depending on local laws and regulations, the enforcement and extent of covenants that run with the property may change. It is necessary to get legal advice and research local property laws in order to fully comprehend the particular ramifications and enforcement of these covenants in a particular country.

Attempts to avoid privity of contract other than the established exceptions

The legal connection that exists between the parties to a contract, enabling them to pursue the rights and responsibilities resulting from that contract, is known as privity of contract. Although the necessity of privity of contract is a basic premise, there have been several efforts to ignore or go around it. To establish legal duties between the parties that are different from the primary contract, the parties may engage into collateral contracts, commonly referred to as side agreements or separate agreements. These collateral contracts get around the privity

requirement by allowing a third party to profit from the commitments or pledges made by one of the original parties.

In certain circumstances, trusts are utilised to bypass contractual privity. An official arrangement known as a trust allows one person, the trustee, to keep and manage property on behalf of another, the beneficiary. The beneficiary may enforce the contract despite not being a direct party by putting the rights and responsibilities under a trust. Agency ties are a further means of avoiding privity. One party may engage into contracts on behalf of another if they are acting as the principal's agent. Even if they are not a direct party to the contract in these situations, the principal may nonetheless enforce it.

Contractual duties and rights may be transferred to a third party via assignments and novations. A party may assign its rights under a contract to another party, who can subsequently use those rights to take legal action against the other original party. Novation entails the replacement of one party with another, with the new party taking on all duties and responsibilities under the agreement. In certain countries, the privity requirement may be exempted under certain conditions thanks to legislative laws. Even though they are not directly privy to the deal, these regulations permit third parties to enforce contractual rights. For instance, regulations governing consumer protection may provide customers' rights to those that weren't involved in the original transaction.

It's crucial to remember that efforts to prevent privity of contract may have restrictions and might change based on the legal system and certain situations. These methods' accessibility and enforcement might vary greatly. Legal counsel should be sought by parties trying to establish rights or uphold responsibilities under a contract without privity, and they should take local laws and regulations into account.

III. CONCLUSION

The idea of privity of contract, which establishes the rights and responsibilities of parties to a contract, is a key premise in contract law. The legal connection that only exists between the parties who directly entered into the contract is known as privity of contract, and it limits the power of other parties to enforce or be obligated by the terms of the contract. The freedom of contract concept and the idea of privity of contract both seek to safeguard the independence of the contractual parties. It acknowledges that parties need to have authority over the conditions and commitments they make, and it forbids third parties from meddling in contractual arrangements. According to the concept, only the parties to a contract have the authority to make changes to it or seek compensation for a violation. This implies that a third party normally cannot file a lawsuit to enforce the contract, even if they may profit from it or have a stake in how it is carried out.

REFERENCES

- [1] L. Zhao, "FOB seller under Chinese law and privity of contract in carriage of goods by sea," *Asia Pacific Law Rev.*, 2019, doi: 10.1080/10192557.2019.1699311.
- [2] J. Köpke, M. Franceschetti, and J. Eder, "Balancing Privity and Enforceability of BPM-Based Smart Contracts on Blockchains," in *Lecture Notes in Business Information Processing*, 2019. doi: 10.1007/978-3-030-30429-4_7.
- [3] C. Turner, "Third party rights and privity of contract," in *Contract Law*, 2019. doi: 10.4324/9781315879659-5.
- [4] J. Arcari, "Decoding Smart Contracts: Technology, Legitimacy, & Legislative Uniformity," *Fordham J. Corp. Financ. Law*, 2019.
- [5] H. R. Damayanti, A. S. Yunita, and M. L. Aprilia, "Arbitration Agreement to Non-Signatory Parties in Indonesia," *Notaire*, 2019, doi: 10.20473/ntr.v2i2.14494.
- [6] K. Sobel-Read, G. Anderson, and J. Salminen, "Recalibrating Contract Law: Choses in Action, Global Value Chains and the Enforcement of Obligations Outside of Privity," *SSRN Electron. J.*, 2019, doi: 10.2139/ssrn.3315752.
- [7] G. C. Silva, "Between galaxies and the code: Contractual networks and the contours of the privity of contracts," *Civilistica.com*. 2018.
- [8] C. MacDonald, "Not 'all natural': Modernizing privity to allow breach of contract claims for mislabeled food products," *Iowa Law Review*. 2018.
- [9] J. Salminen, "The accord on fire and building safety in Bangladesh: A new paradigm for limiting buyers' liability in global supply chains?," *Am. J. Comp. Law*, 2018, doi: 10.1093/ajcl/avy030.
- [10] O. Omolaja, "Comparative Analysis of the Laws of Delaware and U.K Company Law on Enforcement of Pre-Incorporation Contracts," *SSRN Electron. J.*, 2018, doi: 10.2139/ssrn.3117638.
- [11] B. Akbari, "The Position of the UN Conventions to Determine and Guarantee Human Rights," *J. Polit. Law*, 2017, doi: 10.5539/jpl.v10n3p38.
- [12] M. E. Storme, "A civilian perspective on network contracts and privity," in *George Washington Law Review*, 2017.