Contract (Formation and Remedies) (Scotland) Bill
[As amended at Stage 2]

Revised Explanatory Notes

Introduction

1. As required under Rule 9.7.8A of the Parliament's Standing Orders, these revised Explanatory Notes are published to accompany the Contract (Formation and Remedies) (Scotland) Bill, introduced in the Scottish Parliament on 2 October 2025 as amended at Stage 2. Text has been added or amended as necessary to reflect amendments made at Stage 2 and these changes are indicated by sidelining in the right margin.

2. These revised 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.

3. The Notes should be read in conjunction with the Bill as amended at Stage 2. 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

4. The Bill implements recommendations of the Scottish Law Commission ("the SLC") published in its Report on Review of Contract Law: Formation, Interpretation, Remedies for Breach, and Penalty Clauses ("the Report").[1] It changes aspects of the law of formation of contract and the law of remedies for breach of contract.

5. References in these notes to recommendations are to the recommendations made by the SLC in the Report.

6. The Bill is in 3 Parts, as follows:

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[1] Scottish Law Commission, 'Report on Review of Contract Law: Formation, Interpretation, Remedies for Breach, and Penalty Clauses' at Report on Review of Contract Law: Formation, Interpretation, Remedies for Breach, and Penalty Clauses | www.scotlawcom.gov.uk

- Part 1 contains a statement of the law on formation of contract.
- Part 2 contains provisions that reform parts of the law of remedies for breach of a contract, namely mutuality, restitution after rescission, retention, and contributory negligence.
- Part 3 contains the Bill's final provisions, including a power to commence the provisions in the Bill by regulations.

Crown application

7. Section 20 of the Interpretation and Legislative Reform (Scotland) Act 2010 provides that the Crown will be bound by an Act of the Scottish Parliament or Scottish statutory instrument unless the provision expressly exempts it. The freestanding text in this Bill applies to the Crown in the same way as it applies to everyone else. The Bill makes no change to the application to the Crown of the enactment that it amends in section 22 (the Law Reform (Contributory Negligence) Act 1945).

Commentary on sections

Part 1 - Formation of contract

Autonomy of parties

Section 1 - Autonomy of parties: application of sections 2 to 13

8. Section 1 implements recommendation 5 of the Report. It sets up the principle of party autonomy in relation to sections 2 to 13 of the Bill, which relate to the formation of a contract. The principle of party autonomy means that those entering the contract can decide how the contract is going to be agreed to. This principle is discussed in paragraphs 4.46 to 4.55 of the Report and paragraph 4.55 of the Report recommends that the Bill's provisions on formation of contract should allow parties to depart from the default rules.

9. Section 1(1) states that sections 2 to 13 apply only to the extent that the parties to the contract have not agreed otherwise. In other words, sections 2 to 13 are only default rules and the parties can decide if they apply or not. There are two ways in which the parties can provide for rules other than the default rules: by putting the different rules in the offer (or any counter-offer) (subsection (1)(a)), or by agreeing separately that different rules apply (subsection (1)(b)). An arrangement to apply different rules can be express or implied (subsection (2)(b)(i)), meaning that a rule might be excluded by parties including an express statement that "section x does not apply" or including other provisions which by implication exclude the application of a particular rule. Parties can either apply different rules than those in sections 2 to 13 or can modify the rules in sections 2 to 13 (subsection (2)(b)(ii)).

10. Examples of party autonomy when applied to the formation of a contract include: parties agreeing that no contract will be formed between them until its terms are

recorded in writing and signed by each person; an offeror specifying that a particular form or method of acceptance is required; or, a party making agreement on some specific matter a requirement for the formation of a contract despite agreement having been reached on other issues.

Requirements for the formation of a contract

Section 2 - Formation of contract: general

11. Section 2 implements recommendation 4 of the Report. It provides for the general principle that contracts are agreements between two or more parties which have sufficient content and which they intend to have legal effect between them. This general principle underpins the statutory statement on formation.

12. The basic elements of a contract are discussed in paragraphs 4.6 to 4.22 of the Report where it is noted that to form a contract there must be (i) agreement on the essentials of a contract (usually the basic pieces of information required are who the parties to the agreement are, the subject-matter of the contract (e.g., the property to be transferred, the service to be supplied) and the price, if any); (ii) an intention to create legal relations; and (iii) certainty of terms. These elements are provided for in section 2(1).

13. Section 2(1)(a) requires the parties to the contract to intend the agreement to have legal effect. Section 2(1)(b) then requires that the agreement is one which *can* be given legal effect, both in terms of the specific kind of contract that it is (for example, meeting any requirements that apply to a contract for the sale of land or a contract of employment) and after taking any relevant enactment or rule of law into account. Therefore, not only must the contract meet any statutory or common law requirements for that specific type of contract (for example, that a contract for the sale of land must be in writing and comply with some other requirements[2]), it must also be one which the courts would enforce. The latter requirement ensures that general concepts such as illegality and incapacity are recognised. For example, a contract for the commission of a crime would not be given legal effect on the basis of illegality. Similarly, a contract would not have legal effect due to incapacity where, for example, a small child signed a contract to buy a house. The parallel definition of “offer” in section 4(1)(b) means that an offer accepted in terms of section 7 forms a contract under section 2(1).

14. Section 2(2) provides that if parties agree on sufficient matter for the law to recognise their agreement as a contract under section 2(1), then there can be a contract even though the parties are continuing to negotiate on other matters relevant to their transaction. For example, a tailor and customer identify themselves as parties to the contract, agree what alterations need to be made to the customer’s dress, and settle on a price. This agreement contains the usual minimum information required for a contract to be agreed (see above) but there may still be a need to settle on the timeframe or how payment is to be made.

[2] The Requirements of Writing (Scotland) Act 1995, section 1 | www.legislation.gov.uk

15. However, section 2(3) allows parties to guard against being found to be in contract under the rule in section 2(2) before they are ready for that if they explicitly specify in advance the matter or matters on which they must be agreed before any contract is formed. For example, if two parties are negotiating the hire of a band, the hiring party may stipulate at the beginning of negotiations that the songs to be played by the band must be approved before there is a contract (even if other essential matters like the time, date, location, and price of the hire are agreed).

16. Section 2(4) provides that the existence of agreement between parties is to be determined from their statements and conduct, including but not limited to whether there are offers and acceptances. This recognises that while some agreements are expressed clearly in a single written document which all parties sign (which would occur in the case of a lease of property, for example), other agreements might be formed differently and with a combination of words or conduct. For example, friends may verbally discuss the possibility of organising a trip and then begin to send emails suggesting locations, flights and accommodation. Some friends provide details which allow bookings to be made by one on behalf of the others and the trip is confirmed. While there may have been no clear ‘offer’ and ‘acceptance’ with all terms set out in full and in one place the statements and conduct of those involved may be used to conclude that there was an agreement (for each person to cover their share of the trip costs). Thus, for example, agreement may be expressed in a single document subscribed to by all parties or implied from parties’ actings only, or from a combination of their conduct with statements not amounting to offer and acceptance.

17. By virtue of section 1 parties can contract out of any or all of these rules.

Section 3 - Conclusion of contract by unnotified acts

18. Section 3(1) implements recommendation 11 of the Report. It provides an exception to the general rule that an acceptance must reach the offeror in order to form a contract between the parties (see section 13). The reasoning for including such an exception to the general rule is discussed in paragraphs 4.95 to 4.99 of the Report. The exception facilitates party autonomy by allowing parties to agree in various ways that the performance of certain acts by the offeree forms the contract even if the offeree does not communicate their acceptance to the offeror. The exception applies where (i) the offer either expressly or impliedly allows for the offer to be accepted without notification to the offeror, (ii) the parties in the course of interacting with each other have established a practice of accepting offers without notifying the offeror, and (iii) there is a customary usage of acceptance without notification in the industry or geographical area common to the parties.

19. For example, someone owns a place for caravans to park overnight in a rural area. As the signs clearly indicate, those using the space must pay by depositing cash into a box on site before their departure. The owner does not necessarily know in advance that someone is going to park overnight (e.g. there is no prior communication with an offer and acceptance) and may not be present when a caravan arrives. However, the fact that a caravan has shown up and parked creates the agreement to pay. In other circumstances, the same kind of arrangement might apply by custom in a

town, where goods are left for sale alongside honesty boxes. Despite no sign, the geographical usage and custom means that a person who takes a product without interacting with the seller is obliged to leave an amount in the box.

20. Section 3(2) implements recommendation 12 of the Report. It provides that a contract is formed when the offeree begins to perform certain acts described in subsection (1), even though these acts are not notified or known to the offeror at the time they take place. However, this must occur within any time limit for acceptance which is stated in the offer.

21. Under section 3(3), subsections (1) and (2) are subject to section 11(1)(b), which provides that the performance (which means doing what the contract requires e.g. painting a house, delivering a couch) must begin within any time limit for acceptance stated in the offer.

22. By virtue of section 1 parties can contract out of any or all of these rules.

Offers

Section 4 - What constitutes an offer

23. Section 4 implements recommendation 13 of the Report.

24. Section 4(1) specifies what constitutes an offer. Paragraphs 5.7 to 5.11 of the Report discuss the definition of an offer, which is a proposal made to one or more specific persons containing sufficiently definite terms to form a contract and indicating the intention of the offeror to be bound if the offer is accepted by the other party or parties. Subsection (1)(a) requires that there are reasonable grounds for the offeree to understand that the offeror intends for the offer to result in a contract if accepted. Section 4(1)(b) mirrors section 2(1)(b), to say that the offer must be capable of being given legal effect, which has the effect that an offer accepted (in accordance with section 7) forms a contract under section 2(1).

25. Section 4(2) makes clear that an offer may be addressed to various persons and groups of persons including the general public (provided the offer otherwise meets the criteria in section 4(1)). For example, a poster advertising a reward for the return of a lost dog is an offer made to the public at large and would create an agreement to pay the reward to whoever returned the dog.

26. Section 4(3) deals with the application of the law of unilateral promises in relation to the rest of section 4. In particular, an offer made to the general public may also be analysed as a unilateral promise (for example, a promise to pay a reward for performing a specified act can also be understood as a unilateral promise to pay someone for satisfying particular conditions – as noted by paragraph 5.8 of the Report). Section 4(3) therefore implements recommendation 14, so that subsections (1) and (2) are without prejudice to the possible application of any enactment or rule of law in relation to what constitutes a unilateral promise.

27. By virtue of section 1 parties can contract out of any or all of these rules.

Section 5 - Revocation of offer

28. Section 5 implements recommendation 16 of the Report about how an offer may be revoked, specifically where an offer has reached the offeree but has not yet been effectively accepted by the offeree.

29. Section 5(1) sets out the basic circumstances in which an offer may be revoked. Section 5(1)(a) provides that the offer may be revoked and ceases to be capable of acceptance if the revocation reaches the offeree (in terms of section 13) before the offer has been accepted. Section 5(1)(b) deals with revocation when agreement is to be reached by statements or conduct of the parties (described in section 2(4)). In those circumstances, revocation can only occur if the revocation reaches the offeree before the agreement by statements or conduct has been reached. Section 5(1)(c) deals with the case of acceptance by un-notified conduct of the kind described in section 3, where the contract is agreed by performance of the contract without the agreement being communicated to the offeror. Here the revocation of the offer is effective only if it reaches the offeree before the offeree begins the performance which forms the contract. These rules of revocation are subject to subsections (3) and (4).

30. Section 5(3) implements recommendation 17 of the Report. It applies in cases where an offer has been made to no specific offeree and instead to persons in general, persons of a particular description, or the public at large (discussed in paragraphs 5.21 and 5.22 of the Report). For example, a police force may offer a reward for information leading to the arrest of a suspect. Where an offer is addressed to persons in general, the public at large, or persons of a particular description, revocation is to be effected by the same means as were used to make the offer (subsection (3)(a)(i)), or where the means of revocation are specified in the offer by those means (subsection (3)(a)(ii)). The provision encourages those making general offers to consider whether or not to include in such offers express statements about their revocation.

31. Section 5(4) implements recommendation 18 of the Report. It deals with irrevocable offers (which are discussed in paragraphs 5.23 to 5.26 of the Report). An irrevocable offer arises (i) when the offer itself includes a specific statement about its intended irrevocability, or (ii) if the offeror otherwise declares that the offer is irrevocable and this declaration reaches the offeree.

32. By virtue of section 1 parties can contract out of any or all of these rules.

Section 6 - Lapsing of offer on fundamental change of circumstances

33. Section 6 implements recommendations 28 and 29 of the Report, dealing with when offers lapse as a result of there being a fundamental change of circumstances. Lapsing of an offer on a material change of circumstances is discussed in Chapter 6 of the Report. That chapter outlines the general effect that a change of circumstances (in particular, death or supervening incapacity of an individual, and insolvency) may have on an offer. Essentially, the death (or loss of capacity to make a decision to form a

contract) of the offeror should terminate the offer. Similarly, death (or such loss of capacity) of the offeree should cancel any acceptance that has been dispatched by the offeree but has not received by the offeror.

34. Section 6(1) provides generally that an offer lapses and can no longer be accepted on a fundamental change of circumstances, while section 6(2) provides specifically that death or loss of capacity of either party to make a decision to form a contract before formation of the contract are examples of such a fundamental change of circumstances. Section 6(2) does not however change the rule that contracts and other obligations, as distinct from offers, generally continue to bind the estates of parties who die while the contract or obligations have effect. The case of a company ceasing to exist after making an offer or having dispatched an acceptance which has not yet reached the offeror can be dealt with under the general rule in section 6(1).

35. Section 6(3) implements recommendation 30 of the Report. Paragraphs 6.25 to 6.29 of the Report discuss the effect of a party's supervening insolvency. It notes that persons may contract until the date of their sequestration and that a trustee in sequestration has powers to adopt or disclaim contracts previously entered into. It also notes that while businesses may continue to trade despite insolvency. As a result, the Report concludes that it would be inappropriate for the rule to be that offers lapse on apparent insolvency. Instead, section 6(3) provides that an offer in relation to the formation of a contract does not lapse where, after it is made, but before a contract is formed, the offeror or offeree becomes insolvent. Section 6(4) sets out when an offeror or offeree becomes insolvent, with the ability in section 6(6) for Scottish Ministers to, by regulations subject to the affirmative procedure, amend the existing examples of when an offeror or offeree becomes insolvent in subsection (4)(a) or (b) and specify further circumstances in which a person becomes insolvent.

36. Section 6(5) implements recommendation 30 of the Report. The rules in section 6(1) to (4) do not affect the application of any other enactment or rule of law to the transaction proposed in the offer.

37. Section 6(7) provides that "incapable" has the same meaning as used in section 1(6) of the Adults with Incapacity (Scotland) Act 2000. Section 1(6) defines incapable as meaning incapable of acting, making decisions, communicating decisions, understanding decisions, or retaining the memory of decisions, by reason of mental disorder or of inability to communicate because of physical disability. But a person does not fall within this definition by reason only of a lack or deficiency in communication if that lack or deficiency can be addressed by human or mechanical aid (whether of an interpretative nature or otherwise).

38. By virtue of section 1 parties can contract out of any or all of these rules.

Section 7 - Acceptance of offer

39. Section 7 implements recommendation 21 of the Report.

40. Section 7(1) provides that any form of statement or conduct by the offeree is an acceptance if it indicates unqualified agreement to the offer. Acceptance by conduct occurs where a party does something that indicates agreement even if it is not communicated in written or verbal words. For example, if a petrol station's signage indicates that motorists should fuel first and then pay the advertised price, it is clear that by fuelling their car the motorist agrees to pay for that fuel and the offer (of petrol for payment) has been accepted. By virtue of section 13 acceptance must reach the offeror to form a contract.

41. Under section 7(2) acceptance by conduct is effective to form the contract when the offeror becomes or ought to become aware of the conduct in question. However, this does not affect the further possibility of acceptance by an un-notified act under section 3.

42. An offer accepted is then a contract by virtue of section 2.

43. Section 7(3) implements recommendation 22 of the Report. Silence or inactivity from the offeree is not to be taken in itself to show assent. This is not however an absolute prohibition, and it will be possible for silence or inactivity to be sufficient in exceptional cases. An example of such an exceptional case cited in the Report is Shaw v James Scott Builders & Co [2010] CSOH 68, where a written contract was drawn up in terms which the homeowner and the builder had informally agreed. A copy was emailed to both parties, and it specified that any changes would have to be requested within five days. The homeowner responded accepting the terms of the contract, but the builder did not respond. The surveyor then wrote to both parties confirming that the contract had been finalised. Construction of the property continued until disagreements arose and the court held that the builder had agreed to the contract through his silence.

44. Section 7 is without prejudice to the possibility under section 2(2) that to have a contract parties need not be agreed about all matters on which they are negotiating if they are in agreement on sufficient matters for there to be a contract, or to the further possibility under section 2(3) that a party requires there to be agreement on a particular matter before a contract can be formed.

45. By virtue of section 1 parties can contract out of any or all of these rules.

Section 8 - Qualified acceptance of offer

46. Section 8 implements recommendation 26 of the Report about qualified acceptances of offers (an issue discussed in paragraphs 5.64 to 5.73 of the Report).

47. A qualified acceptance occurs when the "acceptance" by the offeree makes some change to the original offer, with section 8(1) setting out what these changes are: the addition of terms, the alteration of terms, and the omission of terms. If any of these changes have been made, then section 8(2) says that the qualified acceptance is to be

treated as both a rejection of the initial offer (which means that under section 9 the offer lapses and ceases to be capable of acceptance) and a new offer or counter-offer.

48. Section 8(3) provides that subsection (2) is without prejudice to the possibility under section 2(2) that parties need not be agreed about all matters on which they are negotiating to have a contract if they are in agreement on sufficient matters for there to be a contract. In these circumstances, there may be a contract with further negotiation on other details which have not been agreed.

49. By virtue of section 1 parties can contract out of any or all of these rules.

Section 9 - Rejection of offer

50. Section 9 implements recommendation 19 of the Report, which is discussed in paragraphs 5.32 and 5.33. An offer lapses and ceases to be capable of acceptance when it is rejected by the offeree. It does not matter whether or not the offer is irrevocable under section 5. An acceptance that is qualified in the way described in section 8 is to be treated as a rejection of the offer.

51. By virtue of section 1 parties can contract out of this rule.

Withdrawal of offer or acceptance

Section 10 - Withdrawal of offer or acceptance

52. Section 10 implements recommendation 15 of the Report. It provides that an offer, even if it is irrevocable under section 5, may be withdrawn if the withdrawal reaches the offeree before or at the same time as the offer. An offer may still be revoked so long as any statement that the contract was irrevocable had not yet reached the offeree. Section 10 also makes similar provision in relation to the withdrawal of an acceptance by the offeree, allowing the acceptance to be withdrawn if the withdrawal reaches the offeror before or at the same time as the acceptance. Section 13(3) provides for the meaning of reaching for these purposes.

53. Paragraphs 5.17 to 5.20 of the Report discuss the difference between withdrawal and revocation of offers. The difference arises based on whether the offer has reached the offeree or not. A withdrawal occurs before or at the same time as the offer reaches the offeree (for example where a lawyer mails her client an offer for services, realises there is an error, and phones the client to withdraw the undelivered offer). Revocation on the other hand may occur in certain circumstances once the contract is received.

54. By virtue of section 1 parties can contract out of any or all of these rules.

Time limits

Section 11 - Time limits

55. Section 11 implements recommendation 23 of the Report. It makes provision for time limits for acceptances of offers (both by statement and by conduct). This issue was discussed in paragraphs 5.47 to 5.52 of the Report.

56. In general, acceptances must be completed within any time limit stated in the offer (subsection 1(a)) or within a reasonable time of the notification of the offer (subsection 1(b)). A notification of an acceptance occurs in the circumstances set out in section 11(2). If the acceptance is by statement notification occurs when the statement reaches the offeror (see section 13(3) and (4) for when a notification is considered to have reached a party). If the acceptance is by conduct notification occurs when the offeror is aware or ought to be aware of the conduct.

57. Section 11(3) covers where there may be acceptance by an un-notified act under section 3 and requires that the performance of the act must have begun before the expiry of any time limit mentioned in subsection (1).

58. By virtue of section 1 parties can contract out of any or all of these rules.

Section 12 - Commencement of a period of time within which a response to an offer is required

59. Section 12 implements recommendation 25 of the Report. The commencement of a period of time within which a response to an offer is required is discussed in paragraphs 5.53 to 5.55 of the Report.

60. Section 12 says that where an offer specifies that the offeree must respond in a particular timeframe but does not say when that time period begins, the time starts to run when the offer reaches the offeree (see also section 13).

61. By virtue of section 1 parties can contract out of any or all of these rules.

Notification

Section 13 - When notification takes effect

62. Section 13 implements recommendations 6 to 9 of the Report and relates to when notification takes effect. The issue of when notification of statements takes effect is discussed in paragraphs 4.56 to 4.71 of the Report. Paragraphs 4.72 to 4.85 focus on when electronic communications take effect.

63. Section 13(1) provides that any notification in relation to formation of contract takes effect when it reaches the person (the addressee). The significance of a statement reaching the other party is that, in general, it only has legal effect from that

point onward. Notification includes offers, acceptances, counter-offers, withdrawals, rejections, revocations and declarations (such as a declaration that an offer already made is irrevocable (see section 5)). However, by virtue of subsection (2), it is subject to section 11(1), whether within any time limit for acceptance referred to in paragraph (a) or a reasonable time referred to in paragraph (b).

64. Section 13(3) provides that a notification reaches its addressee when the notification is made available to that person in such circumstances as make it reasonable to expect the person to be able to obtain access to it without undue delay. This is a broad and flexible test which enables contracting parties to deliver notifications to each other in the way which suits their needs best.

65. Section 13(4) gives instances of when reaching occurs in commonly encountered situations. These are illustrative of rather than additional to the general rule of section 13(3).

66. One instance is a notification transmitted by electronic means (section 13(4)(d)), which is to be taken to reach a person when it becomes available to be accessed by the person (recommendation 9). The provision focuses on the accessibility to the addressee as the test of legal effectiveness, in order to avoid some of the technical difficulties that may arise from the nature of electronic communications (for example, delays and failures in the transmission of emails between servers). With regard to a notification made by email, however, an appropriately worded, automatically generated out-of-office response may make it unreasonable under section 13(3) to expect the addressee to be able to obtain access to it without delay. The same applies where an electronic communications system generates an automatic message advising of a notification's non-delivery in the addressee's system.

67. By virtue of section 1 parties can contract out of any or all of these rules. This leaves it open to parties to make alternative provision, for example requiring the use of read receipts to emails, or something similar if they chose.

Section 14 - Abolition of any rule of law as to when notification of postal acceptance takes effect

68. Section 14 implements recommendation 10 of the Report, which deals with the postal acceptance rule. This rule and the question of whether there is a need to retain special protection for acceptances sent by post in modern conditions and a digital age, is discussed in paragraphs 4.86 to 4.90 of the Report.

69. The postal acceptance rule is an exception to the general rule that an acceptance must reach the offeror to form a contract. Under the rule, an unqualified acceptance takes effect when the acceptance is posted, rather than when it reaches the offeror. The rule only applies to acceptances: postal offers, withdrawals and revocations of offers, and qualified acceptances do not benefit from it, and qualified acceptances in particular only become counter-offers when actually communicated to their offerees.

70. Section 14 provides that in relation to the formation of a contract, any rule of law whereby an acceptance sent by means of a postal service takes effect when posted (the postal acceptance rule) is abolished.

71. Section 1 does not apply to section 14. However, by virtue of section 1's application to section 7, parties can agree that a postal acceptance will form a contract upon the acceptance's dispatch.

Section 15 - Interpretation of Part 1

72. This section sets out definitions applicable to Part 1.

Part 2 - Remedies for breach of contract

Autonomy of parties

Section 16 - Autonomy of parties: application of sections 17 to 21 and of the Law Reform (Contributory Negligence) Act 1945

73. As with the statutory statement for formation, the principle of party autonomy in contracting is also recognised in Part 2 of the Bill in relation to remedies for breach of contract.

74. As with section 1(1) of the Bill, section 16(1)(a) provides for the principle of party autonomy and has the effect that the provisions or rules in sections 17 to 21 (primarily dealing with rescission) are default rules. It is therefore left open to parties to provide their own, different, rules on what remedies apply in relation to breaches of contract. Section 16(1)(b) applies where a contract has been rescinded (terminated) by a party in response to another party's material breach of the contract (the situations to which in particular sections 17 to 21 apply). In that case, the Bill's provisions do not prevent the continuing effectiveness of any term of the rescinded contract which was intended to remain effective after rescission.

75. Subsection (1A) applies the principle of party autonomy to the sections covering contractual retention (sections 21A to 21C), applying those rules as default but allowing parties to contract out of them if they wish to.

76. Section 16(2) implements recommendation 35 of the Report. It similarly provides for the principle of party autonomy, by allowing the contributory negligence rule inserted into the Law Reform (Contributory Negligence) Act 1945 ("the 1945 Act") by section 22 of the Bill to be subject to contrary provision in parties' contracts. The 1945 Act will be discussed further below.

77. Subsection (3) means that an agreement to deviate from the default rules may be express or implied (see section 1(2)).

Mutuality of contract

Section 17 - Mutuality of contract

78. Section 17 implements recommendation 31 of the Report which relates to mutuality of contract.

79. Mutuality of contract applies where any two parties to a contract are each in breach of contract (those parties being referred to in the provision as “PA” and “PB”). The concept of mutuality of contract has two major consequences: (a) if one party does not perform, the other need not perform, and (b) a party which has not performed or is not willing to perform its obligations cannot compel the other to perform (this concept is discussed in paragraphs 10.1 to 10.11 of the Report). This second consequence creates significant difficulties such as a party in breach not being able to exercise any rights under the contract or sue for damages for its breach by the other party. Section 17(2) addresses these difficulties by abolishing any rule of law to the effect that a party who is in breach of contract is thereby not entitled to exercise any right or pursue any remedy arising from a breach of contract by the other contracting party.

80. However, section 17(3) makes it clear that the party in breach (PA) may not claim performance of duties either after the contract has been rescinded or if PB is lawfully retaining performance. In the first case, if the contract has been rescinded, the obligations under the contract no longer exist. In the second, contractual retention allows a party to a contract to withhold performing their obligations if an equivalent obligation has not been performed by the other party.

81. It is open to parties to contract out of this rule, in terms of section 16 of the Bill.

Rescission for breach of contract

Section 18 - Rescission for breach of contract: return of benefits received

82. Section 18, along with sections 19 to 21, implements recommendations 32 and 33 of the Report. Together the sections define a new remedy of return after rescission (termination) of a contract for material breach. As discussed in paragraph 10.27 of the Report, in line with the general principles of Scots law on remedies for breach of contract, this new remedy may be cumulated with other remedies so long as their exercise together is compatible with one another. This is one effect of section 23(a)(iii) of the Bill, which provides that the Bill is without prejudice to any enactment or rule of law regulating any question related to remedies for breach not provided for in the legislation.

83. Sections 18 to 21 apply in circumstances where a contract has been lawfully rescinded on the basis of a breach of contract and a party has received a benefit from the other party (see section 18(1)). However, they do not apply if the party which received the benefit has fully reciprocated that performance (section 18(2)). That means that it is not necessary to reverse all performance that has taken place under the contract – only those which have not been the subject to a reciprocal performance. So,

it is only any benefit which has not been the subject of a reciprocal benefit which must be returned (section 18(4)). The goal is to redresses the economic imbalances caused by rescission of a partly performed contract.

84. Sections 18(5) to 21 implement recommendation 33 of the Report and provide detailed rules as to how reciprocal restitution works in practice: in particular, rules on how the benefit is to be returned according to whether or not it took the form of money, with non-money benefits to be returned if still transferable.

85. Section 18(5) requires that if the unreciprocated benefit was monetary, that money must be repaid. If the benefit was not monetary and is instead a transferrable item, section 18(6) applies but only if it is not unreasonable or impractical to return the benefit. A useful example of a benefit that is not a payment of money but nonetheless must be returned to the party who is in breach of contract, is supplied in the Commentary for the equivalent Article to this provision in the Draft Common Frame of Reference ("DCFR") (on which sections 18 to 21 are modelled).[3] The commentary gives the example of a firm of accountants who agree to lease a computerised accounts system, but contrary to the contract only hardware, and no software, is supplied to them. The accountants, who have not yet paid, can rescind the contract for material breach, but are required to return the hardware. Whereas, an instance of when property may be impractical to return is if a customer has been supplied roof tiles but has since installed them on a house. In a case where it is impractical or unreasonable to return the transferable item then payment of its value is required instead (section 18(6)). Finally, section 18(7) applies when the benefit is not monetary or transferable. In that case its return is to be by payment for its value or, if it has been on-sold for an amount greater than its value, that greater amount. A case where the benefit is not monetary or transferrable is likely to be where the benefit is the provision of a service, such as a haircut. In such a case, payment is to be for the value of the service. Valuation of a benefit is dealt with in section 19 of the Bill.

86. It is open to parties to contract out of the rules in this section in terms of section 16 of the Bill.

Section 19 - Value of benefit

87. Section 19 further implements recommendations 32 and 33 of the Report and sets out rules on the valuation of a non-money benefit that is not returnable by the recipient under section 18(6) and (7) (see section 19(1)). When determining the value which must be paid in lieu of returning an item or for a service, the valuation of the item or service is assessed at the time of the party's performance providing that benefit (section 19(2)). Additional guidance is provided in subsections (3) and (4).

88. If there was an agreed price for the promised performance, section 19(3) applies and the value is whatever the actual performance was, determined as a proportion of

[3] C von Bar and E Clive (eds), 'Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference' (2009) at 912. See Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR) | www.law.kuleuven.be

the agreed price (it may be that the promised performance is the same as the actual performance, in which case the value would be the whole of the agreed price). Another useful example is given in the DCFR Commentary, this time of a non-transferable benefit, which is the result of work that cannot be returned.[4] The example is as follows: a building contract specifies that the builder is to be paid upon completion of the work; however midway through the builder becomes insolvent and stops work. Thereafter the employer terminates the contractual relationship and hires a second builder to complete the work. The amount the employer is required to pay the second builder is less than the original contract price, and therefore the employer enjoys a net benefit. Under the section, the employer will have to pay the first builder a reasonable sum for the value of the work received.

89. If there was no agreed price, then section 19(4) applies and the value is whatever sum two other parties who are willing to make the exchange and capable of providing the performances would be reasonably expected to have agreed for the actual (as distinct from the promised) performance.

90. Section 19(2) to 19(4) (which guide how value is to be determined) are subject to section 19(6), which says that if the recipient of the benefit needs, without compensation, to dispose of the benefit or to sustain a disadvantage in order to preserve the benefit because of the other party's non-performance of an obligation owed to the recipient under the contract, the payment of the value of the benefit is to be reduced accordingly.

91. Again, it is open to parties to contract out of the rules in this section in terms of section 16 of the Bill.

Section 20 - Compensation for reduction in value of a returned benefit

92. Section 20 further implements recommendations 32 and 33 of the Report.

93. Section 20 applies when the recipient is required to transfer a benefit by section 18(6) and there has been a reduction in the value of the benefit. In such a case, the recipient of the benefit must pay compensation for any reduction in the benefit's value that occurs in the time between receiving the benefit and returning the benefit (section 20(2)). The liability to pay compensation is reduced if the change in condition was through a non-performance of an obligation which the other party owed to the recipient, or the recipient's conduct causing the change was made in the reasonable but mistaken belief that the other party's performance conformed with the contract. For example, there is a contract for the hire of a racing bike that includes a condition that repairs may be made only with parts provided by the hire company. If the bike is returned having been repaired with a non-authorised part, there is a reduction in the value of the benefit and this must be reflected in payment of that lost value alongside return of the bike under subsection (2). In this case, the company will need to make the proper repair and

[4] 'Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference' (2009) at 921. See Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR) | www.law.kuleuven.be

fix any damage in addition to losing the time the bike could have been rented while those repairs were required. However, if the company sent the wrong parts and the hirer installed these, the value of any reduction would be reduced under subsection (3).

94. Again, it is open to parties to contract out of this section's rules in terms of section 16 of the Bill.

Section 21 - Use and improvement

95. Section 21 further implements recommendations 32 and 33 of the Report.

96. Section 21(1) requires the recipient of the benefit to pay a reasonable amount for any use made of it, subject to any reduction in value under section 20(2). Section 21(2) applies when there has been an increase in the value of the benefit in the time between the party receiving the benefit and its return. It entitles the recipient to payment of the value of any improvements made to the benefit which the other party can readily recover. However, this entitlement does not apply if either the improvement was itself a breach of contract, or the recipient made the improvement knowing, or when it ought to have known, that the benefit would have to be returned.

97. An example of use and improvement from the DCFR Commentary involves the purchase by D of a number of motorcycles from M, which D proceeds to improve by customising them.[5] However D is unable to re-sell the bikes upon discovery that contrary to the terms of the contract the motorcycles at the time of purchase did not satisfy certain safety regulations. D therefore terminates the contractual relationship with M. Restoration of the bikes to their state at the time of purchase is impossible due to the nature of the customisation. Therefore, while D is required to return the bikes to M under section 18(4), M is liable to pay to D the value of the improvements made, if M can readily obtain that value by selling the bikes.

98. Again, it is open to parties to contract out of this section's rules in terms of section 16 of the Bill.

Contractual Retention

99. Sections 21A to 21D deal with the self-help remedy of contractual retention. Contractual retention is a means to secure the performance of obligations without terminating the contract or in circumstances where the breach (or anticipatory breach) is not sufficient to justify termination of the contract. Contractual retention is sometimes referred to as "mutuality retention" or simply "retention" in case law, and is distinct from equitable or special retention (which results from a court exercising its equitable

[5] 'Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference' at 925. See Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR) | www.law.kuleuven.be

discretion to allow a party to retain performance of its obligations).[6] The term "contractual retention" is therefore used to provide a consistent term for this type of retention in the Bill and to distinguish it from special retention.

Section 21A - Application of contractual retention

100. This section broadly sets out the circumstances in which a party may exercise contractual retention.

101. Subsection (1) defines contractual retention as temporarily withholding or suspending performance of an obligation that is due to be performed under the contract. It then goes on to list the actions which may trigger contractual retention:

- Paragraph (a) sets out that the right to exercise contractual retention is triggered when the other party to the contract has breached a counterpart obligation.
- Paragraph (b) sets out that the right to exercise contractual retention may also operate in response to an anticipated breach of a counterpart obligation by the other party to the contract (an "anticipatory breach"). The anticipatory breach occurs where it is clear the other party is going to breach the contract because they have signalled their intention not to perform or to perform in such a way that there would be a breach of the contract.
- Paragraph (c) sets out that contractual retention may arise where a contract has been ended as a result of the other party's breach (or anticipatory breach) and there are subsisting obligations. Subsisting obligations may include, for example, the payment of damages for the initial breach of contract which led to the termination.

102. Subsection (2) clarifies further what is meant by a "counterpart obligation". There is a rebuttable presumption that the contractual obligations of each party are counterparts. The presumption can be displaced by showing that the parties did not intend for the obligations to be counterparts.[7] In addition, to recognise that some transactions are formed of multiple related contracts and to respect the unity of that transaction, subsection (2) also makes it clear that the counterpart obligations may be drawn from different contracts so long as those contracts are part of the same transaction.[8] This may be distinguished from instances where there are a series of separate, but related, contracts (such as re-ordering products on a rolling basis) wherein each represents a transaction in its own right.

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[6] See the discussion of special retention in Scottish Law Commission, "Report on Review of Contract Law: Formation, Interpretation, Remedies for Breach, and Penalty Clauses" (Scot Law Com No 252, March 2018), at paragraphs 11.17 to 11.20.

[7] For example, obligations may be determined not be intended to be counterparts by reference to the terms of the contract or its structure – a contract for a long project broken into phases might, for instance, suggest that counterpart obligations are only those which exist within each phase, rather than across the whole contract.

[8] For example, in a case decided in 1919 the buyers of two ships under two separate contracts for which a single price was payable were allowed to refuse to pay the whole price in respect of a breach in relation to only one of the contracts. See Claddagh Steamship Co v Steven & Co 1919 SC (HL) 132.

103. The breach of contract giving rise to the contractual retention does not need to be a material breach when it is an actual breach of contract (subsection (3(b)) but must be a material breach if it is an anticipatory breach which gives rise to the contractual retention (subsection (3)(a)). However, the party exercising contractual retention must ensure that their contractual retention is not clearly disproportionate to the effect of the breach (subsection (4)). What is clearly disproportionate will depend on the circumstances, including the nature of the obligations being breached and contractually withheld. In order to satisfy the requirement that the contractual retention not be clearly disproportionate to the breach, the party exercising contractual retention may retain only part of an obligation (subsection (5)).

104. Subsection (6) provides that the right to exercise contractual retention ends when the party who breached the contract giving rise to the contractual retention has performed the breached obligation. Then, the contractual retention must end and the retaining party must perform the retained obligations. The party in breach may also end the contractual retention by paying damages in lieu of performance.

Section 21B - Notification of contractual retention for an anticipatory breach of contract

105. This section deals with circumstances in which the relevant breach giving rise to contractual retention is an anticipatory breach (see section 21A(1)(b)). Where this section applies, the party exercising contractual retention must satisfy the notification requirements set out in subsections (1) and (2). That is, the notification of contractual retention must occur either before the contractual retention begins, or as soon as reasonably practicable after the contractual retention has begun. The notification must be written or oral (subsection (2)).

Section 21C - Contractual retention in proceedings

106. This section contains provisions relation to proceedings for contractual retention.

107. Subsection (1) relates to proceedings which argue that a contractual retention was clearly disproportionate to the breach of contract that gave rise to it. Where a party disputing a contractual retention is arguing that the retention is clearly disproportionate to the breach in terms of section 21A(4), it is for that party to demonstrate that the contractual retention is clearly disproportionate.

108. Subsection (2) allows contractual retention to operate as a defence (as well as a tool to secure future performance of obligations). A party which has proceedings against it for breach of contract may argue that their failure to perform an obligation that would otherwise be a breach of contract was actually contractual retention.

Section 21D - Interaction of contractual retention with existing law

109. This section provides that the preceding sections on contractual retention do not affect the application of other enactments or rules of law, including those related to lien, set off, netting or close out, compensation, anticipatory breach of contract, and the

remedy known as equitable or special retention. These provisions also do not affect any other circumstances conferring rights to retain or abate obligations (including where these are unrelated to contractual breach), which may include statutes which deal with particular areas of law. For example, section 112 of the Housing Grants, Construction and Regeneration Act 1996 contains a statutory right to suspend the performance of obligations under some construction contracts where the other party defaults on payment of a "notified sum". Another example is the common law rule in leases that if a landlord fails, to any material extent, to execute repairs or improvements which they have agreed to make, the tenant may withhold payment of the rent.

110. Paragraph (b) preserves the court's equitable control to refuse an exercise of contractual retention.[9]

Amendment of Law Reform (Contributory Negligence) Act 1945

Section 22 - Amendment of Law Reform (Contributory Negligence) Act 1945

111. Section 22 implements recommendation 34 of the Report. The subject-matter of the recommendation is discussed at paragraphs 10.28 to 10.54 of the Report. The Law Reform (Contributory Negligence) Act 1945 ("the 1945 Act") applies to delictual claims of damages for negligence,[10] but it has been unclear how far or even whether it extends to breach of contract claims. In some instances, an issue might give rise to both a delictual claim and a breach of contract claim. The 1945 Act allows for any damages payable by the party causing harm, or in breach of their obligations, to be reduced when the party claiming the damages has contributed to their loss. Currently, it is not clear if the 1945 Act applies to claims for damages which arise from breach of contract.

112. Section 22 of the Bill clarifies that position by allowing contributory and blameworthy conduct of the party claiming damages to limit any claim for damages for breach of contract.

113. This is achieved by way of addition to the 1945 Act making clear that the defence of contributory negligence under the 1945 Act applies to all claims of damages for breach of contract. The definition of "fault" in section 5 of the 1945 Act is subject to a new provision, which has the effect of extending the definition to include "breach of contract". The approach incorporates all the other relevant jurisprudence under the 1945 Act (e.g. on causation of the loss by both parties, and consideration of their relative blameworthiness in assessing damages for breach). Therefore, the defence of contributory negligence will arise where the pursuer in a claim of damages for breach of contract suffers loss partly through its own fault and partly through the breach of

[9] See McNeill v Aberdeen City Council (No. 2) [2013] CSIH 102 as authority for retention being subject to equitable control by the court and Inveresk plc v Tullis Russell Papermakers Ltd [2010] UKSC 19 where Lord Hope noted that the right of retention is not absolute and the court has the power to prevent its abuse.

[10] Delictual claims are, in very general terms, claims for damages (i.e. money) where someone has suffered injury or loss as a result of someone else's negligent act or omission, e.g. a compensation claim made by a cyclist who is hit by a car.

contract by the other party. The damages recoverable in respect of the breach will be reduced to the extent the court considers just and equitable having regard to the pursuer's share in the responsibility for the loss.

114. When section 22 comes into force, the effect will be that the 1945 Act is amended and section 22 of the Bill itself is then spent.

115. It is open to parties to agree that the Law Reform (Contributory Negligence) Act 1945 is to be disregarded in determining any question as to reducing any damages recoverable from the other party arising from a breach of the contract by a party (see section 16(2) of the Bill).

Part 3 - General

116. This part of the Bill deals with a number of provisions which apply to the whole Bill.

Section 23 - Saving

117. Section 23 implements recommendations 2 and 3 of the Report. It regulates the scope of the Bill, and contains a number of savings for other matters that affect formation of contract. That is, the Bill is clear that it is not changing or superseding other legal rules in enactments or common law that deal with other contractual matters (for example, requiring certain contracts to be in writing). This includes preserving the common law on formation to deal with matters that have not been envisaged and included in the Bill, mutuality of contract, and remedies for breach of contract.

Section 24 - Ancillary provision

118. Section 24 confers a power on the Scottish Ministers to make ancillary provision by regulations.

119. Subsection (2) provides that the power to make ancillary provision can be used to modify enactments. The word enactment is defined for this purpose by schedule 1 of the Interpretation and Legislative Reform (Scotland) Act 2010, it includes Acts of the Scottish Parliament and Acts of the UK Parliament. There is a general presumption that a regulation-making power cannot be used to modify Acts. Subsection (2) overcomes that presumption.

120. Subsection (3) provides for ancillary regulations to be subject to the affirmative procedure if they textually amend an Act of the Scottish Parliament or the UK Parliament, but otherwise they are subject to the negative procedure.

Section 25 - Commencement

121. This section provides that 5 sections come into force on the day after Royal Assent. These sections relate to the commencement of the Bill itself, regulations that

may be made under the Bill, the ability to make ancillary provision and the short title of the Bill. The other provisions of the Bill will come into force on such day as the Scottish Ministers may by regulations appoint.

122. Regulations bringing sections into force may include different provision for different purposes or areas and may include transitional, transitory or saving provision. Commencement regulations are not subject to any parliamentary procedure.

Section 26 - Short title

123. This section provides the short title of the Act. This is the title by which the Bill may be referred to or cited.

This document relates to the Contract (Formation and Remedies) (Scotland) Bill (SP Bill 76A) as amended at Stage 2

Contract (Formation and Remedies) (Scotland) Bill

[As amended at Stage 2]

Revised Explanatory Notes

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