PRIVITY OF CONTRACT AND THE CONTRACTS (MALAY STATES) ORDINANCE, 1950

Kepong Prospecting Ltd. v. *Schmidt* [1]

Kepong Prospecting Ltd. v. *Schmidt* is the first case to raise the question whether the English doctrine of privity of contract is applicable under section 2(d) of the Contracts (Malay States) Ordinance, 1950.[2] The section reads:

> . . . when at the desire of the promisor, the promise or *any other person,*[3] has done or abstained from doing, or does or abstains from doing, something, such act or abstainence or promise is called consideration for the promise.

The first appellant, Kepong Prospecting Ltd. was a company incorporated on 27 July 1954 to take over the benefit of a prospecting permit in respect of some mining rights belonging to one Tan. Tan had obtained the permit with the assistance of the respondent, Schmidt, an engineer, and had agreed to pay him one per cent of the selling price of all ore sold from the mine. On 31 July 1954, Tan entered into an agreement with the appellant company by which the appellant was

6. The Privy Council agreed with the trial judge that the procedure had been defective, being in contravention of the rules of natural justice.
7. [1965] 2 M.L.J. 51 at p.54.

1. [1968] 2 W.L.R. 55.
2. The Contracts (Malaya States) Ordinance, 1950 is based on the Indian Contracts Act, 1872. This applies only to the nine Malay States viz. Perak, Selangor, Negri Sembilan, Pahang, Johore, Kedah, Kelantan, Perlis and Trengganu. It is misleading for the Privy Council in the instant case to refer to the position under the Ordinance as "... the law in Malaysia..." [1968] 2 W.L.R. 55 at p.62.
3. Italics added.

to take over the obligation to pay Schmidt the one per cent tribute. Subsequently, in 1955 a further agreement was made between the appellant and Schmidt which contained a clause by which the appellant company agreed to pay Schmidt the tribute as agreed in the 1954 agreement.

The Privy Council held, *inter alia,* that although the 1954 agreement was made between Tan and the appellants and that Schmidt was therefore not a party to it, nevertheless the 1955 agreement (to which Schmidt was a party) was a perfectly valid agreement and superseded the 1954 agreement. Accordingly, Schmidt was entitled to his claim for the payment of all moneys due to him under both agreements.

The interest in the case does not lie in the actual decision itself but rather in the Privy Council's interpretation of section 2(d) together with paragraphs (a), (b), (c) and (e) of the Ordinance.

It is noteworthy that the Ordinance itself does not expressly provide for the privity doctrine. On the other hand, the definition of "consideration" is wider than that of English law as it enables consideration to move from a person other than the promisee. The Federal Court of Malaysia did not allude to the Ordinance but but simply adopted the doctrine established in *Dunlop Pneumatic Tyre Co. Ltd.* v. *Selfridge.*[4] On appeal, the Privy Council agreed with the conclusion of the Federal Court that the doctrine applied but only arrived at this after an examination (though briefly) not only of section 2(d) but also the following paragraphs:

2(a) When one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to such act or abstainence, he is said to make a proposal;

(b) when the person to whom the proposal is made signified his assent thereto, the proposal is said to be accepted: a proposal, when accepted), becomes a "promise";

(c) the person making the proposal is called the "promisor", and the person accepting the proposal is called the "promisee";

(e) every promise and every set of promises, forming the consideration for each other, is an agreement; . . .

It is respectfully submitted that these paragraphs simply define "proposal", "promise", "promisor", "promisee" and "agreement" and do not lay down the rule that only parties to the contract can sue upon it. However, the Privy Council overlooked paragraph (i) which would appear to be more pertinent. It states:

> ... an agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract.

This suggests that the Ordinance does contemplate that only parties to the contract can have any rights under it. But does section 2(d) leave any doubt as to the contrary? One way out of this difficulty is to argue that "consideration" and "privity" are two separate doctrines. If this is accepted, as it is now in England, then support for the doctrine of privity can still be maintained despite paragraph (d). For the paragraph only deals with the definition of consideration.

The Privy Council relied on the statement of John Beaumont C.J. in the Bombay case of *National Petroleum Co. Ltd.* v. *Popatlal*[5] where his lordship held that the definition of consideration under section 2(d) of the Indian Contracts Act (which is verbatim the Malay States counterpart) does not involve the proposition that a third party can sue upon the promise.

It may now be said that that the doctrine of privity is firmly established not only in the Malay States but also in India. Apart from the generally recognised exceptions

4. [1915] A.C. 847. The Federal Court's decision is reported in (1964) 80 M.L.J, 416.

5. A.I.R. 1936 Bom. 344. There are conflicting Indian decisions but it was pointed out to the Privy Council in the instant case that on balance, authority is in favour of the view that a stranger to the contract cannot without more sue to enforce the contract.

to privity as understood in English law, it may be worthy to note two Privy Council decisions from India which contemplate a further exception to the doctrine as applied in India. The type of agreements which the Privy Council had in mind was that pertaining to family management. Thus, in *Khwaja Muhammad Khan* v. *Husaini Beguan,*[6] the Privy Council observed: [7]

> ... in India and among communities circumstanced as the Muhammadans, among whom marriages are contracted for minors by parents and guardians, it might occasion serious injustice if the common law doctrine [doctrine of privity] was applied to agreements or arrangements entered into in connection with contracts.

This *dictum* was approved by another Privy Council decision, *Mt. Djan. Kuer* v. *Mt. Sarla Devi,* when it said:[8]

> ... it is too late, in their lordships' opinion, to doubt the rule which has prevailed in India that where a contract is intended to secure a benefit under a family arrangement, he may sue in his own right to enforce it.

It would thus seem that insofar as family arrangements are concerned, the doctrine does not apply. Perhaps, it may be submitted as a general proposition that the criterion for the application of the doctrine should be whether or not it would work injustice in particular circumstances. But in the case of a commercial contract such as the present one, no injustice would ensue from the application of the doctrine.

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6. (1910) L.R. 37 I.A. 152; 7 I.C. 237. In that case *C* sued her father-in-law A to recover arrears of certain allowances under an agreement made between *A* and *C*'s father prior to and in consideration of *C*'s marriage with *A*'s son *D*. The agreement created a charge in favour of *C* on certain immovable property belonging to A for the payment of the allowance. The Privy Council held that a trust had been created in favour of *C* and she was thereby entitled to claim.

7. (1910) L.R. 37 I.A. 152 at p.158-159.

8. I.R. 1947 P.C. 8 at p.15.