OFFICIAL REPORT
AITHISG OIFIGEIL

Delegated Powers and Law Reform Committee

Tuesday 14 March 2017

Session 5

The Scottish Parliament
Pàrlamaid na h-Alba

Tuesday 14 March 2017

CONTENTS

DELEGATED POWERS AND LAW REFORM COMMITTEE
9th Meeting 2017, Session 5

CONVENER

*John Scott (Ayr) (Con)

DEPUTY CONVENER

Stuart McMillan (Greenock and Inverclyde) (SNP)

COMMITTEE MEMBERS

*Alison Harris (Central Scotland) (Con)
*Monica Lennon (Central Scotland) (Lab)
*David Torrance (Kirkcaldy) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

George Adam (Paisley) (SNP) (Committee Substitute)
Jill Clark (Scottish Government)
Graham Crombie (Scottish Law Commission)
Hector MacQueen (Scottish Law Commission)

CLERK TO THE COMMITTEE

Euan Donald

LOCATION

The Adam Smith Room (CR5)

Scottish Parliament

Delegated Powers and Law Reform Committee

Tuesday 14 March 2017

[The Convener opened the meeting at 10:00]

Instruments subject to Negative Procedure

The Convener (John Scott): Good morning, everyone. Welcome to the ninth meeting in 2017 of the Delegated Powers and Law Reform Committee. Apologies have been received from Stuart McMillan, and we welcome George Adam in his place. We are grateful to you for coming, George.

Agenda item 1 is the consideration of instruments that are subject to the negative procedure. No points have been raised by our legal advisers on the following six instruments.

Non-Domestic Rating (Valuation of Utilities) (Scotland) Amendment Order 2017 (SSI 2017/42)

Act of Sederunt (Fees of Solicitors in the Court of Session and Sheriff Court Amendment) (Pursuers' Offers) 2017 (SSI 2017/53)

Shellfish (Restrictions on Taking by Unlicensed Fishing Boats) (Scotland) Order 2017 (SSI 2017/57)

Personal Injuries (NHS Charges) (Amounts) (Scotland) Amendment Regulations 2017 (SSI 2017/58)

National Health Service (Payments and Remission of Charges) (Miscellaneous Amendments) (Scotland) Regulations 2017 (SSI 2017/59)

Non-Domestic Rates (Renewable Energy Generation Relief) (Scotland) Amendment Regulations 2017 (SSI 2017/60)

The Convener: Is the committee content with the instruments?

Members *indicated agreement.*

Instruments not subject to Parliamentary Procedure

Act of Sederunt (Rules of the Court of Session 1994 and Ordinary Cause Rules 1993 Amendment) (Pursuers' Offers) 2017 (SSI 2017/52)

10:02

The Convener: No points have been raised by our legal advisers on the instrument. Is the committee content with it?

Members *indicated agreement.*

Contract (Third Party Rights) (Scotland) Bill: Stage 1

10:02

The Convener: Agenda item 3 is the consideration of evidence on the Contract (Third Party Rights) (Scotland) Bill at stage 1. This is our first evidence session on the bill.

I welcome Graham Crombie and Hector MacQueen from the Scottish Law Commission; and Catriona Marshall and Jill Clark from the Scottish Government.

We now move to questions from the committee. I will ask the first one. In general terms, what is the rationale for moving from a common-law position to a statutory footing?

Jill Clark (Scottish Government): I think that the Scottish Law Commission's submission of written evidence to the committee helpfully sets out the benefits of the move from the common law to a statutory footing. I am sure that Professor MacQueen will be able to elaborate on that.

Of course, we considered this issue ahead of settling on our preferred policy approach. It seemed to us that the law is uncertain and is not fit for purpose at the moment, because it has been left to develop in this way. Court decisions have resulted in a reluctance to use the existing law, which, in turn, means that there is little, if any, opportunity for the courts to resolve the current issues with the law.

That is why, when we considered alternative approaches, we thought that the only alternative to our approach would probably be to leave the courts to improve the law through judicial reform. However, the outcome of that could not be guaranteed and, on past experience, it could take a long time to reform the law in that way. Therefore, placing the law on a statutory footing seemed to be the only effective way of making the necessary reforms.

The Convener: Does anyone want to add anything to that?

Hector MacQueen (Scottish Law Commission): The main thing that one can say is that common law is based on the judges' decisions and that the judges' decisions depend on someone putting a question to them for a decision. Occasionally, judges do not get things absolutely right. In this particular regard, that happened in 1920 in the House of Lords. Sometimes, it takes time to realise where and how something is wrong. If you look back at the history, you can see that people realised in the immediate post-war period that that decision in 1920 was unhelpful but, in current commercial conditions, it has become particularly obviously unsuitable as a basis for legal development.

The problem is that you would have to go all the way to the top of the judicial tree—that is, to the Supreme Court—to determine a matter, and in order to do that, you would have to find a litigant who is prepared to pay, because a litigant who loses pays for everything. Understandably, therefore, solicitors and advocates are reluctant to advise their clients to take a chance on these things unless there is an absolute cast-iron guaranteed result. Legislation is the only way in which you can meet the difficulties that exist right now. We might get a case 100 years from now that meets the difficulties of the 22nd century but, meanwhile, the people of the 21st century will just have to struggle on, unless we pass this legislation. That is the major reason for shifting from common law to statute in this area.

It has to be said that, in many ways, the proposed statute expresses what is the existing common law, except for the fact that that particular wrinkle from 1920 is removed or ironed out.

The Convener: Would you be kind enough to cite the particular case, so that it is on the record? That would enable us to see the basis on which we are proceeding.

Hector MacQueen: Yes. The case in question is called Carmichael v Carmichael's executrix. It was dealt with in the House of Lords and it is in the 1920 *Session Cases*. I am confident about that, but I am not sure which page it is on. I think that it is on page 191.

Graham Crombie (Scottish Law Commission): Page 195.

Hector MacQueen: Page 195, sorry.

The Convener: Excellent—page 195. That judgment was found wanting.

Hector MacQueen: Yes.

The Convener: And by "post-war", I presume that you mean the second world war.

Hector MacQueen: Yes.

The Convener: Notwithstanding the fact that the judgment was in 1920.

Hector MacQueen: Yes. The case in question arose out of an air accident in the first world war. It is an interesting story in itself, but it is not relevant to today's proceedings.

The Convener: If no one wants to add anything in response to the initial question, we will move on to questions from Alison Harris.

Alison Harris (Central Scotland) (Con): I appreciate that there is uncertainty about the

scope of the law, but could you explain what the level of uncertainty in the current law is?

Jill Clark: I will probably defer to Hector MacQueen on that. He has already said that quite a lot of the bill restates what people think the law is at the moment. However, there is probably a degree of uncertainty in what people think is the case. We think that there can be third-party rights for someone who is not in existence at the moment—someone who is yet to be born—or for a company that is yet to be formed, but that is not absolutely certain. That uncertainty, and similar ones, are what the bill addresses. It also rectifies the issue of irrevocability, which is the main difficulty with the common law.

Hector MacQueen: The other aspect of the common law, as I said earlier, is that, if you do not get a judicial decision, you do not necessarily get an absolutely clear rule. Quite a number of the sections—particularly the remedies and defences parts—are there because they answer questions that have been asked in writings on the subject but never answered, because no case that squarely presented the issue has come before the courts.

One of the problems with the common law is that there are gaps. We can say, "In principle, it ought to be this," but having a legal rule stated in the statutes creates much more certainty. On one or two aspects—notably, the defences—we cast it in slightly narrower terms than most of the books did. We talk about how the defence must be relevant to the third-party right and, in our written evidence, we give the example—I think that it is example 1—of a case in which the contract from which the third-party right sprang was illegal at the time, although it would not be illegal now. The illegality in question did not apply to the third-party right; there was nothing illegal about giving benefits to the families of the members of that particular association. [*Interruption*.] It was example 2—thank you again, Graham. I am not doing too well on my numbers this morning.

You need a case that directly raises the issue to get it clearly resolved, and we have tried to provide a clear and certain rule on that point.

Alison Harris: Thank you for that answer. In order to help me further, could you expand on some specific areas of uncertainty? You mentioned remedies, but what remedies are available to third parties in the current law? To what degree do defences to carrying out a contract, such as error and misrepresentation, apply to third-party rights? Thirdly, could you expand on the time limits for bringing claims under third-party rights?

Hector MacQueen: Sure. Shall I take the remedies point first?

Alison Harris: Yes, please.

Hector MacQueen: The very specific uncertainty is about whether a third party can claim damages if the performance that is rendered to that third party is defective in some way. There has been almost no case law that raises that point. In principle, it should be clear that the third party does have such a right, but text writers have cast doubt on that, thanks to various 19th century cases. They say that those cases are relevant; others—myself included—say that they are not relevant, so there is a degree of dispute and doubt as to what the law is, hence the wish to be clear.

To give a principled answer, if I breach my contract with you, you are entitled to damages. Likewise, if you were a third party to a contract between Graham Crombie and me, you would be entitled to damages if our performance was not up to the level that you reasonably expected from the way in which we expressed your third-party rights.

When we talk about error and misrepresentation, we start getting into the possible defences that would be available. The question of error and misrepresentation starts when, in entering a contract, one of the two contracting parties makes a representation to the other that brings the other into the contract and that representation turns out to be untrue. That is a misrepresentation and there is an error on the part of the person who is the victim, so to speak. In general contract law, that would make the contract void or voidable, although there is some degree of uncertainty in that area.

The question is about the third-party right that springs from that contract: is it void or voidable in exactly the same way as the main contract? Does the voidness of the main contract impact on the third party? In general, the answer is probably yes, but we need a clear position that says that the misrepresentation impacts as much on the third-party right as it does on the original contracting parties to the basic contract. It might well be the case that it does not apply—that the third party knows nothing of any misrepresentation and is merely receiving a benefit, and that the misrepresentation was not about the third-party right in the first place. Why should that affect the third-party right? If that is what the contracting parties intended, the third-party right is independent of the contract in that sense. The provision on defences tries to allow for that kind of analysis to be made by the courts.

10:15

On the time limit, under section 11, "Prescription", we noticed in the course of our work that the Prescription and Limitation (Scotland) Act 1973 has a long list of the obligations to which its prescriptive period applies, but there is no specific mention of third-party

rights. We could see that as a possible gap, in that some clever lawyer somewhere might say, "Well, there is no prescription in relation to a third party's right," and the third party could claim any time indefinitely into the future.

In principle, we did not think that that was correct. The correct principle is that five years is the period that a party has in which to bring a claim. The provision in section 11 of the bill is to make that clear. It also has a slightly retrospective element: we want the position to be clear for the law as it has been in this area.

Those are the specifics of the lack of clarity. What we are driving at is often about what the law as yet does not say, but now will say.

David Torrance (Kirkcaldy) (SNP): I wish to focus on the irrevocability rule. Will you expand on the problems with the current irrevocability rule? Why would it be useful for contracts that grant third-party rights to be cancelled or modified?

Jill Clark: Hector MacQueen will have more to say on this, but the case that he spoke about—the Carmichael case—set the bar. It said that once someone has been given a third-party right, it cannot be taken away, cancelled or modified. That seems to be a complete nonsense when we think that the two main parties to a contract can decide at any time to cancel or modify their obligations. The fact that that cannot be done with a third party has created a significant inflexibility in the law, and most people shy away from our existing law on third-party rights because of their concerns about that. The law does not allow the flexibility that people need in today's commercial or indeed personal legal transactions.

Hector MacQueen: That is the essential key. What we received from the legal profession that led us in the commission to investigate this topic was the message that the jus quaesitum tertio was perceived as inflexible. Because of the irrevocability rule, you had created a right that you could not change, and that was unacceptable, particularly from a commercial point of view.

Circumstances change and things move on. You may wish to cancel the right altogether. More typically, perhaps, you might wish to adjust it slightly in order to meet new circumstances, in which less resource is available. It is even conceivable that you might want to modify it in favour of the third party and increase the benefit that they will get. However, you cannot do that if you have created an effective third-party right—at least not without the third party's consent, which will not necessarily be forthcoming without cost.

We are trying to create a regime that is flexible rather than inflexible, but that nonetheless lets the third party's right crystallise at certain points in time, so that it can no longer be changed. That is essentially what sections 4 to 6 do. They set out the circumstances in which the third-party right crystallises and can no longer be changed.

We are trying to remove irrevocability as a precondition and instead make it a consequence of the agreement, plus certain other things having happened in three different sets of circumstances, as set out in sections 4 to 6 of the bill.

David Torrance: Does the bill provide the right balance between the rights of the contracting parties to change their minds and the rights of third parties?

Hector MacQueen: I think that it does. The starting point must be that it is the contracting parties who create the situation in the first place, and it is therefore not unreasonable, shall we say, to allow them to remain in control of it up to the points that are set down in sections 4 to 6. If they make their third-party right conditional on something, as in example 2 in our written evidence, it will, when that condition is fulfilled and the third-party right has not been changed in any way, be enforceable. That seems fairly straightforward.

Section 5 deals with a situation in which the third-party right is either unconditional and could therefore be enforced immediately, or is what is known technically as a "futures" contract, whereby payment is to take place on a date in the future—for example, you would have to wait until 30 March and then the right would be enforceable. If the contracting parties notify the third party today that that right will exist and will be enforceable on 31 March, they cannot change their minds—and why should they be able to do so? They have notified the person and made them think that they are going to get that right, payment or whatever it is on that date.

The final, and longest, section involves a right that might be conditional in some sense, going forward into the future, which might have led the third party to change their position on the basis that they were going to get the third-party right eventually. In that case, of course, the third party is not entitled to rely, because the conditions in which the right comes into existence are not yet fulfilled. However, if the third party's reliance is known to the contracting parties and they do not stop it—they acquiesce, in the technical language of the law—or if the reliance is reasonably foreseeable, that right, despite its conditionality, becomes irrevocable, provided that there was reliance that was damaging to the third party, and that, if the contract was cancelled or changed, there would be further damage to the third party.

We gave an instance of that in example 6 in our written submission, in which the dear daughter Tara has her expensive course in the United

States paid for by the firm of partners of which her parent is a member. In that example, there is reliance before the cancellation, and Tara spends money on flying to the United States. The partners want to cancel the right because the firm is no longer making enough money, as they see it. If the firm is allowed to pull out, Tara will not only have wasted her money, as it were, in flying over to the States, but she will lose out on the opportunity to complete her degree study, so there will be an adverse consequence, as the bill puts it.

There is a twin-headed approach, so it is quite a tough test to pass. We have borrowed it from other legislation on which there has been relatively little case law over the past 20 years, either because the statute is wonderfully clear and no one therefore needs to get into dispute, or because the hurdle is too high for the party who is reliant to cross it and get a successful claim in. Personally, I think that it is more the former. Although the legislation is quite long, it is quite clear if you take it step by step and work your way through the requirements.

We provide for third-party protection in circumstances in which it was clearly fairer to the third party to say, "Yes, you now have an irrevocable right," and before that point, we give the contracting parties the freedom to change the situation to meet their own requirements. I am content that the bill provides a balance.

David Torrance: Thank you for that answer.

Could you explain in more detail how the exceptions in sections 4 to 6 of the bill, which stop the contracting parties modifying or cancelling a third-party right, will operate in practice?

Hector MacQueen: We have given some examples in our submission. A particularly good example in relation to section 4 is example 2. It is a nice illustration of a conditional third-party right, which is what section 4 is intended to apply to.

I will run the committee through the example. It involves a professional association that was formed by contract. At the time at which the case in question—which I mentioned earlier—was decided, the association was, in effect, a trade union, which is where the illegality came from under the law as it stood at the time. The contract between the members said that the association would

"provide benefits to the families of members who become unable to work through death or illness."

In the original case, reference was made to "insanity". I do not think that we would do that today. That is what happened—the member fell insane, and his spouse claimed the benefits that were provided for in the contract.

That is an example of a conditional obligation: the third party has no rights until a certain event occurs, which in this case was the death or illness of the member to whom the lady in question happened to be married. At that point, the right crystallised and she was entitled to it. The rules of the association allowed it to change the rules—they could do so because it was a voluntary association of members—but they could not change the rule in relation to the family member who was making the claim at a time when the rules had not been changed. The association might have thought, "Oh my goodness—this will be very expensive, so we had better change the rules so that we give them a bit less," or it might have said, "This is absolutely miserable," and decided to change the rules to give them more. It could do whatever it liked, but as far as the pursuer in question was concerned, it was committed. She had an irrevocable right at that point, and we think that that is the correct analysis of that particular fact scenario.

That covers section 4. Would you like me to give another example?

David Torrance: That should be sufficient, thank you.

Hector MacQueen: Okay. I already gave the example that relates to section 6—it is example 6 in the submission, which involves the lovely Tara. It goes through the different stages of reliance by the third party that produce the effect that, in fairness, she ought to be allowed the right in question, even though the conditions of it have not yet been completely fulfilled.

The Convener: We move on to practical problems with the current law. Monica, will you give that a blast, please?

Monica Lennon (Central Scotland) (Lab): Good morning. In your answer to the first question, you helpfully set out the rationale for the bill, which is that the current arrangements are not fit for purpose. The policy memorandum indicates that the bill will promote the use of Scots law. You mentioned that your investigation showed that lawyers in Scotland are applying English law to Scottish contracts. Do you have any feel for the extent to which that is happening? Can you quantify that?

Jill Clark: I do not think that we can quantify it. There is a lot of anecdotal evidence. Recently, a lot of articles have been written about third-party rights, because of where we are with the Scottish Law Commission's report and the bill, which all refer to the Contracts (Rights of Third Parties) Act 1999 being used as a workaround. Therefore, we think that English law is probably used quite regularly, but we could not quantify the extent to which that happens.

That is one of the workarounds at the moment, and the other, which is used in certain sectors, is something called collateral warranties. The law does not work as it stands, so Scots lawyers are looking at other ways of making things fit for their purpose.

10:30

Monica Lennon: Can you explain a bit further why that is a negative consequence? Why are the workarounds and applying English law a negative?

Jill Clark: Because we want our Scots law to be fit for purpose and to be used. We want it to be used in the courts and we want it to facilitate transactions. We do not want it to be a hindrance to people. If someone has trained in Scots law, the last thing that they will want to do is to have to apply a different jurisdiction's laws to something that is, in essence, a Scottish transaction. Hector MacQueen might want to add something on that.

Hector MacQueen: It is certainly not that we have anything against the use of English law or, indeed, English law generally. It is more a case of where Scots law is not the doing the job, it is up to Scottish lawyers, the Scottish Parliament and the Scottish courts, where possible, to do something about that. If one leaves a law in a state that means that nobody uses it, there is something amiss. Our attitude to such matters is just part of the mechanics of society, if you like. People will remain free to use English law if they prefer it, and they might do so. However, it is a pity if the legal system is not working for those who work in it.

One of my colleagues in the Scottish Law Commission provided a useful metaphor a few years ago that involves looking at the legal system as plumbing. In the world in which we live—our country and society—we have a legal system that is different but not necessarily the best legal system in the world, and some bits of it are not working so well. So, just as we would not leave deficiencies in our plumbing for too long once we knew about them, we adjust the legal system in order to meet today's requirements. Fitness for purpose is a bit of a cliché, but it is actually a very important point for a legal system, which ought to work for those who are living under it.

Monica Lennon: I just wanted to get a sense of whether people are missing out because of the current limitations and whether there are practical difficulties for the legal profession in terms of being able to apply the law. If Scots law is inadequate and you are having to apply English law, does that present difficulties for the profession?

Hector MacQueen: Solicitors are always very good at finding solutions or workarounds. To me, the major point here is that if we have a client who is sufficiently well-heeled to be able to afford the Rolls-Royce service, solicitors will produce results that work. They will bear the liability for that, which sometimes involves very large sums indeed. In some ways, my concern is more about the kind of people who cannot afford that sort of bespoke service. To my way of thinking it is rather important that the law in its default mode, which we talk about a bit on page 1 of our written evidence, should give a satisfactory outcome for such people.

With regard to the case where the lady's husband was sick, she had no opportunity to find workarounds. In a sense, the provision by the association was her lifebelt. What was important was that the law produced a result that got her the benefit that she was intended to have all the time. However, under the current law, she might well have been in difficulty because the right was not irrevocable from the outset; in fact, it was always revocable because the association could always cancel the provision in question.

The default rule has to be a good working rule because not everyone is in a position to get to workarounds to achieve what the third-party right could give them.

Monica Lennon: Sticking with workarounds, are you able to explain in a bit more detail how the collateral warranties will work in practice? Why are the proposals an improvement?

Hector MacQueen: We have a diagram in our report that we did not include in our written submission, in order to keep it within eight pages, but we will happily send it to the committee. It shows the bewildering maze that can emerge, usually at the end of construction projects.

The usual contractual framework will have a funder, who provides the money and has a contract with a developer. The developer has a contract with a builder and probably also with professional advisers, architects, engineers and so on. The main contractor will have subcontracts with suppliers and people doing bits and pieces of the work on the great project. Out in the distant future is the prospect that someone will actually buy the development or, perhaps more typically, enter into leases, whether commercial, residential or whatever.

Basically, collateral warranties are provided by the people who are doing the work: the professionals, the designers, the main contractor, the subcontractors and the suppliers. They are issued, for example, in favour of the funder, who is way up at the top of the contractual tree, or for the future purchaser or lessee of the development in question. That is a good example of the non-existent or unknown third party at the time of contracting.

What normally happens is that, when the project is completed and tenants are identified and so on, the process of going out and getting collateral warranties begins. That is completely separate from and subsequent to the successful completion of the project. Solicitors have given us graphic stories of that process. Often, it is the young solicitors who are sent out in the pouring rain to knock on doors and get people to sign the collateral warranties. Sometimes people do not want to sign. There are lots of difficulties. The particular or major difficulty is where the person you want to sign the warranty has gone out of business or has been taken over by someone else. There are an infinite range of possibilities.

It is a bit of a nightmare, in purely practical terms. Our thinking is that much of that could be removed if parties wrote third-party rights in favour of funders, purchasers, tenants and so on into the contracts, which are still the frame or spine of the thing. That would be there from the start, and we would not have to go through what is an extraordinarily cumbersome and difficult process at the end.

However, again, we are not abolishing collateral warranties.

Monica Lennon: Does the proposal provide any extra safeguard in the event of people going out of business and so on?

Hector MacQueen: Not really, no—not against the going out of business. There might be some sort of protection against the party that is taken over, because the takeover might involve carrying on the liabilities of the previous business and so on, or the previous business can be resurrected in order to make it liable.

Monica Lennon: On liabilities, can you explain for my benefit what you mean by the "black hole of non-liability" in relation to company groups?

Hector MacQueen: Do you want me to try that one, Jill?

Jill Clark: Yes—go on.

Hector MacQueen: The term "black hole" is obviously a metaphor. It was first used by a judge in about 1980 in a Scottish case, so it is a Scottish invention. The idea is essentially about a situation in which a party suffers a loss as a result of a breach of a contract to which the person suffering the loss is not a party. The basic starting principle in contract law is that someone can sue for damages for a loss only if they are the victim of that loss. That is a fairly obvious general principle right across the law. If the loss happens to fall on a third person—tough. That is where there is a black hole.

In other words, we might have a situation in which, if there is a contract between A and B, and A breaks the contract, B has no loss and a third person has it instead. How do such situations arise? Construction is the classic example. It typically involves groups of companies. A is a contractor to do work—repair, maintain, build or whatever—for B, who is a member of a company group. During the project—a repair and maintenance contract, let us say—B transfers the ownership of the property in question to another company in the group for entirely unconnected reasons. Therefore, when the breach works out in loss, the third person—the one to whom the property was transferred—suffers the loss but has no contract and the person who has the contract suffers no loss. Does that make the position clear?

With third-party rights, we can provide in A and B's contract that the other companies in the group will be entitled to enforce the contract. That is a common solution, as I understand it, but it raises the difficulties, on which we have touched, of companies that do not exist, for example. However, most of the time, that does not happen because, at the time that the contract is made, the parties do not think about third-party rights at all. A and B just carry on and then the company group takes a decision to move the property from B to C. It might even wind up B—who knows?

Our bill does not provide an answer to that scenario. It provides a solution that people could use at the time of drafting a contract but, if they have not thought of it and there is no provision, the bill does not apply. It applies only to provisions in favour of third parties. Therefore, there is a black hole of non-liability, but we are addressing that further question in a discussion paper that is currently in draft and out with an advisory group of solicitors, because we have some ideas about how the problem might be solved. However, it would be premature to go into the detail of that and it might cloud the issue that the bill addresses. We have the problem in mind.

The black hole is simply that it is surely not right that someone should be able to breach a contract and escape liability because the loss is suffered by someone else for reasons that have nothing to do with the contract position. Therefore, we might bring you another bill in two or three years' time to deal with that.

Monica Lennon: Watch this space. Are there any other problems that we should be aware of or any practical issues that have come up from your investigation?

Hector MacQueen: The major issue was the arbitration one, which we did not identify initially but which became clear as we considered the consultation responses that we received. We then proceeded to address it with fairly extensive consultation with the arbitration community in Scotland, which is not large but is quite good.

There was a need to make a provision on that, which is what we have done in the relevant section of the bill.

George Adam (Paisley) (SNP): Good morning. You have already given us examples of how the construction industry may benefit from the bill. However, the oil and gas, financial services, information technology and pension sectors are mentioned in the SLC report as industries that could benefit from the bill as well. Will you expand on what the benefits are for those sectors and how the bill will make a difference to them?

Jill Clark: It is mainly because of the complexity of their contract structures. There is lots of subcontracting and there are lots of people who subcontract to subcontractors, so many third-party rights are created that way. Those people probably have the most to benefit.

In addition to the benefits for particular sectors, certain company structures will find the bill very beneficial. As Hector MacQueen discussed, in a group company structure, the main company may contract for something but, if it has not given third-party rights to the rest of the companies in the group, it may not be able to benefit if something goes wrong. Hector may want to add to what I have said.

10:45

Hector MacQueen: I can add one or two points. George Adam mentioned a number of specific sectors. We have gathered the most information on the oil and gas sector and the position in the North Sea. As Jill Clark said, there are two massively complicated structures of operation in the industry, and many subcontractors. There are also very high levels of risk; we saw those risks clearly with Piper Alpha all those years ago, and they are on-going all the time.

In North Sea contracts, there are provisions for indemnity—there are cross-indemnities with knock-for-knock arrangements between the parties. That arrangement is designed for overall efficiency, and third-party rights to those indemnities are created, but a fairly critical point is that those contracts are all made under English law. From the point of view of Scots law, the North Sea oil industry was a missed opportunity, as business was lost.

If you read the contracts, you will see that they are subject to English law and invoke the Contracts (Rights of Third Parties) Act 1999 to establish those third-party indemnity agreements. Cases have tended to come to the Scottish courts only in extreme scenarios in which the contracts do not apply. That is in fact what happened at the beginning of this century with the great Piper Alpha litigation, which went to the Scottish courts because all the liabilities that we have talked about lay outside the scope of the contracts altogether. That is a very good illustration of the use of third-party rights. The problem that we have in Scotland is that people do not think that our third-party rights system is going to do the business.

With regard to the financial sector, pensions are a good example. For instance, the process of nominating a person to take your pension in the event of your death in service is a third-party right. Insurance provides an example of third-party rights—for example, I might take out a life assurance policy in favour of my spouse or my children. Another example would be if I took out a motor insurance policy that covered other drivers of the vehicle that I was insuring. There are plenty of examples. In fact, last summer I exercised a third-party right myself, in a sense, as I was allowed to drive my father's car when he was not feeling very well. Being a careful lawyer, I checked his policy, which said that other drivers could drive with his permission, so he kindly permitted me—from his prostrate position—to drive him to hospital.

Those are important examples of third-party rights that are created by contracts right now. They are very rarely tested in court under the application of our Scots law rules. The key example is the North Sea oil industry, in which the contracts are all under English law and refer to the third-party rights provision in the 1999 act.

George Adam: I want to follow up on Hector MacQueen's earlier comment that some of the individuals that may be involved in such matters could, if they had an open cheque book, effectively get a workaround and get the answer that they wanted. Is the construction industry an example of where that might happen, given that there are so many subcontractors? Smaller companies may not have access to legal information in dealing with larger companies, so that sector is a perfect example of where the bill would probably help those smaller businesses. Am I getting that right?

Hector MacQueen: I think that that is right—provided that we are talking about those companies being in the position of third parties, claiming rights against others. The measures give them some protection. A small organisation in business will always be under pressure, and the bill does not attempt to alleviate that pressure in any direct sense. There may well be circumstances in which smaller organisations will be able to make use of the provisions as regards rights for themselves, although they will depend on contracts that have not been drawn in great depth or detail, rather than the souped-up versions that big contractors will get. Those big contractors will also probably be able to use standard forms and so on.

Regarding the collateral warranty scenario, a draft contract is available from the Scottish Building Contract Committee, which incorporates provisions of collateral warranty in the main contract. It couches that in terms of the third-party right. Last November, I went to a Scottish Building Contract Committee conference, and I asked its members whether people were using that, but they did not know. It is not the job of that committee to know how its forms are used—it just puts the forms out there, and it is up to people to use them. The anecdotal evidence that came back on that occasion was that collateral warranties are generally used because funders prefer them. They are what the funders know, and they were established in legal practice in England in the 1990s as a way round the lack of third-party rights there at that time.

The 1999 act did not change the minds of funders. The attitude was, "We'll just go on doing what we're doing," and that applied equally to projects in Scotland. They said, "This is what we know and we think it works," which is fair enough.

George Adam: Are there any sectors other than the ones that I have mentioned that the proposed legislation could help or benefit?

Hector MacQueen: There is no sector that the bill definitely could never benefit. Any person or sector that uses contracts and that has any complexity in its arrangements may well find that the bill provides an answer. It is very much a facility, I would say. Part of what will be necessary after the bill process—the after-sales service, as we call it in the commission—is to promote the bill to lawyers and others and say what it does or could do for them. The Scottish Building Contract Committee is a prime example of that. I view that as part of the Scottish Law Commission's job. We have made something to be used, and we certainly do not want it just to lie on the shelf once it has gone through the legislative process.

The Convener: How will the bill affect the use of collateral warranties in future?

Hector MacQueen: It may not affect it at all. By and large, solicitors hate collateral warranties, because they are awkward and difficult things to gather in. For any major project, there are usually a very large number of collateral warranties, not just three or four, as in our simple diagram in our report. There may be scores of collateral warranties, or even more, in a major commercial development. They are disliked from that point of view. There is a sort of time-consuming and almost self-defeating element in their collection.

If solicitors wish to eliminate the collateral warranty, they will have to point to our bill as providing an efficient solution and persuade the funders, developers and so on that it is a valuable alternative. To an extent, it will be part of the commission's job, and I would hope that of others who support the bill, to make the case that it offers a better solution to the particular problem.

The Convener: In England and other jurisdictions, statutory rules on third-party rights have been in existence since 1999. Can you provide further information about the impact of that legislation? You spoke about the North Sea oil industry, but do you have other examples?

Jill Clark: Unfortunately, there is not a lot of research or analysis about how effective the 1999 act has been in changing the way that people treat third-party rights. However, some articles have been written and they all talk about there having been a change. It has been a fairly slow change and there is still the issue about people being familiar with collateral warranties and sticking with what they know. In various articles, there is a lot of evidence that Scots lawyers are using the 1999 act.

The one difference is that our starting points are different. When the 1999 act came into force in England and Wales, they did not already have third-party rights, so it was quite a fundamental change in their law. That will not be the case here in Scotland. We have third-party rights; they just do not work very well. It would not be such a significant step for people and it would be an improvement to what already exists, so there might be a greater readiness for people to throw themselves into third-party rights and to use them more than was the experience down in England and Wales. It seems that third-party rights are being used and that people are getting more familiar with them, but people are still using other options.

Hector MacQueen: Perhaps another example from our report would be helpful. We discovered that Network Rail's contracts with the railway companies—they are called station access agreements and track access agreements—all provide for third-party rights, which are in favour of the UK Government south of the border and the Scottish ministers north of the border, to enforce those contracts.

Why did that happen? The answer is that Network Rail's predecessor, Railtrack—the name might conjure up certain images from 2001 or 2002—crashed and burned, and Network Rail replaced it. The crashing and burning of Railtrack exposed the issue of how to keep those agreements going and, south of the border, the 1999 act was a huge boon. All that had to be done to enforce those contracts against the railway companies was to write in that the UK Government had third-party rights. In the English context, the contracts could go on, regardless of what happened with the new company, Network

Rail—the UK Government could simply say that it had rights under the 1999 act. However, in Scotland, there was a slight difficulty. The contract had to refer to jus quaesitum tertio and to say that it was all irrevocable—a distinguished law firm worked very hard to produce that clause. When the bill is in place, it will be simple to refer to the act under its statute short title and say that the Scottish ministers have those rights.

As far as the experience in England is concerned, I think that, next week, the committee is speaking to Professor Hugh Beale, who has carried out the only piece of research that I know of about the actual use of the 1999 act. That research, which was published in about 2010, is very interesting, because it covers a wide range of examples. His research was based on contacting friends and other contacts in the legal profession and asking them how they used the 1999 act. He was surprised to find that the use of it was increasing gently—lawyers do not like to do anything in a great rush—and that things are moving gently forward.

Our research in Scotland tends to confirm that. We do not expect an instant transformation and, in the construction context in particular, the attitude of funders is key. Funders do not want change to the arrangements that seem to work, and that will probably be a dominant factor for some time to come.

11:00

The Convener: You touched a little on arbitration. Will you expand on the need for Scottish arbitration legislation to deal expressly with third-party rights? Would you like to discuss that further?

Hector MacQueen: I will give that one a go. The starting point for Scotland is the Arbitration (Scotland) Act 2010, which is a successful act of this Parliament. It modernised arbitration and was designed to bring business into Scotland. It is being used, albeit slowly and gently. There is plenty of evidence that the act is successful. However, it does not provide for third parties to have rights to join arbitrations or to invoke arbitration clauses. In a sense, it is not surprising that that should be so.

The English included a provision in their act in 1999 ultimately because they had been approached by the arbitration community in London, which had said that that act would be more useful if it included provisions about arbitration. That took place after the Law Commission there had reported and decided that nothing could be done. What happened then was that the relevant commissioner worked with the arbitration industry to produce solutions to two problems, which we can assume that the arbitration community thought were real or potential issues for arbitration.

We have given examples of such issues in our submission. Example 4 is the first case, and it is relatively easy. The relevant provision in the 1999 act, and a similar one in our present bill, concerns a situation where the contracting parties create a third-party right to payment or performance of some kind, such as supply of goods or whatever it might be. However, they make that third-party right dependent on enforcement by arbitration. That will usually be in some sort of general clause in the contract that says, for example, that all disputes that arise from the contract—or the agreement—will be subject to arbitration. People want to avoid the courts, and the law allows them to do that through arbitration clauses.

The question really is, given that the Arbitration Act 1996 for England, like the 2010 act for Scotland, does not allow third parties to join an arbitration, how can such a clause work? The solution that was provided for in the English act of 1999 and which our bill provides for is that, when there is a substantive third-party right—as we sometimes call it—that is subject to arbitral enforcement, that is the enforcement.

It is perfectly consistent with the policy of third-party rights to say that they can be conditional. If they are conditional on arbitral enforcement, the third party should be allowed to submit any dispute or claim that it has to an arbitration. I think and hope that that is an easy example. There is no real difficulty with that.

The second case is more tricky. In essence, it is about claims by or against the third party that lie outside the contract altogether. Perhaps the simplest way to explain that is through example 5 in our submission. I add that that example was suggested to us by the family law arbitration group Scotland, which is a body of family law practitioners who promote the use of arbitration in family disputes—largely, I think, because it is in the interests of less well-off clients.

The case that was put to us is one of cohabitants who have entered into a pre-purchase agreement. They have definitely decided that they do not want to get married or enter into a civil partnership; they wish just to cohabit, but they wish to buy a house together. Apparently, it is perfectly common for there to be an arbitration provision in such transactions. The point of the pre-purchase agreement is that, if the relationship breaks down, the parties will resolve a dispute about the proceeds from the sale of the house by arbitration rather than going through the courts. The great advantage is privacy—arbitration is, in essence, a private process, whereas what

happens in court is public. Therefore, there are certain win-wins.

The scenario that we developed out of that case was based on my experience not as a party but as a seller to persons who could not afford the price without a relative's financial assistance. When we transferred our house to those people, we included in the title the third-party relative who had funded or supported the acquisition of the property. They became a joint owner with the happy couple.

It can happen that the relationship breaks down, although that did not happen in our case, and the third party—the relative—is involved. However, their involvement is not based on anything in the contract. The pre-purchase agreement does not say anything about them, but they have an independent right of property. They have a share in the property that belongs to the two now-disputing persons.

The second provision on arbitration allows a person who is asserting a right that is relevant to a dispute that is otherwise being arbitrated between other parties—the cohabitants, in this case—to join that arbitration and have their claim considered in that context. Why do we have that? The basic point is that if—as under the present law—the funding relative cannot join the arbitration because they are a third party to it, they have to go to court. In that scenario, the risk is that the arbitration will decide one thing about how the proceeds of the house sale are to be distributed and the court will decide another. It makes sense for all issues that relate to the case to be considered in one forum or tribunal, and the obvious one is the arbitration. Therefore, we provide for a third party to be able to join an arbitration between two others because their dispute or claim is relevant to the matter that is being arbitrated between the arbitrating parties, even if they do not have a third-party right in the substantive sense that is available in example 4.

I understand from the English experience that no one could figure an example of that sort and that a case has never been decided under the equivalent provision in England. We are proud of the example that we have thought of, because it seems to be real. It is of a scenario that we know could occur, and we know that arbitration is being used between cohabitants as a way of resolving disputes when their relationship breaks down. We also know that third-party funders frequently take title along with cohabitants, and the relationship breakdown may involve them as well, as we said in the hypothetical example in our submission.

We have advanced one step beyond where the English were in recognising a practical example of where the provision might work or be useful. We will just have to see how that goes once it is available.

The Convener: Given your fertile mind, do you think that arbitration might be used in agricultural law, particularly with regard to limited partnerships, to settle any number of imaginable and unimaginable difficulties that arise?

Hector MacQueen: The agriculture sector is undoubtedly one in which arbitration is used, often quite effectively. I have not been able to think of an example that might involve a third party in that sense. In Scotland, such an arbitration would simply take place under the 2010 act. I think that there are provisions on statutory arbitrations in agricultural holdings legislation, but I am not completely sure.

The Convener: The policy memorandum states that the bill will encourage greater use of Scots law, which is similar to one of the intended objectives of the Legal Writings (Counterparts and Delivery) (Scotland) Act 2015. Has that act led to greater use of Scots law, as trailed and promised at the time?

Jill Clark: The short answer is probably yes. We surveyed the bigger legal firms in Scotland—ones that are likely to have departments that deal with lots of property leases and commercial transactions—and asked them to make inquiries in their organisations. We received generally very positive comments about that act—comments such as, "It has certainly made the decision to use Scots law easier," and "It has been a boon with regard to international transactions and things that were tight on time."

Of course, that was not a formal statistical or analytical follow-up on the act, which has been in force for only 18 months. It is still early days, but there has been uptake and an improvement, and people think that that will continue. We hope that the bill that we are discussing today will have the same sort of impact.

The Convener: That will benefit the Scottish legal fraternity by bringing in work in Scots law.

Jill Clark: Yes.

The Convener: That is excellent. As members have no further questions for our distinguished panel, I thank everyone for taking the time to come to talk to us and giving us such elegant evidence. I dare say that we will be in touch at a later date.

11:13

Meeting suspended.

11:15

On resuming—

Seat Belts on School Transport (Scotland) Bill: Stage 1

The Convener: Agenda item 4 concerns consideration of the delegated powers in the Seat Belts on School Transport (Scotland) Bill. The bill confers on the Scottish ministers one power to make subordinate legislation. It is suggested that we could be content with the power. Does the committee agree that it is content with the one power in the bill and agree to prepare a stage 1 report to that effect?

Members *indicated agreement.*

11:16

Meeting continued in private until 11:29.

Published in Edinburgh by the Scottish Parliamentary Corporate Body, the Scottish Parliament, Edinburgh, EH99 1SP

All documents are available on
the Scottish Parliament website at:

www.parliament.scot

Information on non-endorsed print suppliers
is available here:

www.parliament.scot/documents

For information on the Scottish Parliament contact
Public Information on:

Telephone: 0131 348 5000
Textphone: 0800 092 7100
Email: sp.info@parliament.scot

The Scottish Parliament
Pàrlamaid na h-Alba