

# IT BYTES

## ANSWERING YOUR COMMON IT CONTRACT LAW QUESTIONS

# WHEN CAN A RELATED ENTITY BRING A CLAIM UNDER A CONTRACT?



### WHEN DOES THIS QUESTION TEND TO ARISE?

It is common for IT contracts to be entered into for the benefit of a corporate group. In such arrangements, the contract will in effect purport to confer rights on third parties that are related to the contracting entity. However, privity of contract may prevent the related entity from directly enforcing the contract. In these cases, various other enforcement options may need to be considered.

### WHAT DOES THE LAW SAY?

The privity of contract doctrine states that only the parties to a contract are legally bound by and entitled to enforce it. In *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107, the High Court established one key exception in that a third party covered by a contract of insurance may enforce the contract even if not themselves a party. However, the common law has resisted finding any other exceptions and the doctrine of privity is firmly entrenched in the common law of Australia.

Nonetheless, there are structures that can be adopted to allow group members to enforce a contract to which they are not a party, or at least to allow the contracting party to enforce the contract on behalf of other group members. Below are some examples:

OPTION	CONCEPT	OPERATION	COMMENTARY
<b>Agency</b>	<p>The contracting party (the <b>agent</b>) may enter into the contract as agent for its group members (the <b>principals</b>).</p> <p>Where an agent enters into a contract on behalf of a principal, the principal can sue or be sued on the contract as the principal is the true party to the contract with the agent acting merely as an instrument on behalf of the principal. Allowing the principal to sue does not deviate from the privity doctrine.</p>	<p>An agency clause will need be included in the contract stating that one party is entering the contract on its own behalf and as agent for each of its group members.</p> <p>Each group member will need to appoint the contracting entity as its agent and authorise the agent to act on its behalf to affect its rights and duties to the contract counterparty. This will require some form of intra-group agreement.</p>	<p>This option has the benefit of providing legal certainty. However, in practice it can be cumbersome as it requires each group member to appoint the contracting entity as its agent, which may require additional documentation.</p> <p>In addition, the effect is that each group member is in fact a party to the contract and may be exposed to claims under the contract. This needs to be carefully thought through, including in relation to the liability regime under the contract, in order not to create any unintended consequences and inadvertently expose the broader corporate group to additional liability.</p>
<b>Trust</b>	<p>The contracting party may hold the benefit of the contract, including the right to sue under the contract, on trust for its group members.</p>	<p>For a contract to create a trust, an express intention to create one must be apparent on the face of the contract, or inferred by the court. It will usually be beneficial to have an express provision to the effect that the contracting entity holds the benefit of the contract on trust for its group members.</p> <p>In such a case, following a breach of the contract, the contracting party as trustee will be entitled to enforce the contract on behalf of its beneficiaries. If the trustee refuses to do so, a third-party beneficiary may, by proceedings in equity against the trustee, compel the trustee to enforce the contract or otherwise the beneficial bring proceedings and join the trustee as defendant. Enforcement will be for the benefit of the beneficiary.</p>	<p>This mechanism will ensure that all group members receive the benefit of the contract. However, it also means that the contracting entity will have fiduciary obligations to the group members (e.g. acting in the best interests of group members and avoiding conflicts between its own interests and the group members' interests, which could for example cause issues in relation to rights of the contracting entity to agree to amendments to the contract). There may also be additional formalities that need to be observed in some jurisdictions for the trust to take effect, including potential application of stamp duty.</p>
<b>Tort</b>	<p>Where a group member suffers economic loss arising out of the negligent performance of a contract entered into by one of its related entities, they may be able to establish a claim under tort law if they are able to establish that:</p> <ul style="list-style-type: none"> <li>• there was a duty of care</li> <li>• the supplier breached this duty of care</li> <li>• the economic loss suffered was caused by the breach</li> </ul> <p>As these claims would be based on a claim in tort rather than contract, the doctrine of privity will not apply.</p>	<p>Where the elements of negligence claim are satisfied, the group member that has suffered economic loss could bring a proceeding against the supplier.</p>	<p>The circumstances in which an action in tort could apply may be more limited compared to agency and trusteeship. This is because the individual group member must establish that a duty of care is owed to it by the supplier, which may not be straightforward if the contract itself doesn't contemplate that the benefit of the supplies made under it being extended to other parties. Generally speaking, it is also more difficult to obtain relief for economic loss compared to instances where negligent conduct results in some personal injury or property damage.</p> <p>While a claim in tort may be made outside of the contract, the terms of the contract will still need to be considered – for example, the contract may require the contracting party to ensure that no direct claims are brought by its group members in relation to the subject matter of the contract, in order to avoid the risk of undermining the liability framework agreed in the contract.</p>
<b>Statute</b>	<p>In Queensland, Western Australia and the Northern Territory, legislation has modified the privity doctrine to allow third party beneficiaries to enforce contractual obligations.<sup>1</sup></p>	<p>In Queensland and the Northern Territory, if a promisor (who has received valuable consideration from the promisee) promises to do or refrain from doing an act for the benefit of a beneficiary and the beneficiary accepts that promise, then the beneficiary may enforce the contract directly.</p> <p>In Western Australia, where a contract expressly purports to confer a benefit on a third party, the contract is enforceable by that third party in their own name.</p>	<p>In order to rely upon this exception, it will be important to specify the governing law that the contract is to be governed by. In addition, the contract will need to be drafted in a way that satisfies the requirements of the relevant legislation. For example, the Western Australian legislation cannot be relied upon unless the third party is named as a third-party beneficiary or is otherwise identifiable.</p>

<sup>1</sup> Property Law Act 1974 (Qld), s 55; Property Law Act 1969 (WA), s 11; Law of Property Act 2000 (NT), s 56.



### WHAT ARE THE IMPLICATIONS FOR YOUR CONTRACT?

If you are entering a contract with the intention of conferring rights on a third party, it is important ensure that the contract is structured in a way that will give effect to that intention. This will require consideration of the various options mentioned above, and careful drafting to ensure that the selected option is implemented appropriately. Supplemental documents (e.g. agency agreements) may also be required to give effect to your chosen structure. Finally, you will need to think carefully about how other provisions in the agreement will work if there are multiple beneficiaries – in particular, you will need to consider how any liability caps and exclusions apply across all beneficiaries, such as whether they apply collectively or to each beneficiary individual.

### KEY CONTACTS



KIRSTEN BOWE

PARTNER  
BRISBANE

TEL +61 7 3244 8206  
MOB +61 409 460 861  
EMAIL kirsten.bowe@au.kwm.com



BRYONY EVANS

PARTNER  
SYDNEY

TEL +61 2 9296 2565  
MOB +61 428 610 023  
EMAIL bryony.evans@au.kwm.com



MICHAEL SWINSON

PARTNER  
MELBOURNE

TEL +61 3 9643 4266  
MOB +61 488 040 000  
EMAIL michael.swinson@au.kwm.com

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