CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

This Act presented a radical change in the law in potentially enabling a person who is not a party to a contract to enforce a term within it.

PURPOSE OF THE ACT

Until the introduction of this Act, only parties to a contract were entitled to enforce its terms. This Act, however, provides that a "third party" who is not a party to a contract, but who is expressly identified in it by name, class or description, may be able to enforce a term within the contract either if the contract expressly says so or if that term "purports to confer a benefit" on that third party.

The application of the Act can be excluded and this is what tends to happen in contracts where it might have an impact, but once a third party's rights under a contract have arisen, the Act will not allow them to be removed without the third party's consent. Great care should therefore be taken before entering into a contract in considering whether any third party rights are likely to arise under it.

IMPACT OF THE ACT ON BROKERS

It is easy to overlook the extent of contractual relations that a broker may have, because all too often these contracts are oral rather than in writing - both oral and written contracts are affected by the Act. When a client asks its broker to arrange cover, and the broker agrees, a contract is formed. Likewise, if a broker suggests that the client purchases a type of cover and the client agrees that the broker should obtain it for him, a contract is formed. If that broker instructs another broker to place cover on behalf of the insured, there will be another contract between the two brokers.

The potential effect of the Act is well illustrated by looking at a situation where there is a client insured/producing broker/placing broker chain. In this scenario it is unlikely that any contractual relationship will exist between the insured and the placing broker. Before this Act, if a problem arose with the arranging of cover on its behalf, the insured's only likely

recourse would be against the producing broker. As that broker would, however, be liable not only for its own errors and omissions, but also for those of the placing broker which it had instructed as its agent, the insured, in the normal course of events, would have an adequate remedy.

Where a difficulty could arise for the insured was if the producing broker became insolvent or had insufficient assets (or insurance) to meet the insured’s claim: the insured would be unable to look to other contractual remedies because it didn't have a contract with the placing broker. The Act potentially opened up a whole new area for an insured in these circumstances, enabling it to enforce term(s) within the contract that exists between the two brokers on the basis that it is a third party to whom a benefit is conferred under it - that benefit being the arrangement of insurance on its behalf. In other words, if the producing broker was financially worthless, the insured could now go directly against the placing broker.

Another area where the Act could have an impact on brokers is where a client instructs a broker to place insurance cover of a type which may subsequently be assigned to some other party. Again, a contract will be formed between the broker and the client who has asked for the cover to be placed. Before the Act, the party to whom the insurance was assigned would step into the shoes of the original client and replace him as a party to the insurance contract with the insurer. That new insured would not have any involvement in the contract between the broker and the client, and so could not pursue the broker for a contractual remedy if some problem arose with the insurance cover which had been placed. The Act changed all of that, potentially enabling such a new insured to enforce a term in the contract between the broker and original client as a third party to whom a benefit is being conferred - that is the arrangement of insurance which will be assigned to him. If that insurance is defective in some way the new insured may be able to pursue a claim against the broker.

These opportunities, presented to insureds by the Act, seem not to have been exploited by many in such situations to date. This may well be because the parties to the contracts concerned have excluded the application of the Act from the relevant contracts, at the time they are entered into.

STEPS WHICH A BROKER CAN TAKE

There are a number of steps which brokers can take to address the potential impact of the Act. These are:

- when entering into contracts with other parties, consider whether these contracts could be taken to construe a benefit on a third party which can be identified from the contract. Where a broker is in a chain of one or more additional intermediaries, the answer to this will invariably be yes. If the answer is yes, these contracts could be dangerous if not amended to exclude third party rights;

- encourage the practice of putting any oral contracts into writing using, where possible, standard terms of business/engagement - it will be very difficult indeed to persuade a Court that an oral contract has excluded the effect of the Act;

- consider including the following provisions in written contracts (and include them in your standard terms):

    - "this contract does not, and is not intended to, confer or create any right enforceable by any person who is not a party to the contract"; and

    - "the parties to this contract reserve the right to amend or rescind the contract without giving notice to, or requiring the consent of, any third party."

RISK MANAGEMENT MESSAGE

It is always preferable to record agreements reached between parties in writing. This Act provides another strong incentive for brokers to do so. It clearly has the potential to increase the scope of brokers' liability exposure and yet this is largely avoidable by forward planning. A clear written record at the outset of the rights and obligations of the parties to an agreement, together with provisions as outlined above to exclude the effect of this Act, should provide a sound foundation for the business being conducted.

Managers: Griffin Managers
Regis House
45 King William Street
London EC4R 9AN
Telephone 020 7407 3588
Facsimile 020 7403 3942
Email griffin@triley.co.uk

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