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A Critical Analysis of the Doctrine of Privity of Contract

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ABSTRACT

The doctrine of privity finds its genesis from the common law principle and is one of the most debated subjects under the Law of contracts. The ambiguity behind the legal position is not solely because of the absence of clarity in the statute or dissenting verdicts but also the academic and judicial discourses that are associated with the genesis of the doctrine. The Indian Law defines the subject broadly as compared to English Law. Herein, according to the Law of contracts, a third party can be awarded damages if the infringement is proved and if that party comes under the scope of 'intended beneficiary' who has reciprocal obligations under the contract. The paper critically scrutinizes the vast kaleidoscopic range and convoluting nuances of the doctrine with the help of favouring as well as dissenting judicial pronouncements in India and England and elaborates cogently upon the essential features of the doctrine. Furthermore, it also highlights the scope of its application and certain exceptions like the rule of estoppel, acknowledgement and so on, wherein a stranger can enforce his/her rights (sue or claim damages) even without being a party to the contract.

Keywords - Contract, Doctrine of Privity, Consideration, Rights

I. INTRODUCTION

Under the Indian Contract Act, section 2(h) mentions that a contract is an agreement between two parties enforceable by Law and backed by some consideration. The essence lies in the promise that both parties have made with each other for fulfilling their part of the contractual obligation.

The principle of privity of the contract states that a contract cannot confer rights or impose duties and obligations arising under it to any person who is not a party and that only those persons who are parties to the contract can enforce the same. In other words, the doctrine of privity debars the third party from enforcing a contract, and the rational consequence is that a stranger cannot acquire rights under a contract.² For instance, if there is a contract between A

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² R.K. Bangia, Indian Contract Act 60 (Allahabad Law Agency, Faridabad, 9th Edition, 2000).

and B, thereby conferring some benefit upon X, X cannot file a suit to enforce the contractual obligations because A and B are the only parties to the contract, whereas X is a stranger to the contract. The rule of privity finds its genesis from the ‘**interest theory**’, which implies that solely the individual having an interest in the contract is entitled to protect his rights.

Under English Law, the doctrine makes it clear that a third party is neither tied by contractual liabilities nor can be considered as entitled to claim the benefits arising out of the contract. At times, the doctrine has often posed myriads of challenges and has come under scrutiny for being superficial and opposing to the intention of the parties to benefit a third party. Therefore, the courts have resorted to certain exceptions such as a right conferred by way of property as, for example, in the nature of trust to allow a third party to enforce a benefit conferred upon it. For instance, in the decision of privy council in *Khwaja Muhammad Khan v. Husaini Begum*³, it was held that the basis of the plaintiff’s claim being a specific charge on an immovable asset in her favour, she is entitled to claim the same and proceed in equity to enforce it despite not being a party to the erstwhile contractual agreement.

II. ESSENTIALS TO THE DOCTRINE OF PRIVACY OF CONTRACT

There are four main important ingredients of the privity of contract⁴-

- **The contract between two parties:** It is imperative that a contract be concluded between two or more parties.
- **Competency of parties and valid consideration:** The competence of parties and presence of a valid consideration act as the sine qua non for the doctrine’s application
- **Eventual breach of contract by one of the parties:** The doctrine can only be applied in cases of breach of contract by one of the parties
- **Only parties in the contract can sue each other:** Each of the parties bound by the contractual obligations has the right to sue each other for breach of contract.

III. TYPES OF PRIVACY OF CONTRACT

There are mainly two types of privity of contract-

- **Horizontal privity of contract:** Herein, the beneficiary is a third party and not one of the individuals participating in the said contract.

³ (1910) 12 BOMLR 638.

⁴ S. Pavithra, ‘Doctrine of privity of contract- Meaning, Types, Essentials, Exceptions’, June 22, 2021, available at <https://lawcorner.in/doctrine-of-privity-of-contract-meaning-types-essentials-exceptions/> (last visited on 17 November, 2021).

- **Vertical privity of contract:** All signatories to an agreement here, on the other hand, stand to be entitled to the benefit directly arising out of the same contract.

IV. COMPARATIVE ANALYSIS BETWEEN INDIAN LAW AND ENGLISH LAW

The general rule under the doctrine of privity is similar under both the Indian and English Law, the only difference being the fact that in India, a person who is a stranger to the consideration can sue, whereas, in England, he cannot.

- **English Law-** In *Tweddle v. Atkinson*⁵, it was held that since the plaintiff was both a stranger to contract as well as the consideration, he could not enforce the claim. The rule of privity was also reaffirmed in the case of *Dunlop Pneumatic Tyre Co. Ltd. v. Selfridge & Co.*⁶ *Ltd.* by the house of lords stating that the principle of “*Jus quaesitum tertio*” arising by way of the contract was unknown to the English Law and that rights can be conferred by way of the property but not on any stranger to the contract as a right to enforce the contract in personam. However, in recent years, the rule of privity has eroded, and third-party beneficiaries have been allowed to claim damages for breaches of the contract despite not being a party to it and the recent legislation of the Contract (Rights of third parties) Act, 1999 buttresses the aforementioned argument.⁷

- **Indian Law-** Under the Indian Contract Act, the definition of consideration is broader than under the English Law, yet the common law doctrine is generally applicable in India, and the authority for this application was established in the decision of the Privy council in *Jamna Das v. Avtar Singh*⁸. Moreover, in the landmark decision of *Advertising Bureau v. C.T. Devaraj*⁹, it was reiterated that there being no privity of contract between the advertiser and the financier, the suit by the advertiser against the financier was bound to be dismissed. However, in some cases, the ‘consideration may move from the promisee or any other person’ as in *Chinnaya v. Rammayya*¹⁰, wherein it was held that the sister of the old lady was entitled to maintain the suit despite her being a party to the same as the consideration moved from the old lady for her sister to the daughter.¹¹

⁵ (1861) 1 B & S 393.

⁶ (1915) A.C.847, at 853, per Lord Haldane.

⁷ Rishabh Soni, ‘Doctrine of privity of contract’, March 14, 2019, available at <https://blog.ipleaders.in/doctrine-of-privity-of-contract/> (last visited on 16 November, 2021).

⁸ (1911) 30 I.A.7.

⁹ A.I.R. 1995 S.C. 2251.

¹⁰ (1882) I.L.R. 4 Mad. 137.

¹¹ Sankalp Jain, ‘Rule of Privity of Contract: Study in English and Indian Context’, July 3, 2014, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2461688 (last visited on 17 November, 2021).

V. CRITICAL ANALYSIS OF THE RULE OF PRIVITY WITH JUDICIAL PRECEDENTS

Position in England was that the rule of privity of contract was strongly rooted in the English Common Law but still was generally criticized in a number of cases like *Beswick v. Beswick* (1949) wherein Lord Denning observed-

“Where a contract is made for the benefit of a third person who has a legitimate interest to enforce it, can be enforced by the third person in the name of the contracting party or jointly with him or, if he refuses to join by adding him as a defendant because the third person has an interest which the law should protect.”

The case also reflects that reform, as was suggested by the Law Revision Committee in 1937, is long overdue, and if the legislature takes any step in this regard, that would hardly be revolutionary. Similarly, the doctrine came under scrutiny in the case of *Darlington BC v. W.S. Northern Ltd.* (1995), wherein the judgment recaptured that-

“There is no doctrinal, logical or policy reason why the Law should deny effectiveness to a contract made for the benefit of the third party where that is the expressed intention of the parties. It is, therefore, unjust to deny the effectiveness of such a contract.”

Moreover, Lord Simond once duly mentioned the fact that if the principle of “*Jus quaesitum tertio*” is to be introduced into the English Law, it must be done by the Parliament post a due consideration of its merits and demerits.

On the contrary, **in India**, there has been no provision in the Contract Act either in affirmation or in rejection of this contentious rule. There has been a great amount of differing views in Indian courts as to how far a stranger to a contract can enforce it. There is a huge repository of observations and rulings in favour of the doctrine. For instance, in *Krishna v. Pamila Bala*¹², the lordships observed-

“There is no doctrinal, logical or policy reason why the Law should deny effectiveness to a contract made for the benefit of the third party where that is the expressed intention of the parties. It is, therefore, unjust to deny the effectiveness of such a contract.”

The Apex court has also expressed its views in favour of the privity rule in the judgment of *M.C. Chacko v. State Bank of Travancore*¹³. Herein, it was held that the State bank of Travancore, not being a party to the deed, could not enforce the covenants and was bound by them. It was further stated that it is a settled law that a person who is not a party to the contract

¹² AIR 1928 Cal 518.

¹³ AIR 1969 SC 504.

cannot enforce its terms. Another case of *Harman Singh v. Purbi Devi*¹⁴ held that the brother of the contracting party could not enforce the agreement of sale of land.

Decisions against the rule have also been given, thereby elaborating the line of thinking based upon the observation of the privy council in *Khwaja Muhammad Khan v. Hussaini Begum* (supra). Moreover, several High courts have enunciated upon the rule that the Indian courts are not bound by the principle laid down in the *Tweddle v. Atkinson case* (supra). The Calcutta High court observed in *Kshirode Behari v. Mangobinda*¹⁵ that there is no provision in the Indian Contract Act either for or against the rule and nor there is anything that prevents the recognition of a right in a third party to enforce a contract made by others which contains a provision for that party's benefit.

Recently, the Calcutta High Court in *Raymond Woolen Mills Ltd. v. Coal India Ltd*¹⁶ observed that the doctrine of privity of contract has undergone a change, and therefore, the principal as a beneficiary under a contract (between his agent and third party) can initiate a lawful action against the third party without being a party to the contract.

It has often been observed that the established rule of privity of contract has caused considerable injustice inconvenience and has provoked criticism by the judges, academicians and law reform agencies alike.¹⁷

VI. EXCEPTIONS TO PRIVACY OF CONTRACT

There are certain exceptions to the rule that a stranger to a contract cannot sue. They are as follows-

- **Acknowledgement/admission/conduct/estoppel:** There are certain cases where there is no privity of contract between the two parties, but if one of them by way of their conduct, acknowledgement or admission recognizes the right of the other to sue them, then they may be liable on the basis of the Law of estoppel. Such an acknowledgement may be expressed or implied. In the case of *Narayani Devi v. Tagore Commercial Corporation Ltd*¹⁸, it was held that the defendants had created such privity with the plaintiff by their conduct, acknowledgement and admission that the plaintiff is entitled to her action even though there

¹⁴ AIR 2000 HP 108.

¹⁵ AIR 1934 Cal 682.

¹⁶ (1998) 1 CALLT 382 HC

¹⁷ Mushtaq Ahmad, 'Doctrine of Privity of Contract and Consideration', available at http://law.uok.edu.in/Files/5ce6c765-c013-446c-b6ac-b9de496f8751/Custom/1588375419391_PRIVITY%20OF%20CONTRACT%202020-fnl.pdf (last visited on 17 November, 2021).

¹⁸ AIR 1973 Cal 401.

was no privity of contract between the plaintiff and the two defendants. Moreover, in another ruling of *Kshirodebehari Datta v. Mangobinda Panda* (supra), acknowledgement had generated the right to the third party to enforce the contract between the parties. There are several other instances wherein a third party can seek relief against a promisor on the grounds of promissory estoppel principles.

- **Insurance:** As the doctrine stipulates, no one except the parties to the contract can claim for rights and be heavily burdened with liabilities. However, the exception to this case is an insurance contract wherein if a person who has insured his life dies, his/her relatives can claim the insured amount despite not being a party to the aforementioned contract. The verdict in *Tattersall v. Drysdale*¹⁹ best describes this exception.

- **Covenants on land:** Modifications to the rule of privity can occur by the principles governing the transfer of immovable assets. The principle laid down in the landmark case of *Tulk v. Moxhay*²⁰ is that an individual who purchases land with the notice that the owner of the land is bound by certain duties established by an agreement or a covenant affecting the land shall be bound by them despite him not being a party to the agreement.

- **Agency:** In some exceptional cases, if the agent enters into a contract with a third party on behalf of his principle, then that authorized contract is regarded by Law as having been made by the principle himself/herself. Therefore, he/she can sue on it and be sued on it as well.

- **Trust of contractual rights/beneficiary under a contract:** Indian Law has recognized this exception through the landmark judgement of *Khwaja Muhammad Khan v. Husaini Begum* (supra). It stipulates the fact that a person in whose favour an interest in some specific property is created may enforce it despite not being a party to the contract. For example, in a contract between A and B, a beneficial right with respect to some property might be created in favour of a third party, i.e. C. Thereby, C can enforce his claim based upon the rights conferred upon him. The claim in favour of a beneficiary in the nature of trust was also recognized by the Calcutta High Court in *Narayani Devi v. Tagore Commercial Corporation Ltd.* (supra). Similarly, in England, “trust” has been used as a device for holding the promiser to his promise, as in the case of *Gregory & Parker v. Williams* (1817).

- **Provision for marriage expenses or maintenance under a family arrangement:** When the contract is intended to secure a benefit to a third party, in the case of a family arrangement, he/she may sue in one’s own right as a beneficiary. In the case of *Veeramma v.*

¹⁹ (1935) 2 K.B. 174.

²⁰ (1848) 41 ER 1143.

Appayya (1955), it was held that the daughter was entitled to sue for the specific performance in her favour. Similar is the stance when at the time of partition, the parties to it agree to incur marriage expenses of a female, who is not a party to the contract as it has been observed in the case of *Sundaraja Aiyangar v. Lakshmiammal*²¹. Furthermore, in *Manali Singhal v. Ravi Singhal*²², it has also been held that under a family setup between husband and wife for providing maintenance to the wife, the contract cannot be hit by section 25 on the ground that there is an absence of consideration.²³

VII. CONCLUSION

The doctrine of privity of contract refers to the fact that a contract cannot confer rights or impose obligations/liabilities arising out of it on any individual except the parties to it. This principle stems from the common law theory. However, due to the emergence of myriads of complexities, exceptions have been enumerated in the legal provisions. Despite the many challenges posed by the doctrine of privity, it is still believed that it cannot be simply discarded through the process of judicial decree for its wholesale abolition might result in severe repercussions exceeding beyond the ability of the courts to anticipate and address. However, even with its growing unpopularity, the judiciary has come up with innovative ways to tackle it. To cull out the gist, there is a labyrinth of legal predicaments put forth by the principle, which vary on a case to case basis, and the courts will have to take resort to certain exceptions permitting the third party to sue to safeguard their interest.

²¹ (1915) 38 Mad. 788.

²² AIR 1999 Delhi 156.

²³ Supra note 2.