

Contract (Third Party Rights) (Scotland) Bill

Explanatory Notes

Introduction

1. As required under Rule 9.3.2A of the Parliament's Standing Orders, these Explanatory Notes are published to accompany the Contract (Third Party Rights) (Scotland) Bill, introduced in the Scottish Parliament on 31 January 2017.
2. The following other accompanying documents are published separately:
 - statements on legislative competence by the Presiding Officer and the Cabinet Secretary for Justice (Michael Matheson MSP) (SP Bill 5–LC);
 - a Financial Memorandum (SP Bill 5–FM);
 - a Policy Memorandum (SP Bill 5–PM).
3. These Explanatory Notes have been prepared by the Scottish Government in order to assist the reader of the Bill and to help inform debate on it. They do not form part of the Bill and have not been endorsed by the Parliament.
4. The Notes should be read in conjunction with the Bill. They are not, and are not meant to be, a comprehensive description of the Bill. So where a section, or a part of a section, does not seem to require any explanation or comment, none is given.

The Bill

5. The Bill reforms the common law known as *jus quaesitum tertio* which enables parties to a contract to create an enforceable right in favour of a third party, replacing the common law with a statutory version.

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Commentary on sections

The structure of the Bill

6. The Bill contains 15 sections. Section 1 sets out the circumstances in which a person who is not a party to a contract acquires a third-party right. Section 2 provides further detail about the creation of a third-party right. Section 3 provides contracting parties with the right to modify or cancel the third-party right. Sections 4 and 5 set out the exceptions to the general modification and cancellation rule. Section 6 provides the circumstances in which an undertaking becomes irrevocable. Section 7 sets out the remedies available to a third party and section 8 the defences available against a third party. Section 9 provides a mechanism whereby any arbitration agreement between the contracting parties can operate in respect of third party rights. Section 10 enables a third party to renounce their right. Section 11 provides that a third-party right is an obligation arising from the contract for the purposes of the Prescription and Limitation (Scotland) Act 1973 and that the right prescribes after the short negative prescriptive period of five years. Section 12 abolishes the common law rule known as *jus quaesitum tertio*. Section 13 applies the provisions of the Bill only to those third party rights created after commencement, unless the contract provides otherwise. Section 14 deals with commencement and section 15 sets out the short title of the Act.

Section 1 – Creation of a third-party right

7. This section sets out the essentials necessary for the creation of a statutory third-party right.

8. Subsection (1) states that the contracting parties may create a right in favour of a person who is not a party to the contract. It sets out two requirements: first, the contract must contain an undertaking that one or more of the contracting parties will do or not do something for that person's benefit. (This requirement is further discussed in section 2(5) and (6).) Additionally, the contracting parties must intend that the person is to be able to enforce or otherwise invoke the undertaking. (This guards against accidental or incidental benefits qualifying as third party rights.) Subsection (5) specifies the time at which the contracting parties' intention is to be measured.

9. Subsection (2) defines the third-party right as the right of the third party to enforce or otherwise invoke the undertaking in the contract. Generally, the third party will wish to enforce the right but there will be

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cases where it is more appropriate to talk about the right being invoked, especially where it consists of an immunity from liability.

10. Subsection (3) sets out a further requirement for the creation of a third-party right, namely that the intended beneficiary must be identifiable from the contract either by name, or alternatively by way of description (e.g. “the subsidiaries of [a named company]”, or “the spouse or civil partner of a member of the [named] pension scheme”).

11. By subsection (4), the right may come into existence at a future date if, at the time the undertaking is entered into, the person who is named or (more typically) who answers a particular description has either not yet come into existence or does not yet fall within that description. By these subsections, it is open to the contracting parties to describe the class of persons who are to have a third-party right. For instance, a company may want a contract with an IT supplier to confer third-party benefits on other companies in the same group, including ones which may become part of the group in the future; or contracting parties may wish to provide rights for as yet unknown sub-contractors to be employed during the course of the main contract.

12. Section 1 is to be read in conjunction with the general Scots law rules of contract. For example, it is competent, save in specified situations, to make an oral contract; hence there is no requirement that the undertaking be written. Equally, since – as a general principle – the existence of a right is dependent on there being a right-holder, no right arises until (in the case of a person identified in the contract by name) such a person comes into existence or (in the case of a person identified by description) there is a person answering the relevant description.

Section 2 – Creation: further provision

13. This section gives further detail about the creation of a third-party right.

14. Subsection (2) provides that the undertaking can be dependent on something happening or not happening. This applies whether or not it is certain that the thing will or will not happen. In this way, the third-party right may be future (i.e. it is dependent on the occurrence of an event which is certain to happen) or conditional. In the latter case, the general law of conditions applies; thus the condition may be suspensive, that is the

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existence of the right is suspended pending the occurrence of an event which may or may not happen, or resolute, when the right comes into existence but will be brought to an end on the occurrence of an event which may or may not occur.

15. An example of a suspensive condition is given by the case of *Love v Amalgamated Society of Lithographic Printers of Great Britain and Ireland* 1912 SC 1078. Mr Love's employer operated a benefit scheme for dependants of sick employees, and there was a mechanism for changes to be made to the scheme. Mrs Love's eventual entitlement to benefits was thus dependent on her husband falling sick (which is classified as the fulfilment of a suspensive condition, as her right is suspended until the condition is met). For an example of a resolute condition, the case of *Kelly v Cornhill Insurance Company Ltd* 1964 SC (HL) 46 serves as an illustration. The son's right under his father's insurance policy had come into existence once his father granted permission but could have been brought to an end at any time by the permission being withdrawn.

16. Subsection (3) provides that there is no requirement that the contracting parties' intention to create a third-party right be express. It can also arise by implication, if the contract is interpreted as having that meaning. The usual rules for interpreting contracts apply to this exercise.

17. Under the common law of *jus quaesitum tertio*, as set out almost a century ago in *Carmichael v Carmichael's Executrix* 1920 SC (HL) 195, the right must be irrevocable before it can come into existence; a central plank of the Bill is to reverse that position. Subsection (4)(a) does so, by making it clear that the existence of a third-party right is not reliant on it being uncancelable or unmodifiable.

18. Subsection (4)(b) removes any doubt which might exist under the current law on *jus quaesitum tertio* as to whether the creation of a third-party right is dependent on the undertaking having been delivered, intimated or otherwise communicated to the third party. Delivery, intimation or communication will be strong indicators of the contracting parties' intention to create a right in a person's favour, but they are not a necessary step. The subsection is to be read with subsection (7), which signals that any special rules on the creation of obligations must be followed. For example, where the Requirements of Writing (Scotland) Act 1995 applies then the Bill is subject to that Act.

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19. Subsections (5) and (6) provide that an undertaking to indemnify a person, or to limit or exclude a person's liability, may be treated as a third-party right. In certain fields, such as in sectors of the oil industry, it is common to have agreements to hold third parties harmless, and these subsections remove any doubt that such agreements would fall within the Bill's scope.

Section 3 – Contracting parties' freedom to alter third party's entitlement

20. Subsection (1) builds on the freedom enjoyed by contracting parties under section 2(4)(a), which removes the current common law bar on creating a third-party right unless it is irrevocable. Subsection (1) creates an express freedom for contracting parties to modify or cancel an existing third-party right unless (by subsection (3)) any of the exceptions in sections 4 to 6 applies.

21. Subsection (2) provides that contracting parties remain free to declare that a third-party right cannot be modified or cancelled. In some situations, a third party may require a declaration of irrevocability to enable it to enter into obligations of its own; this section clearly allows for such action to be taken.

Section 4 – Third Party's entitlement not subject to retroactive change

22. This section, and sections 5 and 6, are exceptions to the general rule in section 3(1), which allows the contracting parties to modify or cancel a third-party right.

23. Subsection (1) contains a rule as to when a third-party right can, and cannot, be modified or cancelled after it has been created. Its effect is that a right may not be modified or cancelled once any conditions to which its enforcement was subject have been fulfilled. (As an example, see the discussion of *Love* in the note to section 2(2) above.) If, however, the contract provides that the undertaking may be modified or cancelled with retroactive effect, i.e. after the right has crystallised, then that provision overrides the general rule.

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Section 5 – Effect of giving third party notice of undertaking

24. This section provides that – subject to specific exceptions mentioned in the following paragraph – no account is to be taken of the modification or cancellation of an undertaking once the undertaking has been notified to the third party by a contracting party. The Bill does not define what amounts to notification, but it is to be assessed objectively.

25. The exceptions are in subsections (3) and (4). The first provides that, at the point of notification, the undertaking remained conditional. The second applies either where the third party was told by the contracting party, at notification, that the cancellation or modification may still be made, or where the third party agreed to the modification or cancellation.

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Section 6 – Undertaking in favour of a third party cannot be affected by modification or cancellation of contract after it has been relied on

26. Subsection (2) provides that a third-party right becomes irrevocable (i.e. no modification or cancellation will be effective) where the five events in subsection (1) have occurred. The steps are:

- a person has a third-party right;
- the person either does something, or refrains from doing something, in reliance on the right;
- as a result, the person suffers a material adverse effect;
- the contracting parties either acquiesced in the person's action (or inaction) or it was reasonably foreseeable that the person would act (or not act) in that way; and
- only subsequently is the right modified or cancelled.

27. This scheme is closely modelled on that in section 1(3) and (4) of the Requirements of Writing (Scotland) Act 1995, which is sometimes known as the doctrine of statutory *rei interventus*, or 'detrimental reliance'.

28. The effect of subsection (2) is overridden (by subsections (3) and (4)) in two situations: first, where the third party knew or ought to have known before acting that the contracting parties were expressly entitled, under their contract, to modify or cancel the undertaking despite the third party relying on it to its prejudice and, second, where the third party has agreed to the modification or cancellation of the undertaking.

29. Subsection (5) provides that the section replaces any claim which a person would otherwise have had at common law under the rules of personal bar or waiver.

Section 7 – Remedies available to a third party

30. Section 7 specifies what remedies a third party has in the event of its right being breached (which would include reasonably anticipated breach). A breach may be reasonably anticipated when one party to a contract becomes aware of the fact that the other party to the contract has no intention of performing their contractual obligations. At common law, a third party has a wide range of remedies, including the ability to sue for payment

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and to seek specific implement. Under the current law there is a long-standing doubt as to whether a third party has a right to claim damages. This section is included in order to remove such doubt by providing, in subsection (2), that a third party is entitled to any remedy to which a contracting party would be entitled under the contract were the undertaking in favour of that party (instead of the third party).

31. Subsection (3) allows the contracting parties to make contrary provision in their contract. They may exclude, restrict, or even extend the available remedies, if they wish.

Section 8 – Defences available against a third party

32. Section 8 deals with defences which may be raised against a claim by the third party in respect of its right. This would arise typically where the third party claims that the right has been breached. The provision supplements any direct defences available against the third party (e.g. the latter's duress or misrepresentation).

33. The section makes clear that the contracting party is entitled to assert any defence to which a contracting party would be entitled against any other contracting party, provided that the defence is also relevant to the undertaking in the third party's favour. That proviso is added in order to deal with situations in which the contract is (for example) frustrated or involves illegality which, however, does not affect the third-party right as such.

34. Subsection (3) provides that contrary provision as to defences may be made in the contract. This will allow parties to tailor the applicable regime to their own circumstances.

Section 9 – Arbitration

35. Section 9 provides a mechanism by which any arbitration agreement between the contracting parties can operate in respect of third party rights. Arbitration is governed in Scotland by the Arbitration (Scotland) Act 2010. Section 9 creates the conditions necessary so that that Act can apply where appropriate. In doing so, two fundamental features of an arbitration must be borne in mind: first, that only parties to the arbitration agreement can participate in the arbitration (though there are limited exceptions to this) and, secondly, that no party can be compelled to submit to arbitration unless it has signed a valid arbitration agreement. The first of these bars

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the third party (who is, by definition, not a signatory to the arbitration agreement) from participating; section 9(1) overcomes this by deeming such a person to be a party to the arbitration agreement in specified circumstances (as discussed below). The second feature is the requirement for consent.

36. For section 9 to apply at all there must be an arbitration agreement in the contracting parties' contract providing for the submission of disputes to arbitration. The circumstances in which a third party may have an interest in that arbitration agreement are set out in subsections (2) and (3). There are only two of them, and they are mutually exclusive. The circumstances can best be described in terms of the type of dispute which may arise.

37. Subsection (2) covers disputes about a substantive third-party right. This will be the typical situation. For example, the third party may have the right to be indemnified by a contracting party against specific types of claim for which the third party is found liable. If a dispute arises in connection with that indemnity (and the main contract requires contractual disputes, including disputes about the undertaking in the third party's favour, to be submitted to arbitration) then the third party must submit the dispute to arbitration if it wishes to pursue it. Alternatively, if a contracting party raises a court action against the third party in respect of such a dispute, the latter may seek a sist of the legal proceedings. The basis of the third party's ability either to submit to arbitration or to seek a sist is found in subsection (1), by which the third party is to be regarded, in relation to that dispute, to be a party to the arbitration agreement.

38. Subsection (3), by contrast, comprises the relatively rare type of dispute which is not about a third-party right arising from an undertaking in the contract but rather about an independent right i.e. a right created outwith the bounds of the contract. The contracting parties may have provided in their contract that disputes about certain such free-standing rights may be resolved by arbitration. By way of example, a construction contract which envisages the appointment of sub-contractors (i.e. third parties) may specify that certain non-contractual claims involving a third party, such as those arising under delict, can be submitted to arbitration. (It may be that, in addition, the sub-contractors are given substantive third party rights under the contract, in which case any disputes about such rights will fall under subsection (2).) In this situation, a delictual dispute involving the third party will fall under subsection (3), which gives the third

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party the option (but not the obligation) of submitting the dispute to arbitration or seeking a sist in respect of a court action raised against it.

39. Subsections (4) and (5) are interpretation provisions. The former is to be read with subsection (3)(d)(i), and the latter serves to tie section 9 in with the scheme and language of the Arbitration (Scotland) Act 2010.

Section 10 – Renunciation of third-party right

40. Subsection (1) allows a person with a third-party right to renounce it. This may be done either expressly or implicitly. The effect of such renunciation is that the right is extinguished. The power to renounce cannot be excluded by the contracting parties, since otherwise they would be able to force a person to accept a benefit which they may not want.

41. One reason for including this provision is that there is no requirement on a third party to accept the right in order to be able to use it. It is therefore important to have a clear method of rejecting the right if that is desired. This may be done at any time, thus providing the third party with something akin to the freedom of contract enjoyed by the contracting parties. It also offers a practical solution for a third party who, subjectively, considers that the right is onerous. (If, viewed objectively, the contracting parties impose a burden or a duty on a third party then they have not succeeded in creating a third-party right at all, and so there is nothing for the third party to renounce.)

42. Subsection (2) relates to arbitration. As previously set out at paragraph 35, a third party who is regarded, by section 9(1), as a party to an arbitration agreement may take advantage of that status either by submitting a dispute to arbitration or by seeking a sist of court proceedings which have been taken against that party in respect of the dispute. If, however, the third party chooses to raise a court action instead, it is not to be taken to have renounced its right to submit the same dispute to arbitration merely because it chose to raise court proceedings. (Of course, a contracting party will be entitled to seek a sist under section 10 of the Arbitration (Scotland) Act 2010 in respect of those proceedings if it wishes to do so.)

Section 11 – Prescription

43. Section 11 removes any doubt that there may be as to whether a third-party right is an obligation arising from the contract for the purposes of

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the Prescription and Limitation (Scotland) Act 1973. It makes clear that the right normally prescribes after the short negative prescriptive period of 5 years; the same applies to a *jus quaesitum tertio* under the common law.

Section 12 – Abolition of common-law rule *jus quaesitum tertio*

44. Section 12, in conjunction with section 13, provides for the orderly transition between the current common law of *jus quaesitum tertio* and the statutory third party rights regime set out earlier in the Bill. It provides that, on commencement, existing *jus quaesitum tertio*'s will continue in force but it will not be competent to create new ones; instead, third party rights as defined in section 1(2) may be created.

Section 13 – Application

45. By section 13, sections 1 to 10 of the Bill only apply to a third-party right created on or after the day on which section 1 is brought into force (which will be done by regulations made under section 14). Such a right may either be contained in a contract entered into on or after that day, or in a pre-existing contract to which it is added by the contracting parties on or after that day.

Section 14 – Commencement

46. Section 14 provides that it and section 13 and 15 come into force on the day after Royal Assent. The Scottish Ministers may make commencement regulations bringing the other provisions in the Bill into force on a day or days they specify in the regulations.

Section 15 – Short Title

47. This section sets out the short title of the Bill.

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