

IT & Internet - United Kingdom

Implications of the Contracts (Rights of Third Parties) Act 1999

April 18 2000

What Will the Act Do?

Exemptions

Implications

Avoidance

When Did the Act Come into Effect?

The Contracts (Rights of Third Parties) Act 1999 received royal assent on November 11 1999. The act ends the well-established doctrine of privity of contract, whereby only a party to a contract can enforce one of its terms. It is predicted that the act will have a significant effect on commercial contracts in general, and on the information technology (IT) sector in particular.

What Will the Act Do?

The act will allow a person who is not a party to a contract (ie, a third party) to enforce a term within the contract when (i) the contract expressly states that he can, or (ii) the term in question purports to confer a benefit on him and the parties to the contract intend the third party to be able to enforce the term.

A third party must be expressly identified in the contract, either by name, class or description, but does not have to be in existence at the time the contract is made. So benefits can be conferred on, for example, a company that has not yet been incorporated.

The act permits a third party to take advantage of an exclusion or limitation clause in the contract in addition to positive benefits.

Exemptions

Certain contracts are excluded from the ambit of the act. The most important exemption is for contracts of employment. A third party, therefore, will never be able to enforce a term of an employment contract against an employee.

Implications

The act is not retrospective and will therefore not apply to existing contracts. Many organizations, however, use standard terms and conditions which will have been drafted on the basis that privity of contract exists. These will need to be re-evaluated in the light of the act (i) to ensure that they do not unintentionally grant rights to third parties that could expose them to claims, and (ii) to explore how they might make use of the new rules in their contractual arrangements.

The act will potentially have a large impact on the information technology industry, as the following examples show:

- Software developers will be able to benefit from licence terms for their own software in a contract between a reseller and an end-user. In other words, the act could be used to legitimize 'shrink-wrap' contracts.
- In large-scale IT projects where sub-contractors are used, the customer may have rights directly against the sub-contractor. However, customers should be wary of relinquishing legal rights against the main contractor.

- Parent companies will be more willing to enter into large-scale procurement or outsourcing contracts on behalf of their group companies, knowing that any losses sustained by a group company (covered by the parent's contract) will no longer be irrecoverable.
- The act could also assist companies sending data outside the European Economic Area (EEA). The Data Protection Act 1998 prohibits the transfer of personal data outside the EEA to any country with inadequate data protection controls. One way of legitimately transferring personal data is to use a contract and require the data importer to protect personal data. However, these contracts have not been able to give individuals whose data are affected rights against the importer. The act will assist here and make the Data Protection Registrar more likely to accept that the contracts are effective.

Avoidance

The effects of the act can be avoided by ensuring that no express rights are granted in a contract and by inserting some wording into the contract to the effect that the parties do not intend to grant any rights to third parties. A suggested form of wording is:

"Nothing in this Agreement confers or purports to confer on any third party any benefit or any right to enforce any term of this Agreement."

When Did the Act Come into Effect?

The act came into effect on November 11 1999, the day it was passed. For six months from this date, it will only apply to a new contract if the contract expressly provides for its application. After this six-month period, the act will apply to all new contracts.

For further information on this topic please contact Samantha Smith at Bird & Bird by telephone (+44 207 415 6000) or by fax (+44 207 415 6111) or by e-mail (samantha.smith@twobirds.com).

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