

Final Business and Regulatory Impact Assessment

Title of Proposal

Contract (Third Party Rights) (Scotland) Bill ("the Bill")

Purpose and intended effect

- **Background**

A third-party right in a contract arises where two or more parties conclude a contract which contains provision in favour of a third party (i.e. one not otherwise directly involved in the contract's formation) and the contracting parties intend the provision to be legally enforceable by that third party. Such a right can already be created under Scots law but the rules are highly formalistic and inflexible. They are not fit for business purposes, nor for a number of non-commercial situations.

The Scots law on third-party rights, for which the Latin tag *jus quaesitum tertio* is often used, is found in the common law. This means that it has largely been developed by legal writings and court decisions over a long period of time. Unfortunately, the law has become unclear and in need of modernisation. One major hurdle is that to exist at all a third-party right must be irrevocable from the outset, i.e. it can't be cancelled or modified by the contracting parties. This requirement is seen in commercial life and elsewhere as a barrier to the practical value of third-party rights under the current law.

Burness Paull LLP, a major Scottish law firm, have commented:

"Commercially it is frequently the case that contracting parties will want to give a third party a right but might want to reserve the ability to modify (and perhaps diminish) the extent of that right from time to time without the consent of the third party. Therefore, we fully support the proposed reforms to:

1. remove irrevocability as a condition to the existence of the third-party right;
2. clarify and limit the law around when a third-party right becomes irrevocable; and
3. give the contracting parties the ability to agree that the third-party right may be modified or cancelled (subject to certain limitations)."

Reform in this area has been seen in a number of jurisdictions in recent times. Until the commencement of the Contracts (Rights of Third Parties) Act 1999, there was no common law third-party rights framework in England & Wales. That Act has inspired legislation seen in other jurisdictions in the past 15 years, with introduction of third-party rights laws also in Hong Kong, Singapore and some Australian states. New Zealand introduced third-party rights as long ago as 1982. Amongst non-Anglophone jurisdictions which have

long recognised third-party rights, the 2016 revision of the French Civil Code also contains an overhaul and clarification of the laws relating to third-party rights. In none of these systems is there any requirement of irrevocability. Scotland differs from other Anglophone jurisdictions in already having law on this topic but it has fallen behind the emerging international standards.

- **Objective**

The central objective is to clarify when a third-party right can and cannot be modified or cancelled. The Bill removes the present pre-condition of irrevocability, which creates much of the inflexibility in the present law. Instead the parties to the contract are to be permitted to modify or cancel the third-party right unless certain circumstances prevail (i.e. conditions upon which the right depends are fulfilled; the contracting parties notify the third party of an unconditional right; the third party relies on the right and the contracting parties acquiesce or ought reasonably to have foreseen the acts of reliance). Parties can also provide that the right is irrevocable should they wish to do so. But they may contract out of any or all of the rules should that be their preference. Flexibility is the key.

The Bill clarifies a number of points on which there is currently an absence of authority (i.e. third-party remedies, defences against the third-party claim, third-party rights in arbitration, and prescription.)

- **Rationale for Government intervention**

Left to itself, the common law can only be changed by a decision of an appropriate court. The leading case on third-party rights and irrevocability in Scotland was decided in 1920 in the House of Lords.¹ Under the doctrine of precedent, therefore, only a decision of the Supreme Court can change the law, and only if a suitable case arose.

The alternative is to introduce a modern, clear statute such as has been achieved elsewhere, dealing with all the issues in a way not possible in any single case. This is what the Bill does.

When assessing the potential benefits that a Bill would have, particular attention was given to the National Performance Framework. Through considering the benchmarks provided by the Framework, it is possible to show how the introduction of the Bill would aid in the overarching purpose of the Government: 'to focus government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing economic sustainable growth' (National Performance Framework, March 2016).

The Purpose Targets that have been identified as relevant to the Bill are: increase Scotland's economic growth; and improve productivity. In some circumstances the current law is seen as an impediment to commerce and makes Scotland a less attractive place to do business, the present law in this area being described by Scottish legal professionals as "massively inflexible"

¹ *Carmichael v Carmichael's Ex.* 1920 SC (HL) 195.

and “historic and inflexible.” The solution frequently adopted at present is to switch the law of the contract to the recently modernised English law. If Scots law is up-dated to be more useful to business, the turning away from Scots law may be stopped and new business possibly attracted. The National Outcome of living in a Scotland that is the most attractive place for doing business in Europe can also be related to the potential commercial applications of the Bill (see *company groups, construction, energy, arbitration* and *regulatory rights* below). The Bill also contains important possibilities for individuals (see *family/pre-purchase agreements, carer applications* and *holidays* below).

Consultation

- **Within Government**

Scottish Procurement Directorate

- **Judiciary**

Judicial Institute

Senators of the College of Justice

- **Public Consultation**

David Christie, Robert Gordon University

Professor Eric Clive, former Scottish Law Commissioner

Greg Gordon, University of Aberdeen

Society of Advocates, Aberdeen

Lorna MacFarlane, PhD student at University of Edinburgh

Dr John MacLeod, University of Glasgow

Professor Martin Hogg, University of Edinburgh

Gordon Cameron, University of Dundee

Law Society of Scotland

Faculty of Advocates

Professor Andrew Burrows, University of Oxford

David Bartos, Advocate

Rachael Kelsey, SKO LLP

Karen Fountain, Brodies LLP

Jonathan Gaskell, DLA Piper LLP

Kathleen McAnea, Burness Paull LLP

Norman Dowie, Standard Life

- **Business**

Network Rail

Family Law Arbitration Group Scotland (FLAGS)

Scottish Arbitration Centre

Chartered Institute of Arbitrators (Scotland)

Scottish Council for International Arbitration

CMS LLP

Burness Paull LLP

Brodies LLP

DLA Piper LLP

Shepherd + Wedderburn LLP

Options

During this project, 3 options were considered with regards to improving this area of law.

1. Do Nothing

In certain circumstances there is the possibility of working around the current provisions, for example:

- make the contract multi-partite (see *Family/Pre-purchase agreement* below),
- use collateral warranties (see *Construction* below), or
- make the third-party right provision subject to another legal system (see *Energy* below).

But where third parties are non-existent, unidentified, or otherwise incapable at the time of contracting, multi-partite contracts and collateral warranties are not available as solutions to the creation of third-party rights within the present legal framework.

The application to such third parties is a key consideration for a third-party rights framework. Examples of non-existent parties include children who are not yet conceived,² and companies within a group structure which have not yet been formed at the time of creation of the right. Under the current law it is possible to create a third-party right in favour of a party who is not in existence at the time that the right was created without the provision failing for uncertainty. (But the right comes into full existence only with the person.) Where the specific identity of the third party is not known at the outset (e.g. who the ultimate purchaser or tenant of a commercial development will be, who will be appointed as a sub-contractor during a project), the third party may be described in the contract in such a way that the right crystallises as soon as a specific person or persons meeting the description emerges or is identified.

2. Leave it to the Courts

One option considered was the possibility of publishing the Scottish Law Commission Report on Third Party Rights without an accompanying Bill, instead merely outlining why the current law is unfit for modern conditions, and challenging the validity of the basic analysis which led to the present position. This would enable the courts to make the change to the law through their judgments. But that would require an appropriate case or cases to be brought before the courts. The last opportunity so to adjust the law came before the House of Lords in *Allan's Trustees v Lord Advocate* in 1971,³ but the court deemed the case unsuitable as a vehicle to make any change because it could be dealt with under trusts law, and thus third-party rights law remained unchanged. Professional advisers have to base advice to

² But note that where it would be to their advantage, Scots law regards children in the womb as capable of holding rights so long as subsequently born alive.

³ 1971 SC (HL) 45.

clients on the present law and meantime take any available remedial action (such as a switch to the law of England & Wales as the governing law). The problems most commonly present themselves at the stage of planning projects and drafting contracts rather than in the context of a dispute providing a possible litigation platform. For this and other reasons, raising an action by which the law might be changed would be very much a last resort, and moreover one only available to a client with the resources to go to the Supreme Court and willing to take the risk of failure in that forum. All this may lead to loss of business for Scotland as well as continuing reputational damage for the legal system as out of touch with business and other needs. In addition, any court-based reform would turn on the facts of the relevant dispute and would therefore almost certainly not address all the current issues in the comprehensive way in which a Bill can.

3. Introduce the draft Bill

Having taken account of these options, it was concluded that legislation would be the most effective way of remedying the issues raised by the current law. Following the successful reform of the law in England & Wales (based on a report of the Law Commission) in the Contracts (Rights of Third Parties) Act 1999 it has been possible to create and enforce a third-party right under a contract in England and Wales. The Scottish Law Commission Report shows that the 1999 Act has proved useful in various business and other contexts. We are confident that this Bill is at least on a par with that Act and other recent legislative reforms as well as with current international standards generally.

Sectors and groups affected

The Bill is general in its application and not confined to any particular sector or group. A wide range of sectors will potentially be able to make use of it. In terms of business applications, it will be particularly useful for company groups in general and in sectors which rely heavily on contractors and sub-contractors and where projects involve many parties in complex formal arrangements seeking to allocate risk efficiently, e.g. construction, shipping, energy. The scope for application for the provision goes beyond the commercial/business sector, however. Private individuals may also benefit from the change of provisions, specifically where they go on holiday, buy houses, or are involved in caring for other incapable adults on an informal basis.

Benefits

Commercial Benefits

(i) Company groups

The use of subsidiaries within a company group is a very common way of structuring a business. All of the 20 companies with the highest turnover which are owned and located in Scotland have at least one subsidiary.⁴ Of these companies, 11 have over 50% of their subsidiaries based in Scotland. When considering the potential application for this new provision it is important to consider the sectors that these top 20 companies are active in: electricity distribution and supply, energy related

⁴ Business Insider January 2016 <http://www.oascotland.org.uk/wp-content/uploads/2016/01/Top-500-SMEs.pdf>

services, engineering, motor dealers, and diesel equipment. But the 'company group with subsidiaries' structure is not restricted to any specific sector.

Currently, where a company contracts for the provision of a service to the company group (e.g. IT services), the provision in favour of the third parties (typically, the subsidiaries within the company group) must be irrevocable from the outset in order for the third party to be able to enforce it. In a commercial context this inflexibility is unattractive, as it deprives parties of the freedom to adapt to changing circumstances over time by group re-constructions and contract adjustments. It also prevents rights being created in favour of companies which have either not yet been established or which, while in existence, are not – at the time that the principal contract is made – members of the relevant company group.

Under the new provisions company groups would be able to contract for the provision of a service to all companies in the group without the provision being irrevocable. The contracting parties would remain free to cancel or modify the right granted to the third party provided that (for example) the third party had not invoked or otherwise relied on it to its detriment.

(ii) Construction

In the construction sector, it is common for collateral warranties to be sought from the sub-contractors, suppliers and other professional service-providers involved, giving the subsequent proprietors and tenants of the individual properties contractual rights against the former in respect of design and construction defects. Collateral warranties are not an ideal solution for granting such rights to the third party as the time and cost involved in obtaining them for a particular purchaser, tenant, and subcontractor after the project has been otherwise completed can be significant. As an indication of the difficulties, the law firm Burness Paull LLP commented that the:

“[o]btaining of a suite of multiple collateral warranties is an integral part of the legal framework of a construction project in Scotland. They are required in order to protect the interests of third parties such as funders, purchasers and tenants. As an example, a medium sized retail park development in Scotland with 8 tenants is likely to require the production of between 24 and 72 collateral warranties from consultants, the main contractor and selected sub-contractors to the employer/developer, funder, purchaser and tenants as appropriate. A larger retail park development would require considerably more.

The practical and administrative burdens this imposes are considerable. Correspondence is required in respect of each individual collateral warranty. Further, while a party may have agreed to produce a collateral warranty upon demand, it is relatively common for there to be delay in procuring the delivery of the actual collateral warranty itself. Last year, we had to resort to court proceedings to ensure the delivery of one such collateral warranty. The delay can be for a variety of reasons, both legal and practical, but delay has become such a common occurrence that we now regularly advise clients on the cost implications of procuring the outstanding collateral warranties. On major projects, schedules of outstanding collateral warranties have to be maintained in order to monitor the process.”

However, the preference for using collateral warranties as opposed to the current common law of third-party rights is clear and reflects the difficulties and inflexibility inherent in the common law. The Bill provides a new third-party rights framework which can be set up in the contracts at the outset of the project without knowing who exactly will be the beneficiaries thereof, thus minimising the time and cost of putting the relevant rights in place.

(iii) Regulators and regulation

The utility of third-party rights in the regulatory context is well illustrated by Network Rail's Track and Station Access Agreements. Network Rail contracts with the train operators, allowing the latter to use the railway tracks and stations in their services. The contracts also state an express intention to create a *jus quaesitum tertio* (i.e. the inflexible common law third-party right) in favour of the Office of Rail and Road (ORR) and the Scottish Ministers. This allows the ORR and the Scottish Ministers the right to regulate access to track and stations in the event of Network Rail ceasing to exist or to be able to function (as happened with its predecessor body, Railtrack). The Bill would enable other flexibilities, such as adjusting to the replacement of ORR by another regulator of railway facilities.

Financial regulators may seek third-party rights in company-contractor outsourcing agreements. This gives the regulator a right to demand access to information from the contractor to investigate any potential regulation breaches.

(iv) Energy

In the oil and gas industry in the North Sea, and also in joint operating agreements between oil companies, indemnities and cross-indemnities are often deployed in complex arrangements for the allocation of risk. This happens where a company enters a contract with a contractor but each has to indemnify other members of their respective company groups, present and to come, while indemnities and cross-indemnities are also to be provided in respect of sub-contractors, employees, agents, licensees, and others involved in the transaction. These indemnities and cross-indemnities set up third-party rights for the various parties. Currently parties use the law of England & Wales for such contracts. It is too late to suppose that the enactment of the Bill will make Scots law a more realistic option for the parties to such transactions in future. This is an example of Lord Gill's recent observation that Scots law and the Scottish legal system missed the great opportunity which the development of the North Sea energy sector provided in the 1970s.⁵ But, as other energy-related opportunities arise in Scotland (e.g. renewables), it may still be possible to ensure that the law is ready and able to cope with that. Meantime, the North Sea example well illustrates the commercial significance of third-party rights in general.

(v) Arbitration

The Arbitration (Scotland) Act 2010 has modernised the law of arbitration in Scotland with a view, *inter alia*, to attracting more international arbitration business to the country. In one respect, however, the 2010 Act has not caught up with international

⁵ <http://www.scotland-judiciary.org.uk/Upload/Documents/LPHolyroodDigitalJusticeConferencespeech28January2015.pdf>, esp pp11ff.

standards, and that is in the area of third-party rights. Even if the parties to an arbitration agreement intend a third party to have a right to participate in their arbitral proceedings, they cannot insist that the third party do so, nor can the third party submit to the proceedings if the contracting parties for some reason now wish to do so. It is clear, however, that this is no longer the usual position internationally. The law of England & Wales was changed to accommodate third-party rights in arbitration proceedings in 1999; a similar position has been reached in other jurisdictions; and international commercial arbitration practice also commonly recognises third-party rights as potentially arbitrable subject-matter. With the introduction of the Bill the availability of arbitration for the beneficiary of a third-party right would be clear. The proposed rules are in line with the English & Welsh and other systems, and consistent with international commercial understandings. They help to make Scotland a more attractive place to do business.

Given that there is a desire to make arbitration a more attractive option for disputes in Scotland,⁶ it is evident that a robust arbitration framework is desirable, particularly for its potential application to third-party rights. In the period June 2013 – June 2014, 22 arbitrations with their seat in Scotland took place, the subject matters of these arbitrations including construction (16%), engineering (10%) and property (40%). As we have identified above, these are areas which are particularly predisposed to third-party rights issues, due to the numbers of subsidiaries or the prevalence of contractor/sub-contractor relationships in the sector. We have also identified family law contracts as ones which increasingly make use of arbitration agreements for dispute resolution and in which questions of third-party rights may well arise (see further below, *Family/pre-purchase agreement*). The provisions of the Bill should therefore also be of utility in this field.

Social benefits

(a) Family/pre-purchase agreement

When unmarried couples seek to buy a property together they may be advised to enter into a pre-purchase agreement detailing what is to happen to the property and their shares should the relationship break down. In the period 2005-2015, there was 29.7% growth in the number of co-habiting families in the UK.⁷ There is thus the potential for a large number of pre-purchase agreements to be made in relation to cohabitants.

With a steep decline in the number of unassisted first time buys⁸, the figures are indicative of first time buyers receiving financial assistance from family members in order to be able to afford a deposit. Where the couple in question are not married good practice requires a pre-purchase agreement which will indicate not only what will happen to the property in the event of the relationship breaking down but also what will happen in relation to the repayment of the third party's contribution. It is increasingly common for such agreements to provide for arbitration of disputes, in order to avoid any litigation expense.

⁶ Figures show that 40% of disputes decided by arbitration in Scotland have a value of more than £500,000 – The Scottish Arbitration Survey Report No 1, June 2015.

⁷ Families and Households: 2015, Office for National Statistics, 5/11/2015.

⁸ From 69% of all first time buyers in 2005 to 26% of all first time buyers in 2011: *Measuring National Well-being – Households and Families 2012*, Office for National Statistics 26/04/2012.

As identified above (see *Construction/energy*), the agreement could be made multipartite under the current law. But this can result in the contract, and therefore the process of formation, becoming both more expensive and more unwieldy. The expense would arise where an additional party decided to take independent legal advice about his or her position.

The introduction of this legislation would provide more security for third parties providing money towards deposits. Greater security would encourage more family members to consider helping with the deposit and thus would result in more first time buyers getting on the property ladder. Given that couples often elect to submit to arbitration to deal with property matters on the break-down of a relationship⁹, a clear third-party right framework would make the use of arbitration easier and the process of resolution smoother. The alternative to using third party rights, making the contracts multi-partite, is not attractive and can be costly due to the additional parties involved.

(b) Carer application

Where an adult with incapacity has formally appointed a guardian, the guardian is able to enter into a contract on the individual's behalf. This gives the individual rights under the contract directly. However, where the carer operates on an informal basis, there may be occasions on which they enter into a contract for the benefit of the adult for whom they care, in which case the carer is a party to the contract while the incapable adult is not. The contract may be for the provision of services or relating to the property of the adult, the latter more likely to be a matter of value though service-contracts may be as well.¹⁰ Should the contract be performed defectively, resulting in loss or emotional distress for the incapable adult, the carer's claim under the contract may not be relevant. This is because the loss or distress is the incapable adult's, not the carer's.

(c) Holidays

Inadequate holidays may be due to a variety of issues; here we will consider situations where the inadequacy suffered was the cancellation of the holiday. According to the Association of British Insurers, travel insurance is used to help more than 4300 people/week who are in need of medical treatment. Given that medical claims make up 56% of claims while cancellations represent 34% of claims, approximately 135,720 people made claims for cancellations to their holidays in 2012.¹¹

With more than 135,000 cancellations each year, there is clearly a potential application for the Bill as the family members who are given a right under the contract would then be able to sue for cancellation of the holiday, as opposed to relying on the contracting family member to make a claim.

The Bill could also be used in the cases of family holidays which have been bought by one member of the family party. Should the holiday prove to be inadequate in

⁹ As clarified by consultee Family Law Arbitration Group Scotland (FLAGS).

¹⁰ *ELCAP v Milne's Ex* 1999 SLT 58.

¹¹ Though these figures represent the trends within the UK, the average number of holidays abroad taken by Scots is 1.3 holidays per year, while the average of all the regions in the UK was lower, 1.1 holidays per year (ABTA Consumer Survey).

some way, or be cancelled, and thus require an action under the contract to be brought against the holiday provider, it will only be the family member who entered into the contract who can raise the action, under the current framework.

The introduction of the Bill would allow the other family members to raise the requisite action in relation to their own interests, as they would be the recipient of an explicit right granted under the contract. Under the proposed legislation any one or more of the family members will be able to raise an action, assuming that the contract stipulates that it will benefit other members of the family group as well. (There are at present certain rights for holiday makers, and package travellers in particular, which result from an EU Directive.¹²)

Costs

Option 1

Given that option 1 is to do nothing and to maintain the status quo, there will be no costs imposed by choosing this option. The choice of option 1 will also provide no benefits but given the need for change outlined above, the lack of costs imposed by this option would not have an ultimately positive value. By choosing this option, the additional costs required to include indemnities and collateral warranties would continue, as would the additional costs caused by the relevant contractual provisions being subject to the law of another jurisdiction, if that is what is decided.

The production of collateral warranties may be taken as an example of the costs which would continue to be incurred were this option taken. The length of time to produce a collateral warranty varies from 2 days to several years after the conclusion of the construction project to which it relates, depending on the ease of locating the potential warrantor and the attitude that party takes to completing it.¹³ On average, a client is charged £250 for the production of one collateral warranty, the price ranging typically from £150 to £350. With a medium-sized retail park typically requiring between 24 and 72 collateral warranties, the cost can rise to between £6,000 and £18,000. Due to the increasing costs with warranties that take years to produce, firms might charge on a cost per warranty basis with a cap on the amount the firm will be charged for any individual warranty. This means that for the production of collateral warranties that takes a significant amount of time, firms will be losing money. Collateral warranties can also prove costly for firms where clients expect weekly updates on progress if ingathering takes a great of time. "Anchor" tenants (i.e. the leading tenant identified with the retail centre whose business attracts other tenants and consumers to it) typically seek a full suite of collateral warranties (i.e. from contractors, subcontractors and consultants) as they intend to remain in the development for a long period of time. In contrast, non-anchor tenants (who generally pay a higher rent than the anchor) can find it much more difficult to obtain a full suite of collateral warranties, resulting in added expense or risk for them.

¹² Council Directive 90/314/EEC on package travel, package holidays, and package tours (OJ No L158, 13 June 1990, p.59), implemented by the Package Travel, Package Holidays and Package Tours Regulations 1992 (SI 1992/3288, made under the European Communities Act 1972).

¹³ For an example of the difficulties which may arise in procuring the execution of a collateral warranty see *Keir Construction Ltd v Wm Saunders Partnership LLP* [2016] CSOH 17.

Option 2

The impact of this option, including the continuation of existing costs under the present rules, would be very similar to option 1, given in particular that it would be for the court's judgement whether the recommendations made by the Scottish Law Commission were accepted and applied.

Option 3

There would be a small initial training cost and familiarisation cost, principally for solicitors but perhaps also for other professionals in the relevant fields. This cost would only be incurred when the Bill is first implemented but would be quickly offset by the savings which may be made under the Bill compared to the current law.

Generally, familiarisation costs of any significant change in the law will be incurred by those providing the training within the solicitors' firm. Professional Support Lawyers (PSL) at the firm may prepare a seminar which will explain the reforms to fee-earners. The PSL may take 3-4 hours to prepare the seminar. However, the provision of such training is typically already provided for within a firm's budget. It is probable that a proportion of the fee that a lawyer charges represents the cost of maintaining the fee-earner's current legal knowledge. For the fee-earners, there is a requirement that 20 hours of Continual Professional Development is completed throughout the year so the additional time taken by familiarisation will count towards this figure. It is therefore unlikely that this will represent a significant additional cost to law firms.

We do not anticipate that this training will require a large amount of time as the Bill is seeking to simplify and clarify the existing common law. Furthermore, a similar statutory framework is already in place in England & Wales which firms often use in place of Scots law, and therefore the substance of the Bill will not be wholly unfamiliar to the profession.

After this initial period of familiarisation, there will be no additional costs incurred as firms learn to work with the Bill. The Bill will soon result in a reduction in costs for the firms given that, if their clients wish, they will not have to dedicate time to producing indemnities, collateral warranties or multipartite contracts, and there will not be the additional costs caused by using a foreign legal system as a "work around".

A third-party rights framework which enables arrangements to be largely in place before a project begins means that costs incurred in the production of collateral warranties firms can be reduced, or removed entirely.

On the drafting of third-party right contracts, it will be possible to use existing forms of model documents deploying third-party rights (e.g. the Scottish Standard Building Contract 2011 form). These are readily adaptable to the Bill's provisions.

With regard to the use of the Bill in a family law context (e.g. for the pre-purchase agreements discussed above) advance assessment of the extent to which it is used is difficult. One factor is the way in which statistics are collected in the court system. A dispute about a pre-purchase agreement which arises in divorce proceedings is likely to be classified for these purposes as a family action, but this will not be the case if the dispute involves co-habiting couples. This makes the collection of relevant

and useful statistics highly problematic in respect of disputes before the courts.

Furthermore, when considering the general economic value of arbitration in comparison with court proceedings, while the belief that arbitration is generally more cost-effective, flexible and efficient is widely held, few statistics can be given to back this up, since arbitration is an essentially private process between the parties. With the introduction of the Arbitration (Scotland) Act 2010 and the creation of FLAGS (Family Law Arbitration Group Scotland), there has been a recent resurgence in the number of arbitration clauses in minutes of agreement, but the precise effect may take some time to emerge. This is in large part because disputes under such minutes of agreement are generally subject to there being a "material change in circumstances" which by definition generally requires a certain passage of time.

Nothing in the Bill is mandatory, so parties are free to use its provisions or to exclude them. The costs and benefits of using the Bill's provisions in any given setting would be for the relevant parties to assess.

Scottish Firms Impact Test

No Impact Test was carried out. The aim of the Bill is to correct and clarify the current law as it relates to third-party rights. Given that this issue was highlighted by the profession as an area in need of reform, we anticipate that the Bill will be beneficial to the legal sector in their commercial work.

Competition Assessment

It is not anticipated that the Bill will have an impact on competition within Scotland. The proposals within the Bill do not create a competitive advantage for any particular sector or individual; they simply offer benefits which can be reaped by businesses and individuals alike.

- As discussed below, the legal sector will be positively affected by the Bill. We do not anticipate an impact upon any other particular markets or products.
- The Bill will not result in any restrictions on competition in the legal services market. The number and range of suppliers in the legal sector will not be affected, nor will it limit the ability of legal practitioners to compete. We do not consider that the proposal will reduce practitioners' incentive to compete vigorously.

The Bill has the potential to bolster the competitiveness of Scots law. Currently, transactions are often subject to the law of England & Wales instead of Scots for the sole reason of the difficulty inherent in using the current law on third-party rights.

Legal Aid Impact Test

From the potential benefits identified above, there are two areas where the Bill has the potential to create legal aid implications: holidays and carers.

Currently, as mentioned above, a right of action already exists with regard to holiday claims. The only change that the Bill would make to the current position would be in cases where the party with the basic contractual right cannot or will not raise the action. This would be the case, for example, where the individual is a child or an

adult with incapacity.

For carers, the Bill would apply to a very small subset of cases. The new framework would apply specifically to contracts to benefit an adult who has incapacity but does not have a formally appointed carer. The number of cases where this would occur would be minimal and thus the application of third-party rights here would not be common.

Therefore we anticipate only a very modest increase in the number of cases which would be applicable for legal aid. Conversely, we also anticipate an increase in negotiated settlements of cases concerning holidays and carers which would currently be eligible for legal aid. Where the Bill does apply we expect that it will be very useful though we do not expect the legal aid impact to be significant.

Enforcement, sanctions and monitoring

The Bill does not require public enforcement and imposes no sanctions. The Bill provides for optional methods of providing third-party rights under Scots law, and disputes concerning the rules in the Bill would be resolvable ultimately by way of litigation between the affected parties. Parties may contract out of the new provisions should they so wish.

Implementation and delivery plan

If passed by the Scottish Parliament, sections 13 and 15 will come into force on the day after Royal Assent while the other provisions will come into force on the day of appointment by Scottish Ministers.

- **Post-implementation review**

In accordance with the Law Commissions Act 1965 section 3(1), the Scottish Law Commission has a duty to “keep under review” the laws with which it is concerned, and will endeavour to stay informed of the Bill’s reception by the legal profession and wider business community. The proposals form part of a long term-project which will likely provide other opportunities for review within its time-frame, and we expect that Scottish Ministers will also review the legislation within the next 10 years. It is hoped that, in light of the demand for the Bill, the operation of the reformed law will be uncontroversial.

Summary and recommendation

Option 1 was dismissed as it preserves the status quo, which has been shown to be too inflexible to be fit for business purposes, and to leave costs issues unaddressed.

Option 2 was dismissed as any change would be dependent on a suitable case coming before the UK Supreme Court, and whether the law was changed would be dependent on the court’s judgement on the particular facts and legal arguments before it. The immediate cost of the change would fall on the parties to the litigation, with no consideration given to the wider cost implications.

Option 3 is recommended as the most effective way of creating an effective and useful third-party rights framework in Scotland. It has the positive benefit of bringing Scots law into line with comparable regimes elsewhere in the UK and abroad, and it

removes the drawbacks in the current law (which can lead to time-consuming and often unwieldy work arounds).

• **Summary costs and benefits table**

Option	Total benefit per annum: - economic, environmental, social	Total cost per annum: - economic, environmental, social - policy and administrative
1	£0	£0 There would be no direct cost or benefit in choosing Option 1 as this represents the status quo.
2	£0 The benefit in allowing the courts to implement a change in the law is the saving involved in not introducing a statute. It is negligible (and also very difficult to quantify), so we take it to be zero for present purposes.	£0 The law could only change if a case was taken to the Supreme Court, which would involve considerable cost for the parties. But as those costs are borne by the parties (and are only incurred if the parties instruct litigation), we have taken them to be zero for present purposes.
3	<p>The Bill would save the parties time as they would not need to work around the current common law. Parties would not need to invest time into elaborate drafting nor familiarising themselves with the law as it applies in foreign jurisdictions (the provision now being subject to Scots law). Therefore, commercial transactions would be able to be conducted more efficiently.</p> <p>In relation to replacing collateral warranties or the provision of an alternative option, styles of equivalent third-party right documents already exist. These limit the need to develop new styles, allowing for low transitional costs.</p> <p>For the specific example of collateral warranties for a medium sized retail park: the developer's saving with a third-party right framework would be in the range of £6,000 to £18,000.</p> <p>In certain specific social situations, the Bill would give a clear right of action to a third party, saving them potential</p>	<p>Training: £450 (approximate)¹⁴ per firm. This is not an annual cost, and is likely to be incurred only once per firm.</p> <p>There will be a small cost incurred in preparing new documentation for transactions involving third party rights.</p>

¹⁴ This sum represents the approximate hourly rate of a Professional Support Lawyer or lawyer at associate level taking 3-4 hours to prepare a seminar for the firm about the Bill. In addition, there is likely to be training provided by professional bodies (such as the Law Society of Scotland) or commercial providers. The figure is an estimate.

litigation costs by encouraging early settlement. In the context of pre-purchase agreements, the Bill would allow an alternative to multi-partite agreements. This will provide clarity to the contracting parties and will save time and money in the production of the documents. It would also save the extra legal costs that would inevitably be incurred for each party involved.

The possibility of meeting the general policy goal of improving the reputation of Scots law would be met, ensuring that the system keeps pace with foreign law.

Declaration and publication

I have read the Business and Regulatory Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs. I am satisfied that business impact has been assessed with the support of businesses in Scotland.

Signed:



Lord Pentland, Chairman, Scottish Law Commission

Date: 8th July, 2016