Dear Mr Donald,

Thank you very much for giving me the opportunity to submit evidence in order to help inform the Delegated Powers and Law Reform Committee in the consideration of the Contract (Third Party Rights) (Scotland) Bill. I am delighted to do so because I have a keen interest in this particular topic, from both a comparative and a historical perspective. However, I have to add the caveat that I would in no way claim specific expertise on Scots law, so I am not in a position to comment on the ‘fit’ of the Bill with other parts of Scots private law – surely one of the most important points to consider. I nonetheless hope that my comments on the general quality of the Bill will be of some use to the Committee.

Yours sincerely,

Professor Stefan Vogenauer
Managing Director of the Institute

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Policy objectives and need for legislative reform

1. Law reform is not an end in itself. Each change in the law requires practitioners to familiarise themselves with the new rules, and there is bound to be at least initially some uncertainty about the application of these rules which may result in an increased need for legal advice and perhaps even litigation. Every new rule, therefore, creates costs which can only be justified if they are offset by its beneficial effects. This Bill, it might be argued, will effect a relatively modest change in the law. Scots law already acknowledges a *jus quaesitum tertio* which enables parties to a contract to create an enforceable right in favour of a third party. The main objective of the drafters is to clarify and ‘make more usable’ a doctrine that is rarely used and that has become clouded with uncertainty, particularly with regard to its relationship to other private law doctrines, such as assignation, trust, donation and collateral warranties (Policy Memorandum (‘PM’) paras 3, 20). It is therefore tempting to suggest that legislative reform is not required because the gradual development of common law rules by way of refining and clarifying their content and scope is better dealt with by the courts, and even the issues that merit substantive reform (most importantly, the question of irrevocability, as laid down in *Carmichael*) should be left to the courts or more targeted statutory intervention.

2. This would be short-sighted for at least two reasons. First, as set out in PM paras 58-60, the opportunity for judicial reform may not arise any time soon and, in any event, will not provide a coherent framework for the law in this area. Secondly, there is an urgent need for such a framework if there is indeed a lack of legal certainty surrounding third-party rights which induces parties to effectively ‘opt out’ of the doctrine of *jus quaesitum tertio*, either by making alternative transactions or by choosing another contract law to govern their contract or the relevant part of the contract (PM paras 15, 20, 61). Both these opt outs are inefficient and create additional cost. The first requires the parties to enter into a second transaction (collateral warranty, assignation, establishing a trust, etc) in order to achieve the desired economic result: they do not simply have to make one contract which, among other things, creates an enforceable right in favour of a third party; they rather have to make a contract and, for example, a collateral warranty. The second opt-out, ie choosing a different contract law altogether, will invariably require (additional) legal advice and therefore generate extra cost, particularly for small and medium-sized enterprises that do not act as repeat players in the market.

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3. In sum, there is a compelling argument for simplification and clarification in this area of the law. This is all the more so because in an economy based on the division of labour the complexity of contractual relationships is constantly increasing. A simplistic, bilateral model of contract is no longer apt to fulfil the main purposes of the institution of contract: to help the parties realise their goals and facilitate trade. The Bill therefore clearly has ‘the potential to make a positive impact on commerce’, as suggested in para 4 of the Financial Memorandum. It is one of the positive features of the Bill that it makes it clear that third party-rights are not in any way exceptional but a normal feature of a mature contract law – quite unlike the English Contracts (Rights of Third Parties) Act 1999 (‘the 1999 Act’) which is commonly regarded as not having rejected the doctrine of privity but merely having created a further exception to it.3

4. Somewhat between the lines the Policy Memorandum also seems to suggest that the Bill will not only discourage ‘opt outs’ from Scots law but might even encourage ‘opt ins’, ie positive choices of Scots law as the governing law in international commercial contracts (paras 6, 7, 15). This can be inferred from a number of passages that refer to the need for Scots law to have a reputation ‘throughout the world as being of high quality’, not to ‘fall[1] behind’ other jurisdictions that acknowledge third-party rights, and to have its ‘standing and value’ improved ‘internationally’ in a multi-jurisdictional context (paras 9, 14, 15).4 The implicit assumption underlying these references is that parties to international commercial contracts ‘shop around’ for the best available contract law regime and choose this law to govern their transactions. This idea of a ‘law market’ has been increasingly asserted in recent years.5 However, there is no empirical evidence that parties choose the applicable contract law ... on the basis of the quality of specific legal rules. ... Choices of law ... are hardly made with a view to the substantive merits of the available legal rules but are dominated by other factors, most importantly the degree of familiarity with the chosen regime and, less importantly, intuitive global judgments on the overall sophistication of different legal systems’.6

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3 The sympathetic general approach of the Bill to third-party rights is also evident from the fact that it avoids giving prominence to specific types of transactions that will not be affected by the Bill, as is done in the lengthy enumeration in s 6 of the 1999 Act.
4 Discussion Paper No 157 para 1.6 was even more explicit in this regard.
5. As a result, it cannot be realistically expected that international parties will increasingly insert choice of law clauses in favour of Scots law in their contracts simply because of this Bill. Such choices will only increase if Scots contract law overall acquires a reputation for being flexible, business-friendly, certain, balanced and sophisticated. At present, there is only a very small number of contract laws that – deservedly or undeservedly – enjoy such a reputation: Swiss law and English law amongst European parties\(^7\) and English law in the Far East.\(^8\) It is difficult to see Scots law compete at this level. However, given that choices of law are mostly based on perceptions (para 4 above), there might be a unique opportunity for Scots law to position itself as a kind of new ‘law of choice’ for international contracts in a post-Brexit (and perhaps even post-independence) environment. This would require a vigorous pursuit of the Scottish Law Commission’s ‘Review of contract law’ agenda which would enable Scots lawyers to convincingly claim that their contract law is the most modern regime available and that it provides ‘best solutions’ if measured against international benchmarks. This issue is obviously beyond the scope of this consultation but it is raised here to put the respective suggestions in the Policy Memorandum into perspective and at the same time give a glimpse of further opportunities ahead.

**Benchmarks for reform**

6. As long ago as 2010, the Scottish Law Commission decided to use the Draft Common Frame of Reference (‘DCFR’) throughout its review of contract law initiative as a benchmark ‘against which to check the fitness of Scots law’ (PM paras 8-9). While this might be a good choice in some areas of contract law, it is not necessarily so with regard to third-party rights. The part of the DCFR dealing with the ‘Effect of stipulation in favour of a third party’\(^9\) is overly complex and convoluted and should not be used as a model.\(^10\) It is therefore to be welcomed that the Law Commission considerably broadened its comparative work for this particular project and had extensive regard to other national contract laws and the two transnational ‘comparator instruments’ (PM para 44) that deal with third-party rights in a much more satisfactory manner, ie

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\(^9\) Book II, Chapter 9, Section 3 of the DCFR.

the UNIDROIT Principles of International Commercial Contracts (‘PICC’) and the Common European Sales Law (‘CESL’). Overall, the amount of serious comparative research done by the Law Commission on this project is truly impressive and exemplary.

7. However, the most important yardstick is of course not the ‘best practice’ in other jurisdictions but rather the intrinsic quality of the rules proposed. Given that nearly all the provisions of the Bill are default rules (PM para 16), the decisive test is whether they would be contracted for by the majority of the parties if they were to negotiate over the relevant issues (‘majoritarian default rules’). On a traditional analysis, this would normally be the case if the rules align with the typical (or ‘hypothetical’) interests of the parties. 11 This is particularly so in the case of the tripartite relationship arising from a contract for the benefit of a third party. Here, the interests of the parties involved have to be carefully balanced. In what follows, I will assess some of the provisions of the Bill in this light.

**Mechanism for the creation of a third-party right**

8. Contracting parties who wish to create a right in a third party will normally have an interest in being given the maximum freedom to shape the tripartite arrangement according to their preferences. The Bill undoubtedly furthers freedom of contract in the area of third-party rights to the greatest possible extent: (i) it does not limit the availability of the institution of contracts for the benefit of a third party to certain types of transaction (no *numerus clausus* of contracts for the benefit of a third party), as was traditionally the case in some legal systems in the civilian tradition (eg, ex-Art 1121 French Cc); (ii) it makes it abundantly clear that nearly all its provisions are mere default rules (eg, ss 4(2), 6(3)(a), 7(3); cf PM para 16); and (iii) it expressly provides, for the avoidance of doubt, that the parties may make certain choices, including the creation of a conditional third-party right (s 2(2)).

9. Moreover, the parties will typically have an interest in having at their disposal a mechanism that makes the creation of a third-party right as easy as possible and does not add unnecessary requirements, such as formalities or special conditions for creating the right. The Bill is perfectly in line with this interest in that (i) such additional conditions will only be required if the underlying transaction requires these for other reasons (s 2(7)); (ii) the intention to create a third-party right does not have to be express (s 2(3)); (iii) as opposed to traditional solutions in France and the United

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11 Law and economics scholarship, of course, insists that these interests coincide with the efficiency of the rules in question.
The nature of the relationship between the recipient of the undertaking and the third party is irrelevant for the creation of the right; and (iv) no further statement or conduct by the third party or anyone else is required in order to bring the right into existence (as is the case, for example, under Dutch law and South African law), nor is it required that the third party should know of the undertaking to create a third-party right or have relied on it (s 2(4)(b)).

10. On the latter point in particular, the Bill also corresponds to the hypothetical interest of the third party. Because the third-party right comes into existence as soon as the parties conclude their contract the third party does not bear the risk of death or insolvency of one of the contracting parties: at no moment in time does the right become an asset of one of them, and the creditors, heirs, receivers or administrators of these parties will not be able to seize it before it is passed on to the third party. This feature distinguishes contracts for the benefit of third parties from many of the alternative mechanisms that were used to achieve similar economic results in the past (cf para 2 above), and it was one of the main drivers for the recognition of contracts for the benefit of third parties in civilian systems in the late 19th century. The Bill is superior to many domestic contract laws and also to the transnational comparator instruments because it is explicit on this point.

11. Overall, the mechanism for the creation of the third-party is therefore to be commended for being perfectly in line with the typical interests of the parties. Furthermore, one of its positive features is the clarity with which the general test for the creation of the right is set forth in s 1(1). It is made perfectly clear that all that is required is a respective undertaking (s 1(1)(a)) made with the intention to create an enforceable right (s 1(1)(b)). Most importantly, the provision rightly avoids the complex solution of the 1999 Act and its presumption in s 1(1)(b) and (2). While the solution of the Act may have been necessary to pre-empt potential judicial hostility

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13 For comparative references, see ibid para 28.
14 S Vogenauer, ‘§§ 328-335: Versprechen der Leistung an einen Dritten’ in M Schmoeckel, J Rückert and R Zimmermann (eds), Historisch-kritischer Kommentar zum BGB, vol II/2 (Tübingen: Mohr Siebeck 2007) paras 76-94; s 328 German Cc is a direct response to the 19th century debate in that it stipulates that, unless otherwise agreed, the third-party right arises ‘directly’ and ‘immediately’. See now also the new Art 1206(1) French Cc.
15 The PICC only deal with this issue in the Official Comment to Art 5.2.6 PICC; the lack of a further requirement can only be inferred a contrario ex Art 9:303(1)(2) DCFR. The PECL are particularly confusing because Comment H to Art 6:110 states that notification of the third party is required; yet the text of Art 6:110 PECL does not warrant this restriction.
against the relaxation of the doctrine of privity in England, no such opposition is to be expected in Scotland and the solution of the Bill is thus perfectly appropriate. Finally, the Bill avoids one of the mistakes of the DCFR\textsuperscript{16} in making it clear that it only deals with enforceable rights, rather than referring to mere benefits that are conferred on a third party (s 1(1)(b) and (2); Report paras 3.9, 4.19-4.20), thereby staying clear of the problem of ‘incidental beneficiaries’ that has tended to muddle the waters in the United States. The Bill is arguably even clearer on this point than the 1999 Act.

**Nature and identity of the third party**

12. The contracting parties, while wishing to have their intention to create a third-party right recognized without further restrictions, normally have an equally strong interest in not having any such intention imputed to them where it did not exist. If the third-party right regime recognises, as the Bill does, implicit intention and does not require the third party to ‘accept’ or otherwise assent to the creation of the right (para 9 above) there is a risk that the scope of the obligation incurred by the contracting party making an undertaking is expanded too much. The ‘floodgates’ problem occurred, for example, in France and Germany where the courts arguably extended the scope of contractual liability of the first party too far by permitting ‘tacit promises for the benefit of a third party’ (stipulations pour autrui tacite) and ‘contracts with protective effects for the benefit of a third party (Verträge mit Schutzwirkung zugunsten Dritter).\textsuperscript{17} As a result, third parties in these jurisdictions are often held to have acquired a contractual (rather than merely delictual) right against the party making an undertaking although the latter would most probably never have agreed to be contractually liable to such (third) parties. While the French and German extensions of contractual liability can be understood against their respective domestic backgrounds of contractual and non-contractual liability more generally, they are better avoided. Like the 1999 Act, the Bill, in its s 1(3), does a good job in preventing such unwanted extensions by setting forth an ‘identifiability’ requirement and linking it to objective factors that can be easily ascertained. The solution strikes the right balance between foreseeability and legal certainty on the one hand and the need for flexibility on the other.

13. The typical interest of the parties in leaving some flexibility to accommodate future events is particularly evident in the case of third parties that are not in existence at the time when the parties make the contract. This is highly relevant in practice, and by

\textsuperscript{16} See the criticism of Vogenauer, ‘Common Frame of Reference’ (n 10) 166.

making it explicit that this option is open to the parties (s 1(4)) the Bill is making an advance over older codifications in the civil law tradition that do not mention the issue.\textsuperscript{18}

**Scope of the third-party right**

14. The third party will typically have an interest in not being confined to enforcing the right conferred on it. It will rather wish to have the broadest possible range of remedies available if one of the contracting parties does not perform, including damages. In contrast, the contracting party that fails to honour its undertaking and is in breach does not deserve protection. It is therefore appropriate to let the third party avail itself of all the relevant contractual remedies. Older third-party right regimes in the continental tradition and some of the comparator instruments fail to mention this and thus leave room for misunderstandings when they are applied.\textsuperscript{19} The Bill avoids this trap\textsuperscript{20} and provides a clear solution (s 7(2)).

15. Older regimes also tend not to address another issue that may be of great interest to the third party, ie whether it may avail itself of exclusion and limitation clauses in its favour.\textsuperscript{21} Again, there is a risk of misunderstanding, so the issue is better dealt with expressly, as is done in s 2(5) and (6) of the Bill.\textsuperscript{22}

**Freedom of the parties to alter the third party-right**

16. The exercise of balancing the typical interests of the parties in the tripartite relationship arising out of a contract in favour of a third party is particularly delicate with regard to the question of whether or not the contracting parties should retain the freedom to cancel or modify the agreement that creates the third-party right. The contracting parties will normally have an interest in retaining this freedom as long as possible, ideally right until performance by one of the contracting parties occurs. The policy argument in favour of this solution is straightforward: it flows from the general principle of freedom of contract that the parties are entitled to agree to cancel or modify their contract at any moment in time before performance has taken place; it is all the more justified that the parties should be allowed to exercise this freedom in the third-party right context, given that the third party only gains a right and does not

\textsuperscript{18} For references to Dutch, French and German law, see Vogenauer, *Commentary on the PICC* (n 12) Art 5.2.2 para 2 n 153. However, see also the new Art 1205 French Cc.

\textsuperscript{19} Cf Vogenauer, *Commentary on the PICC* (n 12) Art 5.2.1 para 32. Surprisingly, the new Art 1206(1) French Cc retains this solution.

\textsuperscript{20} As do s 1(5) of the 1999 Act, Art II.-9:302(a) DCFR and Art 78(3)(a) CESL.

\textsuperscript{21} Cf, eg, Art 6:110 PECL. For a comparative overview, see Beale et al, *Ius commune Casebook* (n 17) 1250-59; new Art 1206 French Cc is no improvement.

\textsuperscript{22} This is in line with s 1(6) of the 1999 Act, Art 5.2.3 PICC, Art 9:301(3) PICC, Art 78(2)(2) CESL.
incur any obligation or duty from the contract in its favour. In contrast, the typical interest of the third party is to acquire an ‘immutable’, ‘perfect’, ‘indefeasible’ and irrevocable right from the outset. There are equally potent policy arguments in favour of this solution: the third party needs predictability and certainty, so it is undesirable to leave the right inchoate or, as German lawyers have it, ‘pending’ and abandon its existence and scope to the discretion of the contracting parties.

17. Unlike Scots law at present, most legal systems and the comparator instruments aim to strike a compromise solution and give the parties (or one of the parties only, ie the recipient of the undertaking)\(^2\) the freedom to cancel or modify the third-party right but at the same time limit this freedom by designating a cut-off point from which cancellation or modification is no longer permitted. This cut-off point has been variously fixed at the moment of the third party (i) being notified of the conferral of the right;\(^2\) (ii) being notified that the right has been made irrevocable; (iii) accepting the right;\(^2\) (iv) reasonably relying on it; or (v) different combinations of the aforementioned moments in time.\(^2\) The choice of the appropriate cut-off point ultimately turns on a policy decision which depends on the degree of protection that is meant to be afforded to the third party. All of solutions (ii)-(v) appear to be defensible on this count.

18. Against this background, the Bill strikes a sensible balance. By abolishing the current irrevocability rule (s 2(4)) and expressly allowing the parties to modify or cancel the third-party right (s 3(1)), it takes account of the interests of the contracting parties. By setting the moment of reasonable reliance as the ultimate cut-off point in s 6, it uses the moment in time that best corresponds to the moment at which the position of the third party becomes worthy of protection. Unfortunately the somewhat convoluted drafting style of the provision tends to make the rule more complicated than necessary.

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\(^2\) This is the solution of Art 6:110(3) PECL and some other continental systems (for references, see Vogenauer, *Commentary on the PICC* (n 12) Art 5.2.5 para 3 n 188; see also new Art 1207(1) French Cc). It is not to be recommended because it is based on the outdated idea that contracts for in favour of a third party are restricted to transactions that are, in economic terms, donations of the stipulator/promisee to the third party.

\(^2\) Art II.-9:303(2)(1) DCFR and Art 78(5) CESL; for criticism, see Vogenauer, *Commentary on the PICC* (n 12) Art 5.2.5 para 5 n 194; id, ’Common Frame of Reference’ (n 10) 168 n 127.

\(^2\) For references, see Vogenauer, *Commentary on the PICC* (n 12) Art 5.2.5 para 5 n 194.

\(^2\) See, eg, Art 6:110(3) PECL: (ii) or (iv); Art 5.2.5 PICC and s 2(1) of the 1999 Act: (iii) or (iv); Art II.-9:303(2) and (3) DCFR: (i) or (iv).
Defences against the third party

19. The contracting parties typically have an interest that any defences they might have against each other may also be raised against the third party when it asserts its right. This interest is acknowledged in all modern systems. However, the third party has a legitimate interest that only defences arising out of the contractual relationship that confers a right on the third party may be raised. The Bill is to be commended for not only adopting such a balanced approach but also making it – unlike many other contract law regimes – explicit (s 8(2)).

Renunciation of a third-party right

20. Although the acquisition of a right is, in legal terms, only beneficial, the third party has an interest in not having a right imposed on it against its wishes: beneficia non obtruduntur. Protection against this risk is all the more important because the Bill envisages the creation of the right without acceptance or any other contribution of the third party (para 9 above). Like all other modern third-party regimes the Bill takes account of this interest by providing the third party with the possibility to renounce the right. Quite appropriately, it makes renunciation as easy as possible by allowing it to be implicit (s 10(1)) and by not requiring that it be made to a specific person or in a specific manner.

21. Given that the interest of the third party not to have a right forced upon it will be crucial to this party, it would be desirable if the Bill also made it clear that the entitlement of the third party to renounce does not have to be exercised within a particular or reasonable time (cf Explanatory Notes para 41) and that it is not at the disposal of the contracting parties (cf Report Law Com No 245 (‘Report’) para 6.7).

22. Most importantly, it is necessary to clarify the consequences of the third party renouncing its right. The Bill, in its s 10(1), stipulates that the ‘right is extinguished’. The Report suggested that renunciation should have ‘the effect of bringing the right to an end’ (at para 6.2; see also PM para 57) or ‘the effect that the right then fails’ (Report Recommendation 33). The language implies that the right will come into existence with the contract of the parties and will only become inexisttent at the moment of renunciation. This would be against the interest of the third party if the acquisition of the right were to lead to undesirable consequences (tax liabilities, etc)

27 For a comparative overview, see Vogenauer, Commentary on the PICC (n 12) Art 5.2.4 para 1 n 177.
28 cf, eg, Art 6:110 PECL, Art 5.2.4 PICC. Art 9:302(b) DCFR and Art 78(3)(b) are preferable in this regard; s 3 of the 1999 Act is overly complicated.
29 For a comparative overview, see Vogenauer, Commentary on the PICC (n 12) Art 5.2.6 para 1 n 208. The 1999 Act, however, fails to address the issue.
in the meantime. It is therefore more appropriate that renunciation should take effect \textit{ab initio}, ie that the right is then ‘treated as never having accrued’ to the third party\textsuperscript{30} and that any duty of the third party or the person making the undertaking in favour of the third party is ‘inoperative from the beginning’.\textsuperscript{31}

**Style of drafting**

23. The Bill loses a lot of its punch by its verbosity and convoluted style. It is, for example, not clear why the Bill stubbornly refuses to refer to the third party as ‘the third party’ in the operative text of its provisions while it is content to use the term in the headings of various sections. Rather than using the phrase ‘a person who has a third-party right’ again and again it would be easy to define ‘third party’ together with ‘third-party right’ in s 1 and thus economise on the ink spilt. It appears equally unnecessary to repeat the couplet ‘cancel and modify’ about a dozen times when the Bill itself uses the term ‘amend’ as a generic term covering both cancellations and modifications.

24. It is not clear why s 1 and s 2 would not be combined in a single section or broken down in a different way: s 2(2)-(6) would be better placed in the context of s 1(1) and s 1(2) (mechanism of creation) which they flesh out; s 1(3) and s 1(4) deal with a slightly different issue (nature of third party).

25. Most importantly, the constant repetition that the rules set forth are at the disposition of the parties and can be contracted out (eg, s 3(2), s 4(2), s 7(3), s 8(3)) would be superfluous if there was a single provision to this effect towards the beginning or the end of the Bill which might also mention the rules that (exceptionally) have mandatory character (para 21 above).

26. I am very much aware that this is the peculiar ‘common law’ drafting style and as such in line with the general approach to Scots drafting. However, it should at least be mentioned that there is a lot of potential for making the Bill clearer, shorter and more accessible without sacrificing legal certainty. This would be particularly desirable with a view to making Scots law more attractive as a ‘law of choice’ for international commercial transactions (para 5 above). After all, it is in this very context that PM para 15 highlights the desirability of a ‘clear … and readily accessible statement of the law’.

\textsuperscript{30} Thus Art 6:110(2) PECL, Art II. - 9:303(1) DCFR, Art 78(4) CESL. For similar solutions in national legal systems, see Vogenauer, \textit{Commentary on the PICC} (n 12) Art 5.2.6 para 6 n 218.

\textsuperscript{31} Thus § 306 Restatement 2d Contracts.
Overall assessment

27. The Bill has a legitimate policy aim, and law reform along the lines suggested is desirable. The substantive solutions that are proposed and the underlying policy choices are appropriate throughout. The interests of the parties are balanced in an entirely convincing way. I do not think that any existing domestic or transnational third-party regime, including the recently reformed French Cc, is of similar quality. The Bill certainly lives up to the benchmark of the international ‘comparator instruments’. The only provision that merits reconsideration and clarification is the rule on renunciation (s 10; see paras 21-22 above). More generally, it would be advisable to adopt a more economic style of drafting.