Contracts (Third Party Rights) (Scotland) Bill

With over 5000 members the Royal Incorporation of Architects in Scotland (RIAS) is the professional body for all of Scotland’s chartered architects. Our members work in over 1000 architectural practices of all sizes, as well as in areas of industry from housebuilding to local and central government. The RIAS has charitable status and offers wide range of services and products for architects, students of architecture, construction industry professionals and all those with an interest in the built environment and the design process.

The views of the RIAS were sought on the following questions:

1. What are the benefits of moving from a common law approach to a statutory footing?
2. What impact will this Bill have on third party rights?
3. Do you think the Bill will increase the use of Scots Law?
4. Do you have concerns about the approach taken in the Bill?
5. What are the financial implications of the Bill?

Please find below the corporate response from the RIAS:

1. What are the benefits of moving from a common law approach to a statutory footing?

- Third Party Rights are particularly useful in Construction Law as there are many situations, in commercial developments for example, where third parties need to rely upon rights and obligations contained in the contracts between the developer and the builder and/or designers. Thus funders funding the development, purchasers purchasing the development upon completion and tenants occupying the whole or parts of the completed development on full repairing and insuring leases, need to have recourse against the builders and/or designers of the development should there be any breach of their obligations to the developer which causes loss to those third parties.

- The common law on 3rd party rights has developed over a number of years with the foundation being in Institution Writings (Stair Book I, Title 10, paragraph 5) and its interpretation by many judges, including Lord Dunedin in Carmichael v Carmichael’s Executor (1920 SC (HL) 195 at 197-198). Lord Dunedin emphasised irrevocability as the prerequisite for the establishment of the right rather than being a consequence. The subsequent case law has also raised other issues making the operation and enforceability of such rights less clear than they could be.

- In addition the development of common law is contingent upon relevant cases coming before the courts and the make up of the court or courts before which such cases appear. There is less opportunity, within a particular case, to treat the subject systematically and cover any matters, which are not directly pertinent to the case. This means that to leave the development of third party rights to the courts would mean that there would be no certainty as to how it would develop and less clarity than could be obtained with a statute, which could sum up and codify the present law and, at the same time, clarify any obscurities and improve any deficiencies.

- The persons most in need of third party rights in relation to commercial developments; funders, purchasers and tenants, are also the persons most in need of clarity and certainty in relation to such rights. Whilst statute, just like the common law, requires judicial interpretation, there will, it is hoped, be sufficient clarity in the proposed legislation.
to avoid the need for litigation, or if necessary, to allow for an interpretation which should not surprise.

- From the perspective of the construction professions, any move toward industry-wide acceptance of use of 3rd party rights in place of collateral warranties should carry two benefits:
  - 1) Simplification of the process of negotiating such rights alongside appointment and contract agreements should equate to a saving of time and costs.
  - 2) Removal of the risk (currently widespread through the use of collateral warranties) of granting rights/benefits which are not aligned with appointment or contract terms.

2. What impact will this Bill have on third party rights?

- At the moment, because of the uncertainty regarding the establishment of third party rights by way of the common law, parties requiring the ability to enforce third party rights, especially in relation to commercial developments, usually draft a number of collateral warranties, which are bi-lateral (sometimes tri-lateral where the third party needs to be able to ‘step into the shoes’ of the developer in the building and/or design contracts), contracts between each of the third parties and each of the parties whose breach of one or more of the development agreements may give rise to those third parties suffering loss.

- This means not only that there is a need for a large number of such collateral warranties but also that each of them needs to be negotiated, agreed and executed by the different persons granting such warranties (some of whom, such as specialist sub-contractors, may not exist at the time the principal contracts are entered into) in favour of each of the different third parties (some of whom may not exist at the time the underlying contracts are entered into).

- It will be possible to establish third party rights under the Bill in favour of classes of persons and in favour of persons not in existence at the time the contract is concluded and, subject to the provisions of the Bill, to subsequently crystallise those rights.

- This will mean that the parties to a building contract (or sub-contract) and/or a design appointment will be able to agree that particular named third parties (where they exist) or classes of third parties (such as funders, purchasers or tenants) can enforce certain undertakings in those contracts without them having to draw up, agree and execute separate contracts between the third parties and the parties to the underlying contract. Such rights can be available from the moment the underlying contract is executed and before the particular beneficiaries are named (provided they are described). This should assist development and forward funding deals and agreements for lease.

- In addition, because, in the construction industry, many of the underlying contracts are subject to arbitration for the final resolution of disputes, where such disputes involve issues also arising under one or more of the collateral warranties, it is often difficult to ‘join in’ any dispute under the collateral warranty with the dispute under the underlying contract. Under section 9 of the Bill, where disputes under the underlying agreement are to be resolved by arbitration, the third party can be treated as a party to that arbitration agreement.

- These provisions regarding arbitration should allow multiparty arbitrations where the interests of all the interested parties can be addressed.
3. Do you think the Bill will increase the use of Scots Law?

- The provision of third party rights, where intended by the contracting parties, is available in the majority of European Legal Systems and English Law, with its policy of privity of contract, was in the minority. However with the Contracts (Rights of Third Parties) Act 1999, third party rights were established in English Law making the establishment of such rights more certain and secure.

- At the moment, the uncertainty of the establishment of third party rights in Scots Law means that where there is a need, in a legal document, to ensure that third party rights are enforceable, either the relevant part of the agreement is made subject to another legal system, where third party rights are more clearly enforceable, or separate collateral agreements need to be entered into to establish such rights directly but thereby creating a much more complicated legal structure than needs to be.

- The Bill should therefore increase the use of Scots Law in those development agreements where collateral warranties have been used. However, given the inherently conservative nature of commercial lawyers and especially those working for Banks, it may take a little time for them to realise the advantages of using the provisions of this Bill to get third party rights established at the beginning (including those of parties only described at that stage and not named), without having to persuade the different contracting parties to grant further undertakings, and to have the possibility of joining in different collateral disputes under one arbitration agreement.

- Based on the RIAS experience the bill is unlikely to be a deciding factor in the choice to adopt a different legal system. Institutions involved in the construction industry in Scotland frequently seek to use English Law rather than Scots, but we believe the most common deciding factor is general familiarity. If a specific area of difference between the systems has a significant bearing on the choice, it is probably confidence over prescription periods, rather than 3rd party rights. Therefore the positive impact on level of use of Scots Law may be minimal.

4. Do you have concerns about the approach taken in the Bill?

- Not in general
- We approve of the approach of codifying the existing law and clearing up areas of ambiguity and doubt
- We approve of the provisions regarding arbitration which, in construction in particular, where arbitration is commonly used, will allow greater use of consolidated proceedings, thereby reducing delay and cost and allowing related disputes to be dealt with together in one set of proceedings.

5. What are the financial implications of the Bill?

- The Bill should, in relation to construction contracts, save money and time in that Third Party Rights can be established:
  - within the principal contract or contracts without the need to draft, negotiate and agree numbers of collateral warranties
  - upon agreement and execution of the underlying contracts (which can include sub-contracts entered into after the main contract)
  - in favour of classes of persons and subsequently vested in individuals within that class simply by naming them and notifying the parties and without having, at some later date, to cajole and persuade parties to the underlying contracts to give such undertakings to third parties
• The arbitration provisions within the Bill should allow third parties, where they wish, to join into arbitration proceedings thus reducing the multiplicity of legal proceedings and the danger of conflicting decisions emanating from different forums.