

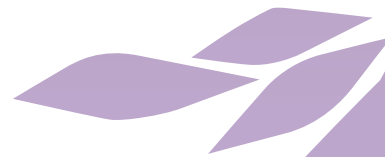


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# **Delegated Powers and Law Reform Committee Comataidh Cumhachdan Tiomnaichte is Ath-leasachadh Lagh**

## **Stage 1 Report on the Contract (Third Party Rights) (Scotland) Bill**



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# Delegated Powers and Law Reform Committee

The remit of the Delegated Powers and Law Reform Committee is to consider and report on the following (and any additional matter added under Rule 6.1.5A)—

- (a) any—
  - (i) subordinate legislation laid before the Parliament or requiring the consent of the Parliament under section 9 of the Public Bodies Act 2011;
  - (ii) [deleted]
  - (iii) pension or grants motion as described in Rule 8.11A.1; and, in particular, to determine whether the attention of the Parliament should be drawn to any of the matters mentioned in Rule 10.3.1;
- (b) proposed powers to make subordinate legislation in particular Bills or other proposed legislation;
- (c) general questions relating to powers to make subordinate legislation;
- (d) whether any proposed delegated powers in particular Bills or other legislation should be expressed as a power to make subordinate legislation;
- (e) any failure to lay an instrument in accordance with section 28(2), 30(2) or 31 of the 2010 Act;
- (f) proposed changes to the procedure to which subordinate legislation laid before the Parliament is subject;
- (g) any Scottish Law Commission Bill as defined in Rule 9.17A.1; and
- (h) any draft proposal for a Scottish Law Commission Bill as defined in that Rule.
- (i) any Consolidation Bill as defined in Rule 9.18.1 referred to it in accordance with Rule 9.18.3.



<http://www.parliament.scot/parliamentarybusiness/CurrentCommittees/delegated-powers-committee.aspx>



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Scottish Conservative  
and Unionist Party



**Monica Lennon**  
Scottish Labour



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# Executive Summary

1. The Contract (Third Party Rights) (Scotland) Bill is a Scottish Law Commission Bill. The Bill reforms the common law on third party rights and replaces it with a statutory version.
2. The Bill has been introduced with a view to providing greater certainty and flexibility in this area of law. The Committee found that as result of the current uncertainty around the current common law on third party rights, legal practitioners and their clients are using workarounds such as collateral warranties or English law.
3. It appears clear to the Committee that codifying the law of third party rights is welcomed by stakeholders.
4. While there is universal support for the Bill, the evidence the Committee received suggested that there would not be an immediate uptake of the Bill. The Committee recognises that the Bill may not be widely used in the short-term, but is hopeful that the flexibility and certainty that the Bill offers will lead to greater use in the future.
5. A number of suggestions were made to the Committee in evidence advocating changes to the drafting of the Bill to improve its clarity. It is critical that this legislation is clear and usable and the Committee therefore welcomes the Scottish Government's commitment to review these suggestions.
6. The Committee welcomes this legislation and recommends that the general principles of the Bill be agreed to.

# Introduction

7. The Contract (Third Party Rights) (Scotland) Bill (“the Bill”) was introduced in the Scottish Parliament on 31 January 2017 by the Cabinet Secretary for Justice, Michael Matheson MSP.
8. The Delegated Powers and Law Reform Committee was designated as lead committee for Stage 1 consideration of the Bill.
9. In addition to carrying out the role of lead committee, under rule 9.6.2 of Standing Orders the Committee is required to consider and report upon any provisions in the Bill which confer power to make subordinate legislation. The Committee considered the delegated powers within the Bill and reports on these at paragraphs 141 to 144.
10. The Finance and Constitution Committee considered the Financial Memorandum to the Bill. It issued a call for evidence, but on receiving no responses to that call for evidence, agreed not to undertake any further consideration of the Bill.

## Evidence Gathering

11. To inform its consideration of the Bill, the Committee issued a call for evidence. The Committee issued the call for evidence to 106 individuals and organisations and also promoted it on its website and via twitter. Although this is a reform to a technical area of the law, its provisions will affect a broad spectrum of society, not just the legal fraternity. Accordingly, the committee through the call for evidence and through its use of twitter made contact with a broad spectrum of society.
12. The submissions received are listed at Annex C.
13. The Committee also held oral evidence sessions on 14, 21 and 28 March and 18 and 25 April 2017. Evidence was taken from law bodies, legal practitioners representing financial, construction and agriculture interests, academics, architects, arbitrators, the Scottish Law Commission and the Scottish Government.
14. The Committee thanks those who informed the Committee’s consideration of the Bill.

# Background

15. The Bill is a Scottish Law Commission Bill (“SLC Bill”) under rule 9.17A of Standing Orders.
16. The SLC Bill process is a relatively new one, which was created in order to improve the implementation rate of Scottish Law Commission reports.
17. The process allows for the Delegated Powers and Law Reform Committee to take the lead role in considering certain bills arising from Scottish Law Commission reports.
18. This is the third SLC Bill to be introduced and the first to be considered by the Delegated Powers and Law Reform Committee in Session 5.

## *What are third party rights?*

19. Contracts allow people, or other legal entities such as companies, to create rights and duties which can be enforced. In general, these rights and duties are only enforceable between the parties to the contract. The idea is that the contractual relationship is exclusive to the parties (known as ‘privity of contract’).
20. Although privity of contract is the general principle, almost all legal systems have rules which allow the parties to a contract to grant rights to third parties.
21. Third party rights are rights conferred by contracting parties upon a person who is not a party to the contract. Such rights have long been recognised in Scots law under the common law doctrine of *jus quaesitum tertio* (JQT), meaning the third party has acquired a right.

## *Why has the Bill been brought forward?*

22. The SLC examined Scots law on third-party rights in a March 2014 Discussion Paper<sup>i</sup> and compared it with international benchmarks.
23. Following a consultation exercise, and input from an Advisory Group comprising legal practitioners, academics and judges, the SLC published a Report on Third Party Rights in July 2016<sup>ii</sup>. This concluded that the existing common law was not fit for purpose and needed to be replaced with new statutory rules.
24. The SLC’s Discussion Paper and Report outline in depth the range of legal and practical problems stemming from the current law on third-party rights.
25. The problems and the solutions the Bill seeks to provide to those problems are explored in more detail later in this report. However, in essence these are concerns about clarity, certainty and inflexibility within the current law, which have resulted in legal practitioners and their clients not using Scots law of third party rights and instead relying on English law or workarounds such as collateral warranties<sup>iii</sup>.

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<sup>i</sup> [SLC Discussion Paper on Third Party Rights](#)

<sup>ii</sup> [SLC Report on Third Party Rights](#)



26. The report included a draft Bill, which has been largely followed by the Bill as introduced.

### *Speed of law reform*

27. The Bill has been introduced three years after the SLC issued a discussion paper on the Scots law of third party rights.
28. The Committee was advised, however, that the uncertainty in the law on third party rights has existed for some time.
29. Common law develops on the basis of the decisions of judges and judges' decisions depend on someone putting a question to them for a decision. The uncertainty which this legislation seeks to remedy relates to a House of Lords decision in 1920.
30. Specifically, it stems from the House of Lords judgment in a Scots appeal in 1920 in *Carmichael v Carmichael's Executrix* 1920 SC (HL) 195. The judgement states that it is not enough for the contracting parties to intend a third party to have a right by saying so in their contract. They must take additional formal steps by which they make this provision irrevocable (incapable of alteration or cancellation). There are various ways of doing this, such as delivery of the written contract to the third party, intimation or notification to the third party, or registration in a public register.
31. Jill Clark from the Scottish Government Bill Team explained to the Committee the problems created by this judgement—
- ” “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.”<sup>iv</sup>
32. The Committee was informed that there has been an awareness of the problems created by this judgement since the post second world war period.<sup>v</sup>
33. Professor Beale, professor of law at the University of Warwick, advised the Committee that there was an equally long period in England and Wales between the identification of the problem and the bringing forward of legislation. He advised the Committee that work had started on legislation in this area in 1937, but the legislation had only materialised in 1999.
34. James Rust, a partner with Morton Fraser, suggested that much of the reason for the delay can be attributed to a lack of parliamentary time to consider law reform—

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iii Collateral warranties are contracts which are designed to establish a contractual link between a third party (the beneficiary) and a contractor or consultant who has carried out certain works.

iv Delegated Powers and Law Reform Committee 14 March 2017, Official Report Col.7

v Delegated Powers and Law Reform Committee 14 March 2017, Official Report, Col 7

” “A lot of very good legislative change has been spoken about in the Scottish Law Commission, but there was no parliamentary time to deal with it. Since we have had the Scottish Parliament, the dam has burst and we have got on with it. Practitioners have, in the past, just got on with the job of life and made do with the law with all its imperfections. We are catching up with this particular imperfection. My personal view is that it would not be fair to characterise the issue in the bill as one that has been particularly noteworthy for being slow to change; rather it is part of a wider problem that we are in the process of dealing with.”<sup>vi</sup>

35. Craig Connal QC did suggest that improvements could be made in the speed with which the SLC responds to concerns with the law. He specifically highlighted as a problem that if a matter is not within the SLC’s current programme of law reform it cannot deal with it at that time.<sup>vii</sup>
36. In general, however, witnesses were not concerned about the speed of law reform. Indeed, Professor Vogenauer was particularly complementary about the ‘amount of serious comparative research done by the Law Commission ...which is truly impressive and exemplary’.<sup>viii</sup>
37. However, mindful of the time taken to bring forward this legislation, the Committee explored with the Minister for Community Safety and Legal Affairs whether there would be benefit in bringing forward legislation making provision for more than one area of law reform at the same time, so as to speed up the process of law reform.
38. The Minister committed to exploring this suggestion with Lord Pentland (Chair of the SLC), but at the same time noted that waiting for multiple pieces of legislation to be ready to bring forward could in fact slow down the speed of law reform.<sup>ix</sup>

**39. The Committee notes the time it has taken to bring forward this legislation, but at the same time recognises the obstacles that have existed to doing so. The Committee also notes the general absence of concern about the time it has taken and the positive comments expressed by Professor Vogenauer about the SLC’s process.**

**40. Nonetheless the Committee welcomes the Minister’s commitment to explore with Lord Pentland the Committee’s suggestion to bring forward legislation making provision for more than one area of law reform at the same time, where appropriate.**

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<sup>vi</sup> Delegated Powers and Law Reform Committee 28 March 2017, Official Report, Col 11

<sup>vii</sup> Delegated Powers and Law Reform Committee 28 March 2017, Official Report, Col 37

<sup>viii</sup> Professor Vogenauer, written submission to the Delegated Powers and Law Reform Committee

<sup>ix</sup> Delegated Powers and Law Reform Committee 25 April 2017, Official Report, Col 16


## What does the Bill do?

41. The Bill implements the SLC's recommendations and reforms the common law on third-party rights, replacing it with a statutory version.
42. The general aim behind the Bill is to provide a new statutory framework with clearer, more usable rules on third-party rights.
43. The main proposal is the abolition of the existing rule that third-party rights have to be irrevocable to be created – in other words that the parties must intend to give up the right to change their minds about granting the right.
44. Other proposals are aimed at clarifying current areas of uncertainty in the common law.
45. The Bill also includes new rules which mean that third-party rights to arbitrate could be created.

## General Principles

46. The evidence taken by the Committee suggests that there is universal support for the Bill.
47. The Committee explored in written and oral evidence what benefits would be derived from moving from the current common law position to a statutory footing.
48. The Bill team and the SLC indicated that relying on the common law position is unsustainable as case law is unlikely to develop fast enough to deal with the problems identified in the law and as a consequence, statutory rules are needed.
49. There was universal acceptance from those who provided evidence to the Committee that the common law approach to third party rights is not satisfactory.
50. The SLC highlighted two principal benefits from moving from a common law approach to a statutory footing. The first is that it enables uncertainty in the law to be removed and secondly it permits reform of aspects of the common law which act as barriers to the use of third-party rights in Scots law, principally that it offers greater flexibility.

### *Legal certainty*

51. Concerns about the absence of certainty in the current common law approach were frequently expressed to the Committee.
52. David Christie described this uncertainty as a ‘death spiral’. i.e. a lack of certainty in the law prevents the use of third party rights which leads to a lack of case law preventing the law from being developed thus continuing the uncertainty of the current position.<sup>x</sup>
53. The Law Society of Scotland highlighted this uncertainty and noted that lawyers do not like to give advice in areas where the law is unclear.
54. Jonathan Gaskell of DLA Piper echoed this view—  
 “Lawyers tend to be quite risk-averse creatures and we do not like to advise clients in areas of law that are not particularly certain. There is no recent case law in this particular area of common law, so there is a lot of uncertainty. Institutions and businesses do not like uncertainty and that is one of the reasons why there is no reliance—in general terms and certainly not in construction, which is my sector— on third-party rights under the common law. For that reason, the bill is a good thing: it codifies the existing law and gives certainty. Businesses and individuals who work in industry like certainty.”<sup>xi</sup>
55. Karen Manning of Burness Paull reflected on her own experience as a lawyer in the construction industry and suggested that there is a general agreement that “...JQT is not fit for purpose”.<sup>xii</sup>

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x Professor Vogenauer, written submission to the Delegated Powers and Law Reform Committee

xi Delegated Powers and Law Reform Committee 21 March 2017, Official Report, Col 17

56. The Committee was informed that as a result of this uncertainty as much as anything, lawyers have resorted to the use of workarounds, such as collateral warranties and the use of English law.
57. David Wedderburn of the Royal Incorporation of Architects in Scotland (RIAS) emphasised that concerns about certainty were also very important to those engaging in contracts as they were often risking significant sums of money.
58. Karen Fountain, a partner with Brodies LLP was hopeful that the legislative approach would provide certainty—
- ” “The legislation helpfully codifies the law and takes it back to the basic principle that people should be able to enter into whichever contractual and promissory rights they want to enter into, as long as they write it down. The bill is effectively taking us back to the Ronseal moment: the contract should do what it says on the tin. At the moment, you cannot be confident that that is the case, and you need to be confident.”<sup>xiii</sup>
59. David Christie echoed Karen Fountain’s sentiments about codification of the law and drew an analogy with IT problems—
- ” “The best way to short-circuit the problem, if we think that third-party rights are a good idea, which I think they probably are, is to codify them in legislation—essentially, we reboot the common law.
- ...it is a bit like what happens when someone has a technical problem with their computer. Often, they just continue to use it and find a way to get along with the problem. That is in some ways like collateral warranties in the construction industry—it is not necessarily easy but it does the job. What we really need is for somebody to upgrade the system and get rid of the problem altogether. At least that would give a choice about how to keep going.”<sup>xiv</sup>
60. The Committee did not hear any evidence to suggest that there was any alternative means to achieve certainty in this area of law. The Committee recognises that legal certainty is essential for legal practitioners and their clients. Furthermore, the Committee appreciates that this certainty was very unlikely to be reached if a common law approach was maintained.

**61. The Committee therefore welcomes this codification of the law of third party rights and the certainty it provides for the users of Scots law.**

### *Flexibility*

62. The other significant benefit attributed to the Bill by the SLC is flexibility.
63. As noted earlier, the Bill abolishes the rule that third party rights have to be irrevocable to be made.

xii *ibid*

xiii Delegated Powers and Law Reform Committee 21 March 2017, Official Report, Col 18

xiv Delegated Powers and Law Reform Committee 28 March 2017, Official Report, Col 21

64. Section 3(1) expressly allows contracting parties to modify or cancel an existing third-party right unless the exceptions in sections 4–6 (which provide exceptions to the general rule allowing the contracting parties to modify/cancel a third-party right) apply. However, section 3(2) allows contracting parties to make a right irrevocable if they wish by providing that they remain free to declare that a third party right cannot be modified or cancelled.
65. Kenneth Rose, a Partner with CMS, explained to the Committee the impact the irrevocability rule has had and why he supports its abolition—
- ” “I support its abolition. The approach that was taken in the 1920 Carmichael case was unfortunate. It may well have applied to the equities of that particular case, but the long-term effect was to create—contrary to what some of my colleagues have said—an inflexibility that has prevented or hindered the use of the JQT principle. Anything that makes the approach more flexible and goes back to the basic principle of two or more parties contracting with each other and voluntarily agreeing a set of obligations and rights would make our legal system more attractive and more user-friendly for individual parties.”<sup>xv</sup>
66. Evidence provided to the Committee suggested that the abolition of the irrevocability rule will make it easier to create and subsequently remove third party rights in contracts.
67. The Law Society of Scotland highlighted this point in its submission stating that the removal of the irrevocability rule means that the law will become more flexible. CMS stated that this flexibility means that rights can be conferred on separate individual companies within a wider corporate group of companies without making all of the companies party to the contract or identifying them by name.
68. Giving evidence to the Committee, both John MacLeod, representing the Law Society of Scotland and Ross Anderson, representing the Faculty of Advocates welcomed the removal of the irrevocability rule. They welcomed both the flexibility and the protections contained in the Bill.<sup>xvi</sup>
69. The SLC stated that a further benefit of the Bill is that it will be easy to exclude third-party rights should they wish to do so. The Law Society of Scotland supported this point, recognising that the Bill creates rights for third parties, but it doesn't impose obligations on contracting parties. They were therefore of the view that there is a fair balance between granting freedom to contracting parties while ensuring the third party is not treated unfairly.
70. Third parties will also benefit from the Bill according to the SLC as there will be clarity about how a third party can enforce their rights. This is something that is not certain in the present law. The SLC also stated that the Bill provides clarity on defences against the third party.
71. The SLC indicated that one area of the Bill that could be considered as impacting negatively on third party rights is that even after contracting parties have concluded a contract with a third party right provision in it, it may be changed or cancelled altogether. The SLC noted that any cancellation or modification will be required to

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<sup>xv</sup> Delegated Powers and Law Reform Committee 21 March 2017, Official Report, Col 20

<sup>xvi</sup> Delegated Powers and Law Reform Committee 25 April 2017, Official Report, Col 6

be agreed by all contracting parties and as a result, this provides some protection for third parties.

72. However, none of the evidence the Committee received identified this as a concern.

73. In its written submission to the Committee, the SLC expanded on these protections to third parties—

” “The Bill does however provide a considerable amount of further protection for third parties against unfair cancellation or modification of their right in certain circumstances. These are:

a) where the contracting parties give a binding commitment in the contract that they will not cancel or modify the third-party right (section 3(2));

b) where the third-party right becomes enforceable only after the occurrence of some event (it is a conditional right), and that event then happens (section 4);

c) where the third party is notified of the right by a contracting party and the parties subsequently cancel or modify the right (section 5);

d) where the third party acts in detrimental reliance on the existence of the right, with the knowledge and acquiescence of the contracting parties, or such activity could have been foreseen by them, and the cancellation or modification of the right would have further adverse effects on the third party (section 6).”<sup>xvii</sup>

**74. The Committee welcomes the abolition of the irrevocability rule and the flexibility the new legislation provides.**

**75. The Committee equally recognises that protections and balances are needed to protect third parties given that the Bill allows their rights to be changed or cancelled altogether. To that end the Committee welcomes the protections included in the Bill at sections 4 to 6. However, this welcome is caveated by some concerns about the drafting of sections 4 to 6, which are explored later in this report at paragraphs 78 to 85.**

## Specific provisions within the Bill

76. Although there has been universal support for the Bill, there have been recurring concerns about the drafting of certain provisions in the Bill.
77. There were also more general concerns about the approach taken in some of the sections.
78. This section of the report explores these concerns.

### *Section 1 - Essentials for the creation of a third-party right*

79. Section 1 sets out the essentials for the creation of a third-party right, including the need for:
  - A contract which intends to grant a right to a third party (section 1(2))
  - A third party identifiable in the contract (section 1(3))
80. The word undertaking is used throughout section 1. The Faculty of Advocates commented that the word ‘undertaking’ is unfamiliar in a Scottish and international context and suggests sections 1(2) and (4) could be improved by replacing ‘the undertaking’ with ‘the contract’ or ‘the third party right’.<sup>xviii</sup>
81. Professor Hugh Beale also raised concerns about the drafting of section 1. He suggested that in section 1(1)(a) it is not clear whether the words of the contract must indicate that an undertaking is for the benefit of the third party, or whether it will suffice that the third party would in fact benefit from performance.
82. Furthermore, Professor Stefan Vogenauer suggested that rather than the Bill using the phrase ‘a person who has a third-party right’ repeatedly, it would be easy to define ‘third party’ together with ‘third-party right’ in section 1 to avoid this issue. It is also his opinion that sections 1 and 2 could be combined into a single section or re-ordered slightly.

**83. The Committee notes these concerns and invites the Scottish Government to reflect upon them.**

### *Sections 4-6 - Exceptions to the rule allowing cancellation/modification of a third-party right*

84. The Faculty of Advocates suggested that sections 4 to 6 are not easy to follow. They suggested that in line with the Principles of International Contracts<sup>xix</sup>, there is scope to encapsulate these sections into a single sentence. This approach is stated as reflecting the terms of the Requirements of Writing (Scotland) Act 1995.<sup>xx</sup>

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<sup>xviii</sup> Faculty of Advocates written submission to the Delegated Powers and Law Reform Committee

<sup>xix</sup> The Principles of International Commercial Contracts (PICC) is a document drawn up by UNIDROIT intended to help harmonize international commercial contracts law



85. The Law Society of Scotland shared these concerns and suggested that signposting regarding their content and effect would significantly improve their accessibility.
86. Craig Connal QC suggested that the language used in the sections potentially provided room for litigation—
- ” “I make it clear to the members of this committee that I am a contentious lawyer—I deal with problems—although for the purposes of giving this evidence I have spoken to people who work in other areas, such as drafting documents, so I may be able to assist on some of those points as well. However, when I see sections that talk about “reliance” and “to a material extent” I wonder what that means and think to myself that we can litigate over that.”<sup>xxi</sup>
87. Professor Hugh Beale suggested that the drafting of sections 4-6 is very sophisticated but hard to understand. In contrast, he stated that the 1999 Act is simpler i.e. once the right has been accepted by the third party, it cannot be varied unless the contract so provides. Professor Beale concluded that while this is cruder, it is easier to understand.
88. The Committee drew these concerns to the Minister’s attention.
89. The Minister suggested that the Government had reflected on the evidence received by the Committee, but remained content that sections 4 to 6 achieved the intention “...to slightly balance the fairness issue in relation to third parties.”
90. The Minister indicated that direct comparisons with England and Wales could not be drawn.
- ” “To go back to first principles, the bill is codifying hundreds of years of Scots law; we have had a tradition of third-party rights. We must not pretend that we are starting from scratch; we must recognise that we are codifying what has been a centuries-old element of our legal system and approach it in that way. To make a direct comparison with the legislation in England and Wales—on any issue—is not to make the right comparison. In this case, we would be comparing an act that introduced third-party rights into a legal system for the first time with a bill that is patently not doing that. We are starting from a different place and we must reflect that in the drafting of our provisions.”<sup>xxii</sup>

- 91. Nonetheless, the Committee received evidence from a variety of sources raising concerns about the drafting of these provisions and invites the Scottish Government to continue to reflect on the clarity and usability of these provisions.**

## *Section 9 - Arbitration*

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<sup>xx</sup> An Act to reform the law of Scotland with regard to the requirement of writing for certain matters and the formal validity of contractual and other documents

<sup>xxi</sup> Delegated Powers and Law Reform Committee 28 March 2017, Official Report, Col 22

<sup>xxii</sup> Delegated Powers and Law Reform Committee 25 April 2017, Official Report, Col 25

92. Arbitration is a way in which legal disputes can be resolved outside the courts. It is frequently used in commercial settings and involves a contractual term (the “arbitration agreement”) requiring disputes to be referred to persons known as “arbitrators”, or a specified arbitration body, who consider the dispute and make a decision (the “arbitration award”). Normally, the parties agree to be bound by this award and options for appealing to the courts are limited.
93. The problem identified by the SLC is that the Scottish arbitration legislation (the Arbitration (Scotland) Act 2010) does not deal expressly with third-party rights. The SLC explained that—
- ” “The issue with which we are concerned ... is where a contract contains a clause under which future disputes are to be submitted to arbitration should they arise. The question then is whether a third party who by definition is not a party to the contract or the arbitration agreement which it contains can nonetheless subsequently invoke the latter.... if the contracting parties are content that the matter ... should be determined by arbitration, there is no problem. But if at the time the third party makes the move it is opposed by one or more of the contracting parties, then it will be confronted with the currently insuperable difficulty that it is not party to the arbitration agreement and so has no entitlement (under the default Rule 1 of the Scottish Arbitration Rules) to submit a dispute to arbitration.”<sup>xxiii</sup>
94. Section 9 provides a mechanism so that an arbitration agreement between the contracting parties can operate in respect of third-party rights. It provides that a third party will become a party to an arbitration agreement in two situations:
- Section 9(2) – Where there is a dispute about a substantive third-party right and the main contract requires contractual disputes, including disputes about the right in the third party’s favour, to be submitted to arbitration. According to the Explanatory Notes (para. 37) this will be the main case and will cover, for example, situations where the third party has a right to be indemnified by a contracting party against claims for which the third party is found liable. In such circumstances the third party must submit the dispute to arbitration if it wishes to pursue it. Alternatively, if a contracting party raises a court action against the third party in respect of such a dispute, the latter may seek a suspension of the legal proceedings (known as a ‘sist’ in Scots law) allowing the arbitration to take place.
  - Section 9(3) – Where the dispute is not about a third-party right arising from the contract, but rather about an independent right such as a non-contractual claim based on delict brought by or against a party to an arbitration agreement which can also apply to the dispute with the third party. In such circumstances the third party has the option (but not the obligation) of submitting the dispute to arbitration or seeking a sist in respect of a court action raised against it.
95. A wide range of comments were received about the Bill in relation to section 9.

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<sup>xxiii</sup> [https://www.scotlawcom.gov.uk/files/2014/6850/9379/Review\\_of\\_Contract\\_Law\\_-\\_Report\\_on\\_Third\\_Party\\_Rights\\_No\\_245.pdf](https://www.scotlawcom.gov.uk/files/2014/6850/9379/Review_of_Contract_Law_-_Report_on_Third_Party_Rights_No_245.pdf)

96. In its written evidence RIAS welcomed this section. It highlighted that it is currently difficult for third parties to join in arbitrations dealing with collateral warranties and that section 9 of the bill will make it easier for multiparty arbitrations to take place.

97. Craig Connal QC questioned whether the Bill had made an error in only making provision for arbitration as a dispute resolution mechanism—

“Many disputes might involve construction contracts, which do not generally have arbitration as their first port of call. Such contracts use what is called adjudication as a dispute resolution mechanism. They have other dispute resolution mechanisms—in particular, a thing called expert determination, which is simply an agreement to refer a particular matter to a skilled person whose decision will be binding. There may be other dispute resolution mechanisms within a contract. If the logic that drives that provision is that third parties should use the same suite of options, I would have expected a wider provision than one that focuses just on arbitration because it happened to be a statutory scheme that recently came into force<sup>xxiv</sup>”

98. Hew Dundas, an International Arbitrator, suggested, however, that it was unnecessary to include provision for adjudication—

” “I see no need for the bill to address adjudication at all, in the same way that, if we suppose that the parties were just to settle the dispute instead of going to adjudication, we would not even look at the bill. After the adjudication is complete, if the parties accept the adjudicator’s decision, the outcome for the purposes of the bill is, in effect, that they have agreed a settlement themselves. I do not see why the bill should be engaged and I can imagine significant complications if it were suddenly, at this stage, to be expanded to bring in adjudication. I would need a little time to think about the matter. In summary, adding adjudication is not necessary and could be confusing.”<sup>xxv</sup>

99. The Minister equally did not see a need to include adjudication on the face of the Bill, noting that the inclusion of arbitration in the Bill was to ensure that third parties can participate in arbitration agreements. The Minister advised the Committee that she was not convinced that similar provision needed to be made for other dispute resolution mechanisms. Nevertheless she committed to reflect on whether or not provision should be made for other dispute resolution mechanisms.

**100. The Committee is not persuaded that it is essential that other dispute resolution mechanisms are included on the face of the Bill. Nonetheless, the Committee welcomes the Minister’s commitment to review this matter further.**

101. The remainder of the concerns about section 9 related to its drafting.

102. The Faculty of Advocates recognised that section 9(3) seeks to address a situation where a third party does not have a substantive right under the contract at all, but suggested that the arbitration agreement in the contract may be intended to extend

<sup>xxiv</sup> Delegated Powers and Law Reform Committee 28 March 2017, Official Report, Col 35

<sup>xxv</sup> Delegated Powers and Law Reform Committee 18 April 2017, Official Report, Col 10

to the third party. However, the Faculty suggested that references to “a third party right to enforce or otherwise invoke the agreement” in section 9(c) and (d) of the Bill is wrongly expressed as section 9(3) is intended to deal with a situation where the third party does not have a third party right in terms of section 1 of the Bill. The Faculty of Advocates advocated removing the words “third-party” in sections 9 (c) and (d) to resolve this matter.

103. The Law Society of Scotland urged careful consideration of the evidence submitted on behalf of the Faculty of Advocates. They support the inclusion of clarification around the application of arbitration which they consider may be helpful where the contracting parties have specified a preference for arbitration.
104. Hew Dundas and David Bartos, both arbitrators, also raised concern with some of the wording on the Bill in relation to arbitration. For example, they stated that as contracts cannot impose duties on third parties without their consent, a third party will not be bound to arbitrate. It is their view that the Bill needs to recognise that in so choosing, a third party may lose this valuable benefit.
105. The Minister advised the Committee that the Scottish Government continued to be content with the drafting of section 9. However, the Government would continue to review the drafting in consultation with the SLC and David Bartos.

**106. The Committee welcomes the Scottish Government’s commitment to review the drafting of this section further.**

107. Subsequent to the Minister’s oral evidence session, the Committee received a further suggestion in terms of the drafting of section 9 from Hew Dundas.
108. At his appearance before the Committee, Hew Dundas emphasised that if parties have contracted to arbitrate then they must go to arbitration. Litigation should not be pursued.
109. Hew Dundas suggested that every effort should be made in the Bill to close off possible litigation in breach of, or in the face of, an arbitration agreement.
110. He provided the Committee with the following suggested amendment to be inserted between the existing sub-sections 9(4) and 9(5) with consequent renumbering—

*“(4A) Where*

- 1. one of the parties to a contract (the “Assured”) is insured by a third party insurer (the “Insurer”) under a policy of insurance (the “Policy”) in respect of any matters arising under or in connection with the contract;*
- 2. under the Policy the Insurer pays out the Assured for loss or damage suffered allegedly caused by the other party to the contract;*
- 3. the contract incorporates an arbitration agreement which covers any claim for that loss or damage suffered; and*

4. *the Insurer acquires, whether by subrogation or otherwise, some or all of the Assured's rights against the other party to the contract in respect of the claim for that loss or damage referred to in sub-section 9(4A)(ii) above*

*then, at the same time as acquiring those rights, the Insurer shall become bound to and by the arbitration agreement incorporated in the contract to the extent that said arbitration agreement covers the loss or damage the subject of the claim.*<sup>xxvi</sup>

111. He advises that this drafting is predicated on proposed amendments by the Faculty of Advocates to sections 9(3) and 9(4) being accepted.

**112. The Committee invites the Scottish Government to reflect on this suggested amendment provided to the Committee.**

#### *Section 10 – Renunciation of third-party right*

113. Professor Vogenauer identifies that the rule on renunciation, as set out in section 10 of the Bill, merits reconsideration and clarification. He highlights the following in his written submission—

” “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...and that it is not at the disposal of the contracting parties.”<sup>xxvii</sup>

114. He goes on to state that most importantly, it is necessary to ‘clarify the consequences of the third party renouncing the right.’

**115. The Committee would welcome the Scottish Government's reflections on this suggestion.**

#### *Section 12 - Abolishing the common law rules on third-party rights*

116. Section 12 abolishes the common law rules on third-party rights (the *jus quaesitum tertio*). On commencement of the Act existing common law third-party rights will continue in force, unless otherwise provided in contract (section 13). However, it will not be possible to create new common law rights. Instead third-party rights as defined in section 1 may be created.

117. Shepherd and Wedderburn LLP noted that the new statutory regime provides that contingent JQT rights may be created. However, by contrast, they claim that the Bill does not provide that a contingent JQT which would have been created under the common law regime on satisfaction of the relevant contingency is preserved in the saving provisions set out in section<sup>xxviii</sup>.

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<sup>xxvi</sup> *Supplementary written evidence from Hew Dundas*

<sup>xxvii</sup> Professor Vogenauer, written submission to the Delegated Powers and Law Reform Committee

118. The Minister reflected on this suggestion in her evidence to the Committee—

” “Shepherd and Wedderburn raised a very good point. It is certainly clear that the intention is to ensure that contingent or conditional *jus quaesitum tertio*, or third-party rights, that are currently in existence can be enforced at the time of crystallisation of the right and that it is absolutely not the intention of the bill to do anything that would hinder that. Therefore, it is clear that we need to reflect further on our drafting on that point, because the use of the word “acquired”, although it is clear in one regard, could perhaps benefit from further clarity to ensure that there is absolutely no dubiety about the fact that contingent third-party rights that are currently in existence are absolutely not affected by the legislation. We will actively look at that.”<sup>xxix</sup>

119. **Again, the Committee welcomes the Scottish Government’s commitment to review this suggestion further.**

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<sup>xxviii</sup> Shepherd and Wedderburn, written submission to the Delegated Powers and Law Reform Committee

<sup>xxix</sup> Delegated Powers and Law Reform Committee 25 April 2017, Official Report, Col 13

## Will the Bill be used?

120. The Policy Memorandum states that the Bill will promote the use of Scots law. While there was widespread support for the Bill, many witnesses did not expect the Bill's provisions to be adopted by the legal profession in Scotland immediately. Witnesses suggested that legal practitioners and their clients are likely, at least in the short-term, to continue to use workarounds with which they are more familiar, such as collateral warranties and English law.
121. Moreover, the experience in England and Wales would appear to suggest that it may take some time for this legislation to be adopted.
122. Legislation on third party rights has been in place in England and Wales since 1999 through the Contracts (Rights of Third Parties) Act (the 1999 Act). However, from the evidence the Committee has received, it appears that only recently has there been an uptake in the use of the Act and even then it appears that in most cases the construction sector continues to use collateral warranties.<sup>xxx</sup>
123. Witnesses, including the Law Society of Scotland and the RIAS, however, suggested that the benefits offered by the Bill could encourage legal practitioners and their clients to use the Bill.
124. Specifically, the Law Society highlights anecdotal evidence to suggest that where parties are looking to create a more flexible/revocable right, they are more likely to use English law. The Law Society highlighted that the new Bill provides such flexibility and revocable rights and as a result, this may lead to the use of Scots Law. This is a view shared by CMS Cameron McKenna LLP.
125. The Faculty of Advocates suggested that, while it seemed unlikely that this Bill would encourage businesses to use Scots Law who would otherwise not have done so, it offers a tool to those operating in Scotland. Ross Anderson, giving evidence on behalf of the Faculty, also suggested that the Bill may benefit persons who might not have the resources to access expensive legal advice—  

” “...whereas sophisticated parties who have the benefit of sophisticated advice—perhaps from some of the lawyers sitting behind me in the public gallery—will always be able to come up with some sort of workaround to any lacuna in the law, those who do not have the benefit of such advice are in a difficult position at the moment because the law is so unclear. One of the great advantages of the bill is that it sets out, in modern language, what the law actually is.”<sup>xxxi</sup>
126. The Law Society of Scotland also highlights that recent experience from the Legal Writings (Counterparts and Delivery) (Scotland) Act 2015 suggests that clarifying legislation in contract law can improve the use of Scots Law.

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<sup>xxx</sup> Delegated Powers and Law Reform Committee 21 March 2017, Official Report, Col 35

<sup>xxxi</sup> Delegated Powers and Law Reform Committee 21 March 2017, Official Report, Col 8

127. The Committee was also made aware that there are problems with the use of collateral warranties. David Wedderburn of RIAS explained to the Committee about some of the technical difficulties associated with collateral warranties—

” “Collateral warranties are independent legal documents, and they can be drafted in any way that parties like. The danger comes if people take them off the shelf from one development and apply them to another. The advantage with the third-party rights approach is that those rights are aligned with the contract, as they are written into it. With a separate document, however, the parties could enter into all sorts of things that do not align with the underlying contract.”<sup>xxxii</sup>

128. David Christie explained to the Committee about the logistical and financial problems associated with the use of collateral warranties and Ross Anderson suggested to the Committee that these practical and financial problems might encourage greater use of the legislation.

129. Nonetheless, the weight of evidence appears to suggest that it is unlikely that the Bill will provoke a significant and immediate increase in the use of Scots Law to govern contracts.

130. Professor Vogenauer states that the choice of law is dominated by factors such as familiarity with the law and ‘intuitive global judgements on the overall sophistication of different legal systems’. As a result, he argues that it cannot be realistically expected that international parties will favour Scots Law as a result of the Bill, unless Scots law can stand out as the ‘law of choice’.

131. In evidence to the Committee the Minister recognised that the uptake of this legislation is not going to happen overnight. She suggested that it will, however, provide a tool to be used alongside other existing alternatives.

132. The Minister also expressed confidence that over time the Bill will be used. Furthermore, the Minister committed to efforts to encourage awareness of the legislation.

**133. The Committee agrees with the Minister that this Bill may not be in widespread use immediately. The Committee does, however, consider it is a useful tool for legal practitioners and the clients to have available to them.**

**134. The Committee recognises that it has taken a long time for the 1999 Act to be used and that lawyers seem likely to continue to use the workarounds with which they are more familiar.**

**135. At the same time, the Scottish context is different from the English one. For example, there is already a legal tradition of third party rights in Scotland that did not exist in England and Wales prior to 1999.**

**136. While the Committee does not in any way suggest that there will be a rapid uptake of the legislation nor does it believe that this change in the law will encourage people not involved in Scottish contracts to use Scots law, it**



**does believe that there will be circumstances where its use will be appropriate and its existence beneficial to legal practitioners and their clients.**

- 137. Moreover the Committee considers that the Bill delivers the flexibility and certainty that has been sought and, balancing this against the disadvantages of workarounds such as collateral warranties, it may lead to greater use of the Bill.**
- 138. The Committee encourages the Scottish Government to contribute to awareness of the legislation that may in turn lead to increased use.**

# Application of the Bill

139. The Committee explored with witnesses the extent to which this Bill will apply to and benefit all sectors.
140. The Committee was advised in evidence that the Bill has been drafted with a view to universal application, that is to say that all sectors and individuals should be able to use its provisions.
141. The Committee sought to test its application. Particularly exploring its application to individuals and also in sectors such as agriculture, which appeared to the Committee to have been given less consideration.
142. In his supplementary evidence provided to the Committee after providing oral evidence on 21 March 2017, Professor Hugh Beale raised some concern that small businesses may not always realise that the rights of third parties are subject to cancellation or variation, particularly if it is hidden away in the small print.
143. This issue was also raised by Jim Beattie, representing a small construction company. He stated that there was scope for larger and more knowledgeable companies to manipulate smaller contractors into accepting liabilities they neither understand nor control.
144. Professor Beale indicated in his written evidence that the problem of unfair clauses in contracts with small businesses is not one that could be ‘sensibly addressed’ in the Bill.
145. The Minister agreed that this was not a matter for this Bill. The Minister noted, however, that the Bill does provide protections and remedies, which it was not entirely clear previously were available—

” “It is important to make it clear that the remedies include the right to damages, which is an issue that has been unclear over the many decades and centuries in which we have relied on the common law third party rights regime.”<sup>xxxiii</sup>

- 146. The Committee accepts that this is not a matter for this legislation. Furthermore, the Committee notes the protections available to third parties in the Bill. The Committee also recognises that consumer protection is a reserved matter under Schedule 5 of the Scotland Act 1998. At the same time, the Committee would welcome further reflection from the Scottish Government on this matter.**

## Delegated powers provisions

147. In addition to carrying out the role of lead committee, under rule 9.6.2 of Standing Orders the Committee is required to consider and report upon any provisions in the Bill which confer power to make subordinate legislation. The Committee may also consider and report on any provision in such a Bill conferring other delegated powers.
148. The Committee considered the delegated powers provisions in the Bill at Stage 1 at its meeting on 7 March 2017.
149. The Bill contains only one delegated power (section 14). Section 14 gives the Scottish Ministers power to commence the Bill's provisions.
150. The Committee was content with the power.

# Financial Memorandum

151. As noted earlier in the report, the Finance and Constitution Committee issued a call for evidence on the Bill, but received no responses and did not undertake any further consideration of the Bill.
152. The Financial Memorandum itself does not anticipate any new costs arising from the Bill.
153. The evidence the Committee received supported this conclusion.
154. The SLC, CMS and David Christie suggested that there will be some limited costs in terms of educating people who choose to use the Bill. For example, there may be costs for the legal profession who will be implementing the legislation and businesses who may wish to take advantage of it.
155. At the same time, the SLC, RIAS and David Christie argued that the Bill may lead to savings. For example, it was highlighted that the use of collateral warranties can be costly and that using the tools provided by the Bill could provide savings to businesses and the legal profession.

# Policy Memorandum

156. The Committee is content with the Policy Memorandum provided in support of the Bill.

## Conclusions on the general principles of the Bill

157. It appears clear to the Committee that codifying the law of third party rights has been generally welcomed by stakeholders.
158. The Committee accepts that consensus exists around the Bill.
159. The Committee recognises that the Bill may not be used widely in the short-term, but is hopeful that the flexibility and certainty that the Bill offers will lead to greater use in the near future.
160. Given that the aim of the Bill is to provide certainty, the Committee welcomes the Scottish Government's commitment to reflect further on the suggestions made to the Committee about the clarity of the drafting of some provisions.
161. The Committee welcomes the recognition that the Scottish Government has given to the evidence provided to the Committee so far and its willingness to reflect on the suggestions made to the Committee.
162. The Committee recommends to the Parliament that the general principles of the Bill be agreed to.

# Annex A

## EXTRACTS FROM MINUTES OF THE DELEGATED POWERS AND LAW REFORM COMMITTEE

### 6th Meeting, 2017 (Session 5) Tuesday 21 February 2017

**Decision on taking business in private:** The Committee agreed to take item 7 in private.

**Contract (Third Party Rights) (Scotland) Bill (in private):** The Committee considered its approach to the scrutiny of the Bill at Stage 1 and agreed (a) to issue a call for written evidence on the Bill; (b) a programme of oral evidence; (c) to hold a discussion, in private, at the end of each meeting at which oral evidence is taken; (d) to consider all draft reports on the Bill in private; and (e) to delegate to the Convener responsibility for arranging to pay expenses to witnesses under the SPCB witness expense scheme.

### 8th Meeting, 2017 (Session 5) Tuesday 7 March 2017

**Contract (Third Party Rights) (Scotland) Bill:** The Committee considered the delegated powers provisions in this Bill and agreed to reflect contentment with the one power in the Bill in its Stage 1 report as the lead committee for the Bill.

### 9th Meeting, 2017 (Session 5) Tuesday 14 March 2017

**Contract (Third Party Rights) (Scotland) Bill:** The Committee took evidence on the Bill at Stage 1 from—

Graham Crombie, Project Manager, Scottish Law Commission; Hector MacQueen, Commissioner, Scottish Law Commission; Catriona Marshall, Solicitor, Scottish Government Legal Directorate; Jill Clark, Bill Team Leader, Civil Law Reform Unit, Scottish Government.

**Contract (Third Party Rights) (Scotland) Bill (in private):** The Committee considered the evidence it heard earlier in the meeting.

### 10th Meeting, 2017 (Session 5) Tuesday 21 March 2017

**Contract (Third Party Rights) (Scotland) Bill:** The Committee took evidence on the Bill at Stage 1 from—

Ross Anderson, Faculty of Advocates and John MacLeod, Lecturer in Commercial Law, University of Glasgow;

and then from—

Kenneth Rose, Partner, CMS Cameron McKenna LLP; Karen Fountain, Partner, Brodies LLP; Jonathan Gaskell, Legal Director, DLA Piper and Karen Manning, Senior Associate, Burness Paull;

and then from—

Professor Hugh Beale, Professor of Law, University of Warwick.

**Contract (Third Party Rights) (Scotland) Bill (in private):** The Committee considered the evidence it heard earlier in the meeting.

**11th Meeting, 2017 (Session 5) Tuesday 28 March 2017**

**Contract (Third Party Rights) (Scotland) Bill:** The Committee took evidence on the Bill at Stage 1 from—

James Rust, Partner, Morton Fraser;

and then from—

David Wedderburn OBE, Forensic Architect, Royal Incorporation of Architects in Scotland (RIAS);

and then from—

Craig Connal QC, Partner, Pinsent Masons and David Christie, Senior Lecturer, Robert Gordon University.

**Contract (Third Party Rights) (Scotland) Bill (in private):** The Committee considered the evidence it heard earlier in the meeting.

**12th Meeting, 2017 (Session 5) Tuesday 18 April 2017**

**Contract (Third Party Rights) (Scotland) Bill:** The Committee took evidence on the Bill at Stage 1 from—

Hew Dundas, Honorary Vice-President, Scottish Arbitration Centre.

**Contract (Third Party Rights) (Scotland) Bill (in private):** The Committee considered the evidence it has received on the Bill to date.

**13th Meeting, 2017 (Session 5) Tuesday 25 April 2017**

**Contract (Third Party Rights) (Scotland) Bill:** The Committee took evidence on the Bill at Stage 1 from—

Annabelle Ewing, Minister for Community Safety and Legal Affairs; Catriona Marshall, Solicitor, Scottish Government Legal Directorate; Jill Clark, Bill Team Leader, Civil Law Reform Unit, Scottish Government.

**Contract (Third Party Rights) (Scotland) Bill (in private):** The Committee considered the evidence it heard earlier in the meeting and reflected on the evidence received.

**15th Meeting, 2017 (Session 5) Tuesday 9 May 2017**

**Contract (Third Party Rights) (Scotland) Bill (in private):** The Committee agreed its Stage 1 report.



# Annex B

## INDEX OF ORAL EVIDENCE

### [9th Meeting, 2017 \(Session 5\) Tuesday 14 March 2017](#)

Graham Crombie, Project Manager, Scottish Law Commission; Hector MacQueen, Commissioner, Scottish Law Commission; Catriona Marshall, Solicitor, Scottish Government Legal Directorate; Jill Clark, Bill Team Leader, Civil Law Reform Unit, Scottish Government.

### [10th Meeting, 2017 \(Session 5\) Tuesday 21 March 2017](#)

Ross Anderson, Faculty of Advocates and John MacLeod, Lecturer in Commercial Law, University of Glasgow;

Kenneth Rose, Partner, CMS Cameron McKenna LLP; Karen Fountain, Partner, Brodies LLP; Jonathan Gaskell, Legal Director, DLA Piper and Karen Manning, Senior Associate, Burness Paull;

Professor Hugh Beale, Professor of Law, University of Warwick.

### [11th Meeting, 2017 \(Session 5\) Tuesday 28 March 2017](#)

James Rust, Partner, Morton Fraser;

David Wedderburn OBE, Forensic Architect, Royal Incorporation of Architects in Scotland (RIAS);

Craig Connal QC, Partner, Pinsent Masons and David Christie, Senior Lecturer, Robert Gordon University.

### [12th Meeting, 2017 \(Session 5\) Tuesday 18 April 2017](#)

Hew Dundas, Honorary Vice-President, Scottish Arbitration Centre.

### [13th Meeting, 2017 \(Session 5\) Tuesday 25 April 2017](#)

Annabelle Ewing, Minister for Community Safety and Legal Affairs; Catriona Marshall, Solicitor, Scottish Government Legal Directorate; Jill Clark, Bill Team Leader, Civil Law Reform Unit, Scottish Government.

# Annex C

## INDEX OF WRITTEN EVIDENCE

### Correspondence from the Minister

[Letter from the Minister for Community Safety and Legal Affairs to the Scottish Law Commission](#)

### Submissions received on the Contract (Third Party Rights) (Scotland) Bill

[Scottish Law Commission](#)

[CMS Cameron McKenna LLP](#)

[Royal Incorporation of Architects in Scotland \(RIAS\)](#)

[Hew R Dundas & David Bartos](#)

[Faculty of Advocates<sup>xxxiv</sup>](#)

[David Christie, Robert Gordon University](#)

[Shepherd and Wedderburn LLP](#)

[Law Society of Scotland](#)

[Hong-Lin Yu](#)

[Beattie Contracts](#)

[Homes for Scotland](#)

[Stefan Vogenauer, Max Planck Institute for European Legal History](#)

### Additional correspondence

[Ross Anderson \(Faculty of Advocates\)](#)

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<sup>xxxiv</sup> Note: This evidence was originally submitted in response to the Scottish Government in October 2016 and re-submitted to the Committee's call for evidence in March 2017.

