Scottish Law Commission

promoting law reform

(SCOT LAW COM No 245)

Review of Contract Law
Report on Third Party Rights

report

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Review of Contract Law
Report on Third Party Rights

Laid before the Scottish Parliament by the Scottish Ministers
under section 3(2) of the Law Commissions Act 1965

July 2016

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The Scottish Law Commission was set up by section 2 of the Law Commissions Act 1965 (as amended) for the purpose of promoting the reform of the law of Scotland. The Commissioners are:

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SCOTTISH LAW COMMISSION

Item No 2 of our Ninth Programme of Law Reform

Review of Contract Law

Report on Third Party Rights

To: Michael Matheson MSP, Cabinet Secretary for Justice

We have the honour to submit to the Scottish Ministers our Report on Third Party Rights.

(Signed) PAUL B CULLEN, *Chairman*
C S DRUMMOND
D E L JOHNSTON
HECTOR L MACQUEEN
ANDREW J M STEVEN

Malcolm McMillan, *Chief Executive*
9 May 2016

Contents

Click on any of the headings below to go to the relevant page

Abbreviations

1999 Act,

The Contracts (Rights of Third Parties) Act 1999 (c.31)

Anderson, *Assignation*,

R G Anderson, *Assignation* (2008)

Beale, "Review",

H Beale, "A Review of the Contracts (Rights of Third Parties) Act 1999" in A Burrows and E Peel (eds), *Contract Formation and Parties* (2010)

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Chapter 1 Introduction

Scottish Law Commission's review of contract law

1.1 We are currently undertaking a general review of Scots contract law in the light of the Draft Common Frame of Reference (DCFR). This is being conducted as part of our Ninth Programme of Law Reform.[1] Our Discussion Paper on Third-party rights in Contract, which we published in March 2014, is the third we have published so far in the review.[2]

1.2 In that Paper we described the DCFR in some detail.[3] It is part of a pan-European effort to promote more consistent and coherent legislation across the EU in the field of contract law, and it also underpinned the European Commission's now abandoned proposal for a Common European Sales Law (the proposed CESL).[4] Together with the EU's Directives on contract law, it is leading a number of jurisdictions to contemplate and indeed execute comprehensive reforms of their laws of obligations.[5] Here in Scotland and elsewhere courts are beginning to refer to the DCFR in their decisions. For example, Lord Malcolm discussed the DCFR's approach to mistake in *Wills v Strategic Procurement Ltd*.[6] And a report from Sweden states that the DCFR has been referred to in a considerable number of cases in the Swedish Supreme Court; the author concludes that, although it has not been accepted as a source of Swedish law, "that does not mean that legal practitioners

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[1] The Ninth Programme runs from 1 January 2015 and can be found at http://www.scotlawcom.gov.uk/law-reform/ninth-programme-of-law-reform/. The review was begun under the Eighth Programme (2010-2014).

[2] DP No 157. We refer to it as "the DP" in what follows. The earlier Discussion Papers were on Interpretation of Contract (No 147, 2011) and Formation of Contract (No 154, 2012). The latter was followed by a Report on Execution in Counterpart (SLC No 231, 2013), whose draft bill was implemented, with minor modifications, as the Legal Writings (Counterparts and Delivery) (Scotland) Act 2015 (in force 1 July 2015). We plan to publish further Discussion Papers on Penalties and Breach of Contract.

[3] See paras 1.2-1.11 of the DP.

[4] For the withdrawal of the CESL see http://www.epln.law.ed.ac.uk/2015/01/07/proposal-for-a-common-european-sales-law-withdrawn/; http://www.lawscot.org.uk/media/455103/brusselsagenda-march2015.pdf (scroll down to first article). More modest proposals for Directives on contracts for the supply of digital content and for the online and distance sales of goods were published by the European Commission on 9 December 2015. The articles in these drafts headed "Third party rights" deal not with the subject-matter of this Report but with guarantees against the existence of third-party claims to the digital content or goods in question.

[5] The reform of the French law of obligations which was promulgated in February 2016 will come into force on 1 October 2016 : Ordonnance n° 2016-131 du 10 février 2016 portant réforme du droit des contrats, du régime général et de la preuve des obligations, accessible at https://www.legifrance.gouv.fr/eli/ordonnance/2016/2/10/JUSC1522466R/jo/texte. For the Swiss *Obligationenrecht 2020* project, see C Huguenin and R Hilty (eds), *Schweizer Obligationenrecht 2020/Entwurf für einen neuen allgemeinen Teil, Code des obligations suisse 2020/Projet relatif à une nouvelle partie générale* (2013). In 2015 the Belgian government commissioned a number of academic teams to carry out research towards the replacement of the country's Civil Code : see further S Stijns, "Faut-il réformer le Code civil? Réponses et méthodologie pour le droit des obligations contractuelles et extracontractuelles: les obligations contractuelles" [2016] JT 305-311.

[6] [2013] CSOH 26, at para 10. Note also the references by the First Division to the work of the European Commission's Expert Group on European Contract Law, in connection with the law on changes in circumstances: *Lloyds TSB Foundation for Scotland v Lloyds Banking Group Plc* [2011] CSIH 87 (reversed on a different point by the UK Supreme Court: [2013] UKSC 3, 2013 SC (UKSC) 169). See too L Richardson, "The DCFR, anyone?", accessible at http://www.journalonline.co.uk/Magazine/59-1/1013494.aspx.

can disregard the DCFR".[7] Comparable references have been made to the DCFR and other European instruments by the Spanish courts.[8]

What are third-party rights in contract?

1.3 Where two (or more) parties reach an agreement with each other and conclude a contract, they thereby create for themselves binding rights and obligations. One party can, if necessary, seek the assistance of the court to enforce those rights against the other party (or parties). But, generally speaking, no right or obligation can be created in respect of someone who is a stranger to the contract (and who is termed a "third party").

1.4 In some legal systems, such as that of England and Wales and many other common law jurisdictions, the rule is strictly enforced, though significant legislative exceptions have been created in recent years.[9] Scots law, by contrast,[10] has long recognised that, in certain circumstances, a contract can contain enforceable rights in favour of a third party.[11] As in all systems of contract law, parties are free to contract with each other in any way they wish (subject to restrictions such as the contract not being for illegal or immoral purposes) but that freedom extends to the ability to give a right – although not a duty or an obligation[12] – to a third party. Indeed, such is the antiquity of this doctrine in Scots law that it is generally still known by the Latin tag of *jus quaesitum tertio* (or JQT for short; we put forward recommendations in Chapter 3 as to a suitable new name). As a practical matter, we have been told by lawyers involved in drafting contracts under Scots law that clients frequently do not understand the term *jus quaesitum tertio*. As a consequence, this can lead to involved drafting in the effort to communicate clearly what the contract means.[13]

1.5 At one level, the utility of JQT has been demonstrated over the centuries, and the recent legislation in common law jurisdictions which provides a statutory version of third-party rights reinforces the idea of such rights being useful. At another level, however, the rules of Scots law in this area have not kept pace with modern usage and certain fundamental aspects of the law remain obscure. One practitioner, writing a blog post for Brodies LLP, has gone so far as to say of the Scots law in this area that it is "stuck in the 17th century".[14] The same article described Scots law on third-party rights as "massively inflexible", while Lindsays LLP used the term "historic and inflexible" in their critique of the present law.[15] In a Scrymgeour lecture given at the University of Dundee Law School on 30

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[7] B Thomaeus, Draft Common Frame of Reference and the Supreme Court (Oct 13, 2014), accessible by searching for the author at http://www.internationallawoffice.com/.

[8] See (in Spanish, with abstract in English) A Vaquer Aloy, "El *Soft Law* europeo en la jurisprudencia española: doce casos" (2014) 1 Ars Iuris Salmanticensis 93 (accessible at http://bit.ly/1wZ1o41); one of the most notable decisions, of the Tribunal Supremo (STS 13.5.2010), used the DCFR IV.H.-4:201 (ingratitude of the donee) as a central part of the legal reasoning.

[9] See paras 1.10-1.12 below. The rule is often termed "privity of contract".

[10] In common with the general approach of civil law jurisdictions: "Every Western codified system of contract law since the French Code Civil of 1804 has recognised that third parties may have rights under other parties' contracts as a result of provision in the contract itself" (para 1.15 of the DP).

[11] For more detail, see Ch 2 below.

[12] See para 2.4 below.

[13] See para 2.8 below for an example.

[14] D Mathie, *Third-party rights – Scots Law stuck in the 17th Century*, August 2010, accessible at: https://brodiestechblog.wordpress.com/2010/08/26/third-party-rights-%E2%80%93-scots-law-stuck-in-the-17th-century/

[15] Lindsays Corporate and Technology Bulletin, accessible at: http://www.lindsays.co.uk/news-and-features/bulletins/bulletin/corporate-and-technology-bulletin---november-2012/#Drafting. See further Ch 2 below.

October 2015 Lord Reed of the UK Supreme Court remarked on commercial parties' need for "clearer rules in relation to third party rights under contract".[16]

1.6 The principal difficulty appears to be, not the recognition of third-party rights, but the requirements for their creation laid down by the House of Lords in its judicial capacity in 1920, namely that the contract in question must be irrevocable by the contracting parties before the third-party right can exist, with the corollary that the third-party right cannot be altered or cancelled in response to changing circumstances.[17] This is the inflexibility which commercial parties in particular find so unattractive.

1.7 The central aim of this Report is to make recommendations for the reform of the rules governing third-party rights in Scots law so that they are easy to find, are clear to use, and suitable to meet the needs of those who wish to use them.

Comparative material

1.8 In the Discussion Paper we examined the approach to third-party rights of many legal systems.[18] In addition, in addressing the potential scope for reform of the Scots law on third-party rights, the Discussion Paper considered the merits of the third-party right provisions of the DCFR, the UNIDROIT Principles of International Commercial Contracts ("PICC") and the proposed CESL. (We refer to them as the "comparator instruments".) In relation to third-party rights, the gist of these texts can be summarised as follows:

- Contracts may create rights in favour of a third party;
- The third party must be identifiable from the contract but need not be specifically identified or, indeed, in existence at the time the contract is made;
- Unless the contracting parties otherwise agree, the right arises immediately without any further action required of the third party;
- The third party may, however, renounce the right;
- The content of the right is determined by what the contracting parties agree;
- The contracting parties can revoke or modify the third party's right so long as it has not become irrevocable;
- The third party's right becomes irrevocable in various situations (e.g. the contracting parties' notification of the right to the third party, the third party's declaration of an acceptance of the right, and the third party's reasonable actions in reliance on the existence of the right);

[16] The lecture, entitled "Triremes and Steamships: Scholars, Judges and the Use of the Past", is accessible on the UK Supreme Court website: https://www.supremecourt.uk/docs/speech-151030.pdf: see pp 9-10.
[17] *Carmichael v Carmichael's Ex* 1920 SC (HL) 195. See further Ch 2 below.
[18] See paras 1.15-1.21 of the DP. In addition to the references there cited, see Hogg, *Promises*, pp 284-313; Vogenauer, *PICC Commentary*, chapter 5, section 2 (noting the "detailed and rigorous discussion of specific issues" in the DP at p 657, note 19).

- The third party may enforce its rights by way of actions claiming performance (such as payment of money) or damages compensating any relevant loss suffered through non-performance or such other contractual remedies as may be applicable;

- The third party may also invoke clauses in the contract excluding or limiting its obligations or liabilities under some other obligation owed to one or more of the contracting parties, or to a fourth party;

- The contracting parties may use against the third party any defences in relation to the contract which they could have used between themselves (e.g. that the contract is in some way invalid or unenforceable);

- The third party right is subject to any conditions or other limitations under the contract.[19]

1.9 These bullet points provide a form of benchmark for a modern law of third-party rights in contract. With regard to the principal problem in the present Scots law, the requirement of irrevocability,[20] one should note in particular that the contracting parties can revoke or modify the right so long as it has not become irrevocable.

1.10 Our thinking on this topic has also been strongly influenced by consideration of the reform of English law by the Contracts (Rights of Third Parties) Act 1999, which implemented recommendations made by the Law Commission of England & Wales in a Report published in 1996.[21] The aim was to reform the law of privity, under which only the contracting parties can have rights under their contract. In general terms the Act is on the same lines as the PICC, the DCFR and the proposed CESL, and it meets the criteria for a modern third-party rights system just set out.

1.11 However, the 1999 Act was introducing third-party rights into a system which previously did not have them, and it may therefore not provide a model that can or should be followed in every detail in Scotland. For example, the Act makes clear that its general relaxation of the doctrine of privity does not affect previous legislation in which the doctrine had been modified in specific areas such as carriage of goods by sea. Since much of that legislation applies throughout the United Kingdom, however, it is already clear in Scotland that it modifies the general law of *jus quaesitum tertio*. Further, since the legislation in question is all in reserved areas, it is also clear that no Act of the Scottish Parliament (such as would implement our recommendations in this Report) could even impliedly repeal it. We discuss some other, more substantive examples below.[22] The general point is that our recommendations are made against a pre-existing legal background which in important respects is different from that in England & Wales at the time the 1999 Act was passed.

1.12 At the very least, however, the 1999 Act provides a useful cross-check to the DCFR and associated schemes, and we have given it very careful attention in consequence. It has

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[19] See also the DP's lengthy quotation (at para 1.17) from S Vogenauer, "Contracts in Favour of a Third Party" in J Basedow, K J Hopt, R Zimmermann and A Stier (eds), *The Max Planck Encyclopaedia of European Private Law* (2012). The reform of the French law of obligations promulgated in February 2016 (above, note 5) contains provisions on third-party rights (arts 1205-6) which meet these standards.
[20] See para 1.6 above.
[21] Privity of Contract: Contracts for the Benefit of Third Parties (LC No 242, 1996).
[22] See paras 1.46-1.62 below.

provided a model for reform in a number of other Common law jurisdictions.[23] In Singapore the Contracts (Rights of Third Parties) Act 2001 follows the 1999 Act closely. In the Cayman Islands, the Contract (Rights of Third Parties) Law 2014, which came into force in May 2014, is largely similar to the 1999 Act.[24] In Hong Kong, the Contracts (Rights of Third Parties) Ordinance 2015, which implements a Report of the territory's Law Reform Commission, also follows the 1999 Act closely in content.[25] The Draft Australian Law of Contract, published in March 2014, contains provisions using an approach to third-party rights similar to that of the 1999 Act.[26] If adopted, this would entail another departure from the general rules of privity still to be found across many of the Australian jurisdictions.[27] Coupled with the abolition of privity in New Zealand in 1982, which provided a model for the 1999 Act, there thus appears to be a worldwide movement away from privity in favour of third-party rights in Common law systems.[28]

Examples of third-party rights in practice

1.13 Third-party rights can occur in many different types of situation, some of which we discuss later in this Chapter. Although they are frequently commercial in nature, the law is important in other areas too. We give some examples:

- Where a father books a family holiday for himself, his wife and children, it may be of value for the other family members to be able to enforce rights under the contract, for instance if the holiday turns out to be significantly worse than was promised.[29]

- An informal carer may enter a contract for, say, structural repairs to the house belonging to and lived in by a person who, perhaps through dementia, lacks capacity to make a contract.[30] If the contract is defectively performed, causing loss to the home-owner's property, the contractor may require to pay damages for the incapacitated person's losses, including for distress and other non-patrimonial loss.

- Where an unmarried couple wish to purchase a home together and contributions (e.g. to the deposit) are made by a relation, it may be practicable to secure the relation's rights by way of a "pre-purchase agreement" between the couple with the relation as the third-party beneficiary.[31]

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[23] See generally para 1.15 of the DP for more detail. New Zealand passed its Privity of Contract Act in 1982.
[24] One notable difference is that the legislation is drafted as an "opt in" measure, so that it only applies if parties so provide. The 1999 Act has an "opt out" approach, in that parties must expressly contract out of it if they do not wish it to apply.
[25] The Ordinance was passed in December 2014 and came into force on 1 January 2016: http://goo.gl/1gYZDW. See further (for employment law) http://hsfnotes.com/employment/2015/07/21/hong-kong-contracts-rights-of-third-parties-ordinance/ and (for construction law) http://www.hoganlovells.com/files/Uploads/Documents/Contracts_(Rights_of_Third_Parties)_Ordinance_and_the_Construction_Industry_HKGLIB01_1564343_v3.pdf.
[26] The Draft Law is accessible at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2403603. See its Articles 32-34.
[27] The rule has been repealed in Western Australia, Northern Territory and Queensland; see generally N Seddon, R Bigwood and M Ellinghaus (eds), *Cheshire & Fifoot: Law of Contract* (10th Australian ed, 2012).
[28] For the position in the USA see Restatement (Second) of Contracts (1981), Sections 302-315.
[29] For facts of this nature (but occurring in England before the statutory third-party rights regime was enacted) see *Jackson v Horizon Holidays Ltd* [1975] 1 WLR 1468. For a recent example of a successful claim by a third party in such circumstances, albeit made under the Package Holiday Regulations (cited in note 35 below) rather than the 1999 Act, see *Lougheed v On The Beach Ltd* [2014] EWCA Civ 1538.
[30] A formally appointed carer, such as a guardian or attorney, will not make such contracts in his or her own right: see further para 2.15 below.
[31] See para 7.23 below for fuller details.

- A company operates a pension scheme for employees under which a person may be nominated by an individual employee as beneficiary in the event of the person's death while still employed by the company. The nominee may have enforceable rights should the insured person die while the policy is still in force.[32]

- Where a client contracts for the construction of, say, an office building or a new school, the main contractor – that is, the other party to the contract – may be obliged, under that contract, to pay its subcontractors within a set period from when the client pays the contractor for the relevant work. This is known as a "pay when paid" clause. It can give the subcontractor the right to claim payment from the contractor under the main contract despite not being a party to it.[33]

1.14 In some cases, third parties benefited by contracts between others may not have rights to those benefits because the contracting parties do not so intend. It is not the aim of the present Report to change this basic approach to the law. The third party's difficulties in such cases can sometimes be met by seeking a different type of remedy altogether. A remedy may, depending on the factual circumstances, be found under, for instance, the law of trusts, delict, assignation or agency.[34] Consumer law also sometimes offers levels of protection which may be at least equivalent, if not superior, to that which might be available by way of third-party rights.[35]

1.15 In the Discussion Paper we mentioned rights under French and German law,[36] which provide a contractual claim for the ultimate or latest buyer in a chain of contracts of supply against the original supplier or any subsequent seller in respect of latent defects in the material supplied. This contrasts with the position under Scots law. Where, say, a home-owner contracts for a new kitchen floor with a floor-fitting firm, and the latter buys the required materials from a manufacturer but they prove defective, the home-owner may find that he or she has no third-party right under the contract between the floor-fitting firm and the manufacturer in respect of the defective product. If only the contracting parties can enforce rights under the contract, that leaves the home-owner with no claim, and so any damages to which the latter would be entitled under a third-party rights regime instead fall into what is sometimes termed a legal "black hole".[37] A similar outcome would result in the situation outlined in the second bullet point in paragraph 1.13 above, if it was not established that the contracting parties intended to provide the incapacitated person with a right of redress.

1.16 In the Discussion Paper we identified two particular areas where third-party rights are often thought to be capable of playing a major role: company groups, and construction

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[32] *Love v Amalgamated Society of Lithographic Printers of Great Britain and Ireland* 1912 SC 1078. This case is discussed at paras 2.29-2.44 below. Another example of third-party rights in the commercial sector (but under English law this time) is in *Joint Administrators of Rangers Football Club Plc, Noters* [2012] CSOH 55, 2012 SLT 599: see G L Gretton, "The laws of the game" (2012) 16 Edin LR 414, 415.

[33] We understand that this is a standard clause in procurement contracts entered into by the Scottish Government: see the Scottish Procurement Policy Note 8/2009 (available at http://www.scotland.gov.uk/Resource/Doc/1265/0088877.pdf).

[34] We do not discuss any of the other possible remedies here, as they are largely irrelevant to the question of what the law on third-party rights should contain.

[35] See e.g. the Package Travel, Package Holidays and Package Tours Regulations 1992 (SI 1992/3288), as amended, which define the consumer as including not only "the principal contractor", but also "any person on whose behalf the principal contractor agrees to purchase the package". (See further para 8.3 of the DP and its note 7.) Applying this to the example of a family holiday booked by the father, the Regulations have the effect of extending the rights enjoyed by him to all members of the family party.

[36] At para 1.20 of the DP. See also para 2.7 below.

[37] See further para 1.22 below.

projects.[38] The restrictions and uncertainties under the current law pose significant difficulties here, especially given the importance of contracts in these areas to the economy.

Company groups

1.17 The subject of company groups was raised with us in 2010 by Douglas Mathie, then of Brodies LLP, who called upon us to reform third-party rights in Scots law.[39] He began:

> "Imagine you are a bank with a complex group structure, i.e. multiple companies in your group. A core computer system has gone wrong and most of the group companies have suffered loss as a result. So you sue the supplier.
>
> The supplier's defence is that it only has a contract with one member of the group, and while that group member can recover its loss, the supplier isn't liable for loss suffered by the other group companies."

"This," he continued, "is a fairly valid legal argument." But it is not one which will bring any comfort to the directors and shareholders of other companies in the group, especially if the contracting company has not in fact suffered a loss.

1.18 Mr Mathie commented that it would be relatively simple to prevent such a situation through use of the 1999 Act, which allows the contracting parties to write in an express term enabling them to rescind or vary the contract without the consent of the third party.[40] In comparison, Scots law is "massively inflexible", the key point being that "once you create a third-party right under [JQT] it can be very difficult to amend it or kill it".[41] This meant that Scots lawyers might advise that a contract which would otherwise be drafted under Scots law should instead be made subject to English law, principally to obtain the benefit of the 1999 Act. Where that is not possible, perhaps because the contract concerns heritable property situated in Scotland (for which Scots law is therefore required), an alternative would need to be found. Mr Mathie's solution was "to expressly apply the English Act to the third-party rights clause, but have the rest of the Agreement subject to Scots law. Very ugly." Such difficulties could be avoided by appropriate reform of third-party rights in Scots law.

1.19 As a further point, it may well be that a loss is suffered by a company which was not part of the relevant group at the point when the IT contract was entered into, but which subsequently became a group company. It is commonplace for new companies to be created within such groups, or for existing companies to be bought in, perhaps by way of share purchase. A doctrine of third-party rights which allows for the creation of such rights in favour of such a party, as the 1999 Act and the comparator instruments do, is therefore of considerable utility in the context of company groups. In the present example, it is possible to create rights that will extend to new companies in the group when they come into being (or when they join the group) so that they can acquire rights against the group's software supplier. But the dissolution or sale of existing group companies is equally commonplace. The problem then arising is the revocability of these companies' rights so that the argument

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[38] See generally Ch 3 of the DP.

[39] D Mathie, *Third-party rights – Scots Law Stuck in the 17th Century*, 2010, accessible at https://brodiestechblog.wordpress.com/2010/08/26/third-party-rights-%E2%80%93-scots-law-stuck-in-the-17th-century/.

[40] See Contracts (Rights of Third Parties) Act 1999, s 2.

[41] This refers, in essence, to the previously mentioned rule that, under the current law, a JQT must be irrevocable in order to be validly created; this is the topic of Ch 5 below.

possible under present Scots law that there never were such rights in the first place can be raised.

1.20 There are other problems arising in the context of company groups to which a law of third-party rights may be thought to offer a possible solution. We consider three of them:

- restrictive covenants in employment contracts,
- so-called "transferred loss" (or "black hole") issues, and
- indemnities.

1.21 In relation to restrictive covenants, there is already Scottish case law demonstrating that an employment contract may impose restraints on departing employees which are capable of enforcement by companies in the group other than the one in which the employee was actually employed.[42] We note *en passant* that this would not be possible in England & Wales, as section 6(3)(a) of the 1999 Act allows no third-party right to enforce any term of a contract of employment against an employee. This was the result of a relatively late amendment to the Bill in Parliament, explained by the Lord Chancellor (Lord Irvine of Lairg) as heading off "a risk of the rights of workers to take lawful industrial action being restricted in unexpected ways".[43]

1.22 As to "transferred loss", we intend to explore this topic in depth in a future Discussion Paper on Remedies for Breach of Contract, which we aim to publish later in 2016. Third-party rights could provide a solution to what is sometimes termed the "black hole" of non-liability if the principal contract identifies a third party company or companies in the group in some fashion and it is objectively clear that the contracting parties intend that the third party or parties are to have a right enforceable by way of a damages claim for defective performance. Again, however, the really critical legal question under the present law will be whether it is necessary for the contractual provision in favour of the third party somehow to be made irrevocable before any right can come into existence at all.

1.23 Lastly, indemnities and cross-indemnities are often deployed in complex arrangements in which 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.[44] Commonly it will not be known at the time of contracting exactly which persons will actually be requiring indemnity, since the persons to perform the work have not been specifically identified at that point. Here the rule that the third party does not need to be identified but must merely be identifiable with reasonable certainty – for example, as a member of a class of persons named in the principal contract (for example, sub-contractors) – comes into play.

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[42] See *Group 4 Total Security Ltd v Ferrier* 1985 SC 70; *WAC Ltd v Whillock* 1990 SLT 213; and discussion in *SME* Vol 15, para 849, quoted in DP 157 para 3.19. Professor Douglas Brodie is doubtful about JQT in such situations: see D Brodie, *Contract of Employment*, para 13.33.

[43] *Hansard*, HL, Vol 596, col 21 (11 Jan 1999). He added: "It is not intended by a by-wind to upset the present balance of our labour laws."

[44] Another example of indemnities for third parties is provided by the English shipping case of *Laemthong International Lines Co Ltd v ARTIS and Fahem (No 2)* [2004] EWHC 2738 (Comm), aff'd [2005] EWCA Civ 519, [2005] 1 CLC 739.

1.24 In his consultation response Greg Gordon confirmed that such arrangements are "endemic" within operator-contractor contracts in the oil and gas industry in the North Sea, and also in joint operating agreements between oil companies. One writer has described a basic indemnity in this way:

> "In the oil and gas sector, a KK Indemnity ["knock for knock" indemnity] in its most basic form provides that party A (eg an operator) indemnifies party B (eg a drilling contractor) against claims in respect of any:
>
> - death of, or personal injury to, party A's employees;
> - loss of, or damage to, party A's property (but, with regard to KK indemnities given under construction contracts, excluding loss of, or damage to, the works being constructed); and
> - pollution emanating from party A's property.
>
> The above are all notwithstanding that party B's negligence or breach (whether of contract or of statutory duty) may have caused or contributed to the death, personal injury, loss, damage or pollution in question. In return, party B provides a reciprocal indemnity in favour of party A."[45]

Mr Gordon also noted that oil and gas contracts are almost invariably written under the law of England and Wales and refer to the 1999 Act when listing specifically where a third-party right is intended, and also when stating that, the list apart, no third-party right is intended.[46]

1.25 This manifests the importance of a clear third-party rights law for significant commercial operations, in this particular instance taking place within the jurisdiction of Scotland but nevertheless making use of English rather than Scots law to achieve its aims.[47] The requirement of initial irrevocability in Scots law might well pose a barrier to its use in this context.

Construction projects and collateral warranties

1.26 The second area in which third-party rights are significant is that of collateral warranties, which are most commonly found in construction projects. Their aim was well stated by Lord Drummond Young: "to ensure that the party who suffers loss has a right of action against any contractor or member of the professional team who has provided defective work".[48] For example, they are often used in shopping centres leases,[49] to provide that the tenants of an individual unit, who would otherwise only have a direct contractual

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[45] C Egbochue, "Reviewing 'knock for knock' indemnities following the Macondo Well blowout" (2013) 7 Construction Law International 4, 7 at 8-9 (available at http://www.herbertsmithfreehills.com/-/media/Files/PDFs/2013/Reviewing%20knock%20for%20knock%20indemnities%20following%20the%20Macondo%20Well%20blowout.pdf). Amongst other disasters, the article cites Piper Alpha in 1988; in that instance, the indemnities were examined in *Caledonia North Sea Ltd v London Bridge Engineering Ltd* 2002 SC (HL) 117 (see paras 75-78, per Lord Hoffmann, for a summary of the contractual provisions, and paras 7-9, per Lord Bingham, for an overview of the market practice in offshore operations).

[46] See LOGIC's standard Supply of Major Items of Plant and Equipment contract form, accessible at http://www.logic-oil.com/standard-contracts. Another example can be seen in the contract underlying the Inner House's decision in *Diamond Offshore Drilling (UK) Ltd v Gulf Offshore NS Ltd* [2005] CSIH 4, 2005 SLT 589, particularly the quotation from the contract, which refers to the 1999 Act (at para 7).

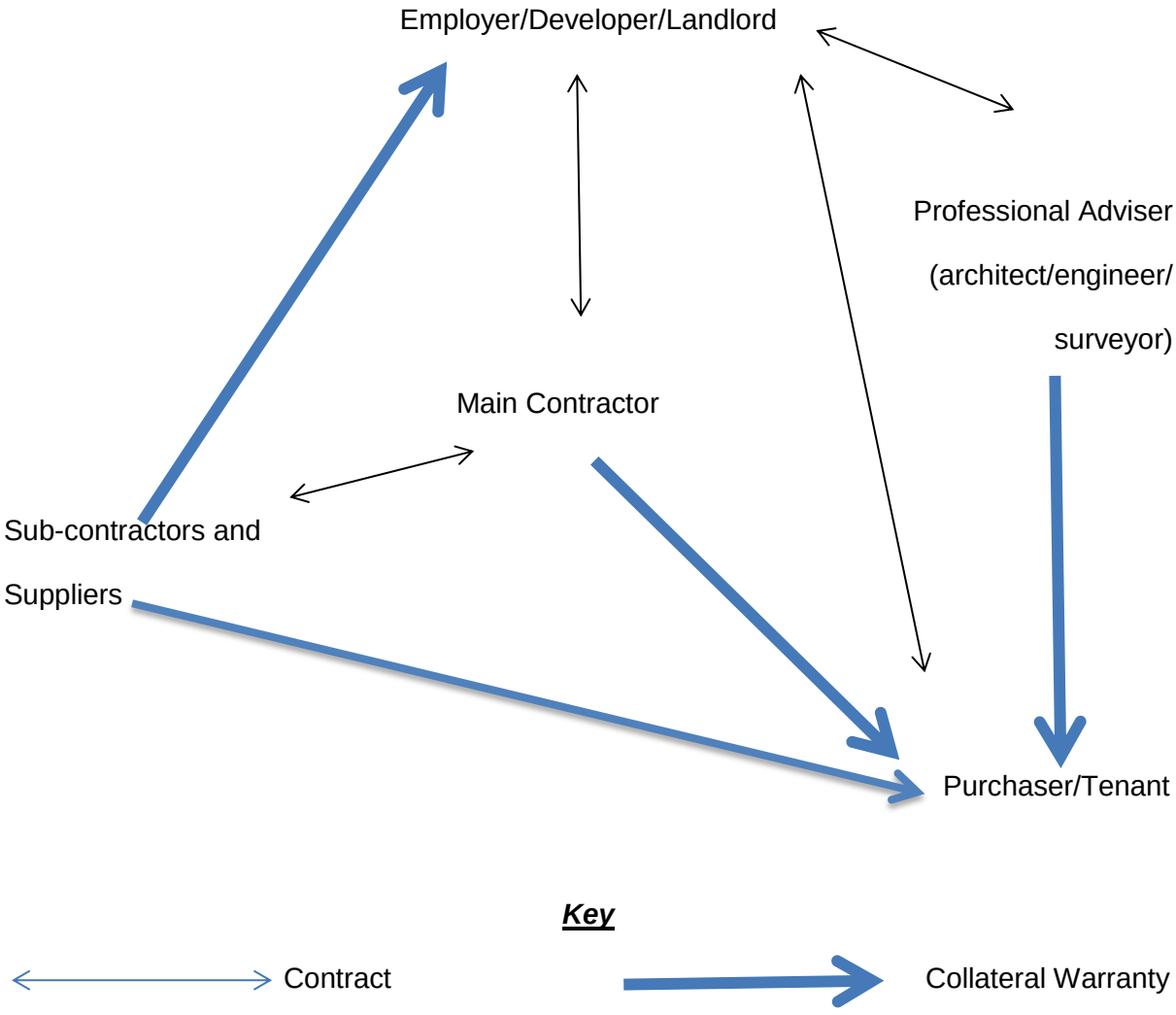
[47] The case cited in the preceding note is a good example of this.

[48] *Scottish Widows Services Ltd v Harmon Facades Ltd* [2010] CSOH 42, para 1.

[49] See e.g. *Macdonald Estates Plc v Regenesis (2005) Dunfermline Ltd* 2007 SLT 791.

relationship with the owner of the centre (i.e. their landlord), can claim against the developer of the site for defects in their unit. Another example concerns purchasers in new residential developments. Suppose a developer concludes a contract with an architect for the design of a block of flats. Under the normal rules of contract, only the developer will have a remedy against the architect for any defects in the latter's work. However, when someone buys one of the flats, he or she will often be protected by a separate collateral warranty granted by the architect in the purchaser's favour.[50] Equally, in the construction phase collateral warranties will often have been sought by the developer from sub-contractors and from suppliers of materials for the project.[51] The diagram at Figure 1.1 illustrates a typical scenario.

Figure 1.1



1.27 In this way, collateral warranties provide a solution to a problem arising from a strict approach to privity of contract, and also from the restrictions which the courts have placed

[50] Thus they can be used to counter the problem of "transferred loss", mentioned at para 1.22 above.
[51] For a summary of the reasons why each of the parties involved in a construction project requires collateral warranties, see *MacRoberts on Scottish Construction Contracts* (3rd edn, 2015), para 13.2.2.

on the recovery of negligently caused pure economic loss in the law of delict. In our flat-building example, the collateral warranty, typically constituted by a document ancillary to the main contract, will provide that the architect is obliged by the purchaser to carry out the work to an acceptable standard.[52]

1.28 Although there is some uncertainty as to exactly what constitutes a collateral warranty in Scots law,[53] a number of commercial law firms have indicated that their use is preferred in Scottish legal practice (as opposed to the *jus quaesitum tertio* doctrine) due to the perceived weakness of Scots law on third-party rights.[54] Our consultees unanimously confirmed this, and said also that it can cause problems in practical terms. In particular, David Christie highlighted the logistical issues that can arise in the procurement of collateral warranties, which often takes place at the end of a project:

> "Collateral warranties are often something of an afterthought in the process of collating, negotiating and agreeing construction contracts and can therefore be difficult to procure; especially once the momentum of negotiations has dissipated and parties relationship "capital" is being spent on dealing with the issues arising from the actual execution of the underlying construction project. While the collateral warranties position is one which often falls within the scope of the "boilerplate" sections of a contract and, therefore, ought to be relatively routine, this does not always recognise the complexity of the interlinking relationships on a construction project."

Mr Christie also noted difficulties in compelling reluctant parties to sign collateral warranties, although the English courts have granted specific performance against a party whose obligation it was to gather in the warranties and even to compel the execution of a warranty by the party to be bound.[55] But as Mr Christie further noted:

> "This does not seem like a solution which can be applied universally – in the face of subcontractor intransigence, there can be no implement/performance (since they are not a party to the obligation in question). Implementation of the obligation would be impossible."

1.29 Our consultees were generally of the view that a modern system of third-party rights, whereby the warranties were put in place in the principal contract at the outset of a project, would be used in practice. However, consultees also suggested that it might take several years for it to become fully established, and that it might not be taken up in all sectors.[56] The

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[52] The Joint Contracts Tribunal, *Collateral Warranties*, accessible at: http://www.jctltd.co.uk/category/collateral-warranties. See also Beale, "Review", p 240. See also Scottish Building Contracts Committee (SBCC) forms of collateral warranty (2011).

[53] See *Royal Bank of Scotland plc v Carlyle* [2013] CSIH 75, 2014 SC 188, rev'd [2015] UKSC 13, 2015 SC (UKSC) 93.

[54] See Macroberts LLP Bulletin, July 2011, accessible at: http://www.lexology.com/library/detail.aspx?g=880de8aa-7996-4e17-aaf2-f70be800275e; M Macauley, "Warranted Inferences" (1999) *Building* (Issue 09), accessible at: http://www.building.co.uk/professional/legal/warranted-interference/8160.article (requires subscription); Gateley LLP *Construct*, Autumn 2011, accessible at: http://www.gateleyuk.com/news-and-events/publications/item/construct-autumn-2011/ (last accessed March 2014); and L Mackenzie, *Don't Like Collateral Warranties? Then Use Your Rights!*, accessible at: http://www.brodies.com/knowledge-bank/legal-updates/don39t-like-collateral-warranties-then-use-your-rights.

[55] See *Liberty Mercian Limited v Cuddy Civil Engineering Limited* [2013] EWHC 4110 (TCC) and [2014] EWHC 3584 (TCC) (both decisions of Ramsey J, the latter ordering the defaulting party to procure the warranties). See also Lord Woolman's decision in *Keir Construction Ltd v Wm Saunders Partnership LLP* [2016] CSOH 17.

[56] The Law Society of Scotland predicted that collateral warranties would be retained for bank-financed transactions. Note also *MacRoberts on Scottish Construction Contracts* (3rd edn, 2015), para 13.5.1: "Compared to collateral warranties, the use of third-party rights schedules is a relatively recent innovation and it remains to

Senators of the College of Justice made the point that much would depend on the attitude taken by those drafting construction contracts. In any case, however, if there were a statutory third-party rights regime akin to that in the 1999 Act, contracting parties would have a meaningful set of options and could decide to use either the new law on third-party rights or collateral warranties, as seemed best to them. We note that the Scottish Building Contracts Committee has already provided a standard form of third-party right contract by which all the usual warranty obligations could be created at the time of contract formation in favour of purchasers or tenants of the development in question, or of the funders of the project.[57]

1.30 One unresolved issue in England & Wales is whether third-party rights in the construction context can be enforced by way of adjudication, the special procedure introduced by the Housing Grants, Construction and Regeneration Act 1996 for speedy resolution of disputes under construction contracts. It has been held that a collateral warranty is a construction contract and that disputes under it can therefore be referred to adjudication.[58] As noted in the Discussion Paper, however, this is controversial.[59] The question of whether third-party rights under a construction contract are also capable of enforcement through adjudication has so far received a negative answer in the English courts;[60] and it does not seem to have arisen yet as a question in Scotland. The position as it stands may encourage a turn towards third-party rights contracts instead of collateral warranties.

Other uses of third-party rights legislation

1.31 We have found much helpful material in a review of the operation of the 1999 Act by Professor Hugh Beale, a former Law Commissioner for England & Wales.[61] Part of his research was to obtain information on the use of the Act in legal practice, and he was particularly assisted by practitioner colleagues in City of London law firms. To some extent his review was a response to a lack of case law on and considerable academic criticism of the 1999 Act, and to its being most commonly expressly excluded in commercial contracts.[62]

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be seen whether in time these will replace collateral warranties as the medium of choice for providing rights in favour of third parties."

[57] SBCC Standard Form for Third-Party Right Contract (2011) Schedule Part 5.

[58] *Parkwood Leisure Ltd v Laing O'Rourke Wales and West Ltd* [2013] EWHC 2265 (TCC).

[59] DP No 157, para 3.27.

[60] *Hurley Palmer Flatt Ltd v Barclays Bank plc* [2014] EWHC 3042 (TCC); *Construction Newsletter* Jan/Feb 2015, 5. Note also *Linnett v Halliwells LLP* [2009] EWHC 319 (TCC), holding that an adjudicator did not have a third-party right by virtue of a contract clause by which the contracting parties were declared to be jointly and severally liable for his fees and expenses, but only because the contract also excluded the 1999 Act. The judgment refers to an unreported County Court decision (*David Cartwright v Lydia Fay*, 9 Feb 2005) in which it was held that an adjudicator had a third-party right under the adjudication rules to payment of his fees by the parties made responsible therefor by the rules.

[61] H Beale, "A Review of the Contracts (Rights of Third Parties) Act 1999" in A Burrows and E Peel (eds), *Contract Formation and Parties* (2010).

[62] We are aware of only three cases in which there has been significant judicial discussion of the 1999 Act. Two relate to arbitration and are reviewed in detail in Chapter 7 below: *Nisshin Shipping Co Ltd v Cleaves & Co Ltd* [2003] EWHC 2602 (Comm); and *Fortress Value Recovery Fund LLP v Blue Skye Special Opportunities Fund LP* [2013] EWCA Civ 367, [2013] 1 WLR 3466. (Note also on arbitration the discussion by Burton J in *AES Ust-Kamenogorsk Hydropower Plant LLP v Ust-Kamenogorsk Hydropower Plant JSC* [2010] EWHC 772 (Comm), [2010] 1 CLC 519, paras 26-32; his decision is affirmed without reference to the third-party rights point by both the Court of Appeal ([2011] EWCA Civ 647, [2012] 1 WLR 920) and the Supreme Court ([2013] UKSC 35, [2013] 1 WLR 1889).) The third major case on the 1999 Act is *Laemthong International Lines Co Ltd v ARTIS and Fahem (No 2)* [2004] EWHC 2738 (Comm), aff'd [2005] EWCA Civ 519, [2005] 1 CLC 739: see further footnotes to paras 3.20, 4.4, 4.19 and 4.27 below. The Act was also applied at first instance in a judgment subsequently

1.32 But it appears from Professor Beale's study – and our own researches have tended to confirm this – that the use of the 1999 Act in practice in England & Wales may be increasing to at least some extent. In addition to the specific types of situation mentioned above, Professor Beale discusses a number of commonplace commercial contexts in which third-party rights can be used to the benefit of all parties involved.[63] These include insurance contracts, settlement agreements, outsourcing financial services, and "community of interest" cases. The last of these merits a brief comment, as we analysed it in some detail in the Discussion Paper, and we believe that our proposed reforms may have some significance here.[64]

1.33 A "community of interest" may arise in a number of situations, in residential and commercial settings. The Title Conditions (Scotland) Act 2003 now largely provides an enforcement mechanism for neighbours where land is transferred and made subject to conditions intended to affect successors (known as "real burdens"). The Act prevents such burdens having contractual effect.[65] As we noted in the Discussion Paper, use of the phrase *jus quaesitum tertio* in this context was probably never very apt and is certainly not so after the 2003 Act.[66] Our proposed reforms will not affect this position; but they will be of possible importance where land is leased rather than transferred outright between the parties.

1.34 We cited a number of examples in the commercial sphere in the Discussion Paper.[67] A common situation is a shopping centre (or, as in a prominent English Court of Appeal case, a parade of five shops[68]), where each tenant has an interest in the effective running of the centre and in the observance by other tenants of any restrictions on them. We understand that, while in practice there may be reasons why a tenant cannot use a third-party right to take action against another tenant,[69] the option remains a useful one should the right conditions arise. Although a tenant may have a right under the lease to require the landlord to take action against a fellow tenant, the latter may not be willing or able to do so. In such situations, a direct method of enforcement by means of a third-party right may be of great value.[70]

1.35 Those who responded to our question about whether special provision should be made to cover these cases were unanimous in their views.[71] While parties to leasing transactions where there is a "community of interest" should continue to be free to make use of third-party rights law, there is no need to make special provision for such cases. We

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reversed by the Court of Appeal because on construction the contract in question gave rise to no third-party right: *Prudential Assurance Co Ltd v Ayres* [2007] EWHC 775 (Ch), [2007] 3 All ER 946, rev'd [2008] EWCA Civ 52, [2008] 1 All ER 1266. For academic criticism of the 1999 Act see e.g. M Bridge, "The Contracts (Rights of Third Parties) Act" (2001) 5 Edin LR 85; P Kincaid, *Privity: Private Justice or Regulation* (2001); R Stevens, "The Contracts (Rights of Third Parties) Act 1999" (2004) 120 LQR 292. The relationship between the courts and arbitration is also discussed in Lord Thomas LCJ's BAILII lecture of 9 March 2016, accessible at https://www.judiciary.gov.uk/wp-content/uploads/2016/03/lcj-speech-bailli-lecture-20160309.pdf.

[63] See Beale, "Review", *passim*; Sutherland and Johnston, "Contracts for the Benefit of Third Parties", pp 234-237.

[64] DP, paras 3.37-3.47.

[65] Title Conditions (Scotland) Act 2003, s 61.

[66] At paras 2.46 (citing *SME* Vol 18, para 402 (K G C Reid)) and 3.37 of the DP.

[67] See paras 3.37-3.44 of the DP in particular.

[68] *Williams v Kiley (T/A CK Supermarkets Ltd)* [2002] EWCA Civ 1645; see paras 3.40-3.41 of the DP for a discussion of the facts and an analysis of the reasoning.

[69] See paras 3.42-3.43 of the DP. For instance, the leases may vary slightly (in which case there will not be a community of interest in the required sense) or there may be practical difficulties in obtaining a copy of other tenants' leases.

[70] See para 3.44 of the DP.

[71] Question 4 in para 3.47 of the DP.

agree, and therefore do not recommend any such provision for "community of interest" transactions in our proposed reform of the law.

Structure and summary of the Report

1.36 The Report aims to address the concerns expressed by our Advisory Group and consultees. A summary of our recommendations is given at paragraphs 1.39-1.45 below. The remaining chapters are as follows. Chapter 2 considers the use of third-party rights in practice in Scotland. Chapter 3 discusses issues related to terminology, and in Chapter 4 we consider the formation of third-party rights, in particular the identification of the third party, and the intention of the contracting parties to confer the third-party right. Chapter 5 focuses on the issue of irrevocability, in particular addressing when the third-party right becomes irrevocable. In Chapter 6 we consider the appropriate remedies and defences as well as the position on renunciation and rejection of the right by the third party. In Chapter 7 we address an issue that we did not raise in our Discussion Paper but which came to the fore as we developed our post-consultation thinking, namely the application of arbitration to third-party rights. Our discussion and recommendations follow informal consultation on the matter with the arbitration community in Scotland. Chapter 8 lists our recommendations. Appendix A contains the draft Contract (Third Party Rights) (Scotland) Bill which gives effect to our recommendations, and in Appendix B we reproduce the relevant provisions from the comparator instruments. Finally, those who responded to our Discussion Paper, and who assisted us on our Advisory Group and in other ways, are listed in Appendix C.

General approach taken by the draft Bill

1.37 We should make it clear that we consider that legislation is necessary in order to bring Scots law up to the standard of clarity and certainty which is required for effective law. The alternative, namely to proceed without recommending legislation, would rest on the basis that judicial reform could still do the job. In the Discussion Paper we sought to outline how this might be argued, but that route would require a determined litigant with deep enough pockets to go all the way to the UK Supreme Court,[72] despite no guarantee of success. Meanwhile the present understanding of the law would remain as a stumbling-block to perfectly reasonable and intelligible arrangements in business and non-business life alike.

1.38 Consultees were asked whether it would be preferable to have a comprehensive statutory statement of the law on third-party rights, replacing the relevant common law, or amendment of the existing common law to achieve the desired reforms. The clear view in response was that the former option was to be preferred for the creation of certainty and the avoidance of doubt. We agree that this is the better approach but also think that it is important not to do more than necessary to achieve the desired result (which we refer to as the "principle of legislative economy"). The proposed reform will take place against the background of the general law on obligations and contract, and the statute should not attempt to do more than refer to that general law. It is also important that the rules in the

[72] In *McLaren Murdoch & Hamilton Ltd v Abercromby Motor Group Ltd* 2003 SCLR 323 Lord Drummond Young said: "No doubt the applicability of the principle [of JQT] might be extended by removing the two restrictions referred to above [i.e. the requirement that the contracting parties intend to benefit the third party, and that the third party beneficiary be identified in the contract], but that is clearly beyond the competence of the Outer House" (at para 39). The decision of the House of Lords in *Carmichael v Carmichael's Ex* 1920 SC (HL) 195, discussed in Ch 2 below, means that, in practice, only the UKSC could reform this area of Scots law.

statute be generally "default" in nature; that is, subject to express provisions made by the parties in their contract. This is the position under the comparator instruments, including the 1999 Act.[73]

Summary of recommended reforms

1.39 The reforms recommended in this Report would, we think, be consistent with the international benchmarks set out earlier in this Chapter.[74] As at present, it would be possible for contracting parties to create by way of their contract a right (but not a duty) for a third party or parties.[75] The third party will have to be identified in or identifiable from the express terms of the contract,[76] but need not be in existence at the time the contract is formed.[77] The third party can either be a specified person, or a person meeting certain conditions laid down in the contract. Those conditions may be, for example, that a person of a specified description (including a person with a specified relationship to one or more of the contracting parties) comes into existence in the future; or that a person does (or does not do) a particular thing in the future (for example, attain majority, get married, or matriculate at university); or that a person becomes a member of a particular class (for example, an employee of a named company); or is later nominated or authorised by one or more of the contracting parties.

1.40 There is no requirement that the third party accept the right,[78] or that the contract be in writing.[79] The intention of the contracting parties to confer a right, as distinct from the third party merely having an interest in or being benefited by the performance of the contract, may be expressed in or implied from the contract.[80] The contracting parties may make clear by express provision that they intend no third-party right to arise from their contract, or to exclude or limit liabilities to the third party which might otherwise arise.[81]

1.41 All the foregoing is more or less the present law. The crucial reform in our recommendations is that it would not be necessary for contracting parties wishing to create a third-party right to take steps to make the third-party right irrevocable from the outset.[82] They would instead be free to make provision in their contract for the cancellation or modification of the third party's right, and to exercise those powers at any time prior to the crystallisation of the third party's right.[83]

1.42 If the third party's right is dependent upon the fulfilment of conditions by the third party, and this happens before any cancellation or modification is made to it by the contracting parties, then the latter lose their freedom to cancel or modify the right.[84] Contracting parties are free to make the third-party right irrevocable or un-modifiable by provision in their contract, or by an independent promise to the same effect made later.[85]

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[73] DCFR II.-9:301(2); UNIDROIT PICC art 5.2.1(2); 1999 Act, ss 1(4), 2(3), 3(5).
[74] See paras 1.8-1.12 above.
[75] See Ch 3 below for the terminology.
[76] See paras 4.2-4.15 below.
[77] See paras 4.9-4.10 below.
[78] See para 4.29 below.
[79] See paras 4.35-4.37 below.
[80] See paras 4.16-4.24 below.
[81] See paras 6.46-6.49 below.
[82] See para 5.5 below.
[83] See Ch 5 below.
[84] See paras 5.7-5.20 below.
[85] See paras 5.32-5.38 below.

Further, the contracting parties deprive themselves of their freedom to cancel or modify an otherwise unconditional right if they notify the third party of its existence (but registration of the contract does not have this effect).[86] Finally, the contracting parties become unable to cancel or modify the third-party right if the third party acts in reliance upon it and this is either known to or reasonably foreseeable by the contracting parties.[87]

1.43 The reform will also clarify a number of points on which the present law provides no authoritative guidance. The right may be renounced or rejected by the third party either expressly or impliedly.[88] The third party has available in principle all the usual remedies by means of which any personal right under a contract can be enforced.[89] The defences available to the contracting parties against the third party include those which may arise from the invalidity, illegality or frustration of the contract, but only insofar as these impact upon the third-party right.[90] Compensation (or "set off") may be available to the contracting parties against the third party's claim.[91] A small adjustment to make clear that third-party rights are subject to negative prescription is also included.[92] The Report also recommends changes to the law which would make third-party rights (including a right to arbitration itself) enforceable in arbitral proceedings in at least some contexts but without ever imposing upon the third party a duty to submit to arbitration.[93]

1.44 In general, but with some exceptions, the new rules are subject to express provision to the contrary in the relevant contract. In other words, they are generally default rules, and they may be varied or disapplied, in whole or in part, by parties if they wish. They will not apply to undertakings in favour of a third party which are entered into before the legislation comes into force, i.e. they do not have retroactive effect. And, from commencement, it will no longer be competent to create a *jus quaesitum tertio*, although any existing JQTs will continue in force. Parties may agree, however, that the new rules are to apply to an undertaking entered into prior to commencement and it is expected that courts and arbitrators will uphold such an agreement as a manifestation of the general principle of parties' contractual autonomy.

1.45 We therefore recommend:

1. (a) The legislation should be a comprehensive statutory statement of the law on third-party rights in contracts, replacing the relevant common law; but it should not do more than that. The statutory rules should in general be subject to any express provisions in the contract, and may be varied or disapplied if parties wish.

(Draft Bill, *passim*)

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[86] See paras 5.22-5.31 below.
[87] See paras 5.39-5.51 below.
[88] Ibid, paras 6.2-6.8.
[89] See paras 6.9-6.15 below. Note that the third-party right is personal (i.e. good only against whichever of the contracting parties is due to perform), and not real (i.e. good against all the world). There can, however, be third-party rights which "run with the land" in that they are exercisable by whoever is the owner (or, in some cases, tenant) of land at the relevant time. See e.g. *Magistrates of Dunbar v Mackersy* 1931 SC 180 (para 3.6 of the DP), in which a contract made between parties was held to give third-party rights to the singular successor of one of them while the other (a corporation) was bound by the relevant duties.
[90] See paras 6.18-6.30 below.
[91] See paras 6.21-6.29 below.
[92] See paras 6.38-6.40 below.
[93] See Ch 7 below.

(b) From commencement, no new *jus quaesitum tertio* may be created, though existing ones will continue to be effective, and the legislation will not apply (unless parties so agree) to undertakings in favour of a third party which were created before commencement.

(Draft Bill, sections 12 and 13)

Legislative competence and relationship with specific rules

1.46 Section 29 of the Scotland Act 1998 sets out the limits of the Scottish Parliament's legislative competence. For the reasons set out below, we consider that our draft Bill falls within those limits. We say this, in part, because the subject matter, the Scots law of contract, is generally devolved;[94] in other words, it is a matter within the competence of the Scottish Parliament. There is no specific reservation relating to third-party rights, although the question of how our recommendations relate to existing specific third-party rights regimes is something which we discuss below.

1.47 In addition, we do not consider that our recommendations raise any issues under EU law or human rights legislation. Nothing in our suggested reform is mandatory, and contracting parties will be free to opt out of the legislation if they so choose. As it is not retrospective, there is no danger of established rights being affected. Our recommendations on arbitration may raise one question about the possible application of Article 6 of the European Convention on Human Rights, but we believe, for reasons set out in detail in Chapter 7 of this Report, that this is fully addressed in our proposals.[95] If there is any doubt remaining on this point, the recommendation could be dropped from the proposed Bill without any repercussions for it elsewhere.

Effect of recommendations on specific third-party rights rules

1.48 In discussing the Scottish Parliament's competence in respect of our recommended reform, there is a particular question which we ought to address. It bears on the issue of how that reform relates to the specific third-party rights regimes in certain areas. The proposals which we outlined in our Discussion Paper for a restated regime of third-party rights were intended to be general in their application. At that stage, we sought views on whether the proposed reform of the law should be expressly subject to such statutory or common law third-party rights rules as already exist, and those which might be created in the future.[96] An example of a specific rule is that to be found in the field of carriage of goods by sea, where the law has developed in ways which are intended to be particular to the types of contract in question.[97] Other examples are set out in section 6 of the 1999 Act.[98] Our question was whether the draft legislation should expressly provide that the recommended general rule is not to apply to such contracts.

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[94] Scots private law is defined in s 126(4) of the Scotland Act 1998 as covering the law of obligations, including obligations arising from contract.
[95] See paras 7.50-7.59 below.
[96] See Ch 8 of the DP, and question 51 in para 8.6 in particular.
[97] See the Carriage of Goods by Sea Act 1992. For a discussion see E M Clive, "*Jus quaesitum tertio* and the carriage of goods by sea" in D L Carey Miller and D W Myers (eds), *Comparative and Historical Essays in Scots Law* (1992), pp 47-56; and, for a comparison of the Act with the third-party right provisions of the DCFR, see S Lamont-Black, "Third-party rights and transport documents under the DCFR – potential for an appropriate and effective EU unification and an improvement for the UK?" in W Verheyen, F Smeele and M Hoeks (eds), *Common Core, PECL and DCFR: could they change shipping and transport law?* (2015) pp 129-52.
[98] See further Law Com No 242, Part XII.

1.49 Those who responded were unanimous that the general reforms should be without prejudice to the specific statutory third-party rights regimes under the current law.[99] In addition, respondents stated that no such regimes should be amended in light of those reforms.

1.50 We agree with these views. As to the first, that the general reforms should be without prejudice to specific regimes (whether existing or to be created in future), we are fortified in our view that this is how our draft legislation would be interpreted because there is a presumptive canon of statutory interpretation to that effect.[100] Furthermore, and this is a point which touches also on the second view expressed by our respondents, many of the existing specific regimes happen to be in areas which are reserved in terms of the Scotland Act 1998. (There is a possible exception to this, which we discuss below.[101]) In common with all legislation passed by the Scottish Parliament, were our draft Bill to be enacted it would require to be read, in any case where its legislative competence was in question, "as narrowly as is required for it to be within competence, if such a reading is possible".[102] Such a reading would, in our view, be possible: the legislation would simply be read as not applying to specific rules which have been enacted in reserved areas.

Employment contracts

1.51 Of the express exceptions in section 6 of the 1999 Act there is one which is arguably not in a reserved area. Section 6(3) provides:[103]

> "(3) Section 1 confers no right on a third party to enforce—
>
> (a) any term of a contract of employment against an employee,
>
> (b) any term of a worker's contract against a worker (including a home worker), or
>
> (c) any term of a relevant contract against an agency worker."

Subsection (4) provides definitions of a number of these terms, by reference to provisions in the National Minimum Wage Act 1998.

1.52 The Explanatory Notes to this provision record that it "prevents a third party (for example, a customer of an employer) acquiring a right under the Act to enforce a term of a contract of employment, or similar contract, against an employee or worker". We do not need to explore here the precise reasons for the provision, but it is relevant to remember

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[99] We discuss a non-statutory regime (concerning employment contracts) at paras 1.51-1.62 below.

[100] It is sometimes known by the Latin tag *generalia specialibus non derogant*: see O Jones and F A R Bennion, *Bennion on Statutory Interpretation* (6th edn, 2013), p 281. Compare the similar rule in the DCFR and the CESL (as discussed in para 8.8 of the DP). *Bennion* describes the canon thus: "Where the literal meaning of a general enactment covers a situation for which specific provision is made by another enactment contained in an earlier Act, it is presumed that the situation was intended to continue to be dealt with by the specific provision rather than the later general one. Accordingly the earlier specific provision is not treated as impliedly repealed." Where the specific provision is contained in a *later* Act, the same result may be achieved: *Richards v Richards* [1984] AC 174, 199.

[101] See paras 1.51-1.62 below.

[102] Section 101(2) of the Scotland Act 1998.

[103] See Appendix B for the full text of the 1999 Act. Section 6(3)(a) was considered in a recent judgment, *Cavanagh and others v Secretary of State for Work and Pensions* [2016] EWHC 1136 (QB). The court rejected the argument that an employment contract permitting an employee to opt for direct deductions from salary to be paid to a trade union was, upon enforcement by the third party union, being enforced "against an employee".

that, immediately prior to the 1999 Act's entry into force, there was no general rule of third-party rights in England and Wales.[104] This meant that there was a risk that, in areas such as employment law, the Act would give rise to rights where none had previously existed and – importantly – where they were not wanted. The decision to exclude such rights should therefore be seen in that context. The position in Scots law is rather different, and it is arguable (though there is scant authority) that JQT is applicable to employment contracts at present.[105]

1.53 The question is, therefore, whether the subject matter of paragraphs (a) to (c) of section 6(3) of the 1999 Act is reserved under the Scotland Act 1998. The relevant provision, in Section H1 of Schedule 5 to the latter Act, is the reservation relating to employment: "Employment rights and duties and industrial relations, including the subject-matter of [specific statutes, including the National Minimum Wage Act 1998]".[106]

1.54 The first question is whether the reservation of "employment rights and duties" is to be read as being broad enough to embrace the possible use of third-party rights in contracts of employment. We do not think so, for two reasons. First, the reservation is specific to the field of employment,[107] and it is therefore arguable that it should be interpreted as referring to those rights and duties which are, in some sense, particular or central to contracts of employment. Thus, not every right and duty which happens to be included in such contracts is covered. To take an example, an employment contract might restrict the places or times at which employees may smoke but that is obviously subject to the general law on smoking (on which the Scottish Parliament has passed legislation). The more central a right or duty is to the relationship between employer and employee, the more likely it is to be caught by the reservation; conversely, the less central it is, the less likely it is to fall within the reservation.[108]

1.55 The second reason is based on the likely extent to which the reservation covers the common law, as it relates to employment. All of the particular matters mentioned in the

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[104] See para 1.11 above.

[105] As well as being scant, such authority as there is points in differing directions. Writing in the mid-1970s in relation to the application of JQT to collective agreements in employment law, R L C Hunter stated: "These rules [on JQT] can be seen not as part of "the core of common principles" of Scots contract law, but as definitely applicable only to the kinds of contract which have already figured in decided cases. Since the Scottish courts have not yet seriously considered, in any recent case in the Court of Session, the rights of third parties under collective agreements, it is still open to them to fashion the law to suit the circumstances of labour relations." (R L C Hunter, "Collective Agreements, Fair Wages Clauses, and the Employment Relationship in Scots Law" 1975 JR 47, 56). On the other hand, an online article on employment law by Brodies LLP, in which a contrast is drawn between Scots and English law in this field, remarks on the fact that the 1999 Act "does not extend to Scotland, with the common law alternative *of jus quaesitum tertio* instead governing when and how other persons may acquire rights under an agreement to which they are not a party": http://www.inhouselawyer.co.uk/index.php/legal-briefing/scottish-employment-law-small-but-significant-differences-can-be-a-trap-for-the-unwary/. See para 3.19 and ch 8 of the DP for further discussion.

[106] It is also subject to an exception, which is not relevant for our purposes. Although the subject-matter of the National Minimum Wage Act 1998 is a reserved matter, the fact that (as we have noted in para 1.51 above) the employment exception in section 6 of the 1999 Act is defined by reference to it does not, in our view, extend the reservation in H1 so as to include that exception. What is reserved is the *subject-matter* of the 1998 Act, and the mere reference in another statute to its interpretation provision does not, of itself, make that other statute a reserved matter. In the present situation, we view the references in s 6 of the 1999 Act to the National Minimum Wage Act 1998 as of no particular relevance to the question of whether third-party rights in employment contracts are, or are not, reserved under the devolution settlement.

[107] Head H of Sch 5 to the Scotland Act 1998 is labelled "Employment".

[108] In saying this we should bear in mind that the reservation in Section H1 includes the subject-matter of a number of statutes in the field of employment law; we should not be understood as wishing to change the law in any of those specific areas (and that would clearly be beyond the Scottish Parliament's competence).

reservation are statutory and, whilst the general reference to "employment rights and duties" is not necessarily so limited, there must be serious doubt as to whether it is intended to embrace the whole of Scots common law as it relates to employment. If that were the intention, it would have been simple to provide for it in clear terms.

1.56 It can hardly be doubted that a common law of employment in Scots law exists.[109] One particular example might be the doctrine of mutuality of contractual obligations in an employment contract, a topic which has recently been examined judicially and held to be different from the law in England and Wales.[110] If a doctrine such as this one, which is of obvious relevance to employment contracts, is part of the Scots common law but not that of England and Wales, it is hard to see that the reservation of "employment rights and duties" is to be read as preventing the Scottish Parliament, were it so minded, from enacting a statutory rule on mutuality. *A fortiori*, it could be argued, there is no bar to the Scottish Parliament enacting a general third-party rights regime which would apply to employment situations, amongst others.

1.57 We should perhaps go a step further in the analysis. Suppose that we are wrong in what we have just set out, and suppose that the reservation of employment prevents the Scottish Parliament from enacting a general rule on third-party rights with express application to employment contracts. Would that automatically render it beyond the Scottish Parliament's competence? We consider that there is a good case for saying, No.

1.58 The reason is that, when read with section 29(3) and (4), section 29(2)(b) of the Scotland Act 1998 (which states that a provision is outside competence if it relates to reserved matters), does not bite on a provision whose purpose is "to make the law in question [here, third-party rights law] apply consistently to reserved matters and otherwise". Under the present hypothesis, by which the legislation sets out a general rule of third-party rights in Scots law which is expressly applicable to contracts of employment, such an application would only be incompetent if it were not to apply consistently to employment contracts and other ones.[111] This would appear to be a simple test to meet in the present situation. There is no policy reason why the application to employment contracts should be any different from the application in other areas.

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[109] See e.g. D Brodie, *The Contract of Employment* (2008).

[110] *McNeill v Aberdeen City Council (No 2)* [2013] CSIH 102, [2014] IRLR 113; for a commentary, see D Cabrelli, "The Mutuality of Obligations Doctrine and Termination of the Employment Contract: *McNeill v Aberdeen City Council (No 2)*" (2014) 18 Edin LR 259-265.

[111] See *Martin v HMA* [2010] UKSC 10, 2010 SC (UKSC) 40 for a discussion of s 29(2) and (4) (para 19, per Lord Hope). Note too *Imperial Tobacco Ltd v Lord Advocate* [2012] UKSC 61, 2013 SC (UKSC) 153, at para 15 (also per Lord Hope): "The fact that section 29 [of the Scotland Act 1998] provides a mechanism for determining whether a provision of an Act of the Scottish Parliament is outside, rather than inside, competence does not create a presumption in favour of competence. But it helps to show that one of the purposes of the 1998 Act was to enable the Parliament to make such laws within the powers given to it by section 28 as it thought fit. It was intended, within carefully defined limits, to be a generous settlement of legislative authority." See *The Christian Institute, Petitioners* [2015] CSOH 7, 2015 SLT 72, at paras 83-89; note in particular para 85 (per Lord Pentland): "the devolutionary scheme recognised that a degree of trespass into reserved areas was inevitable and that it had been intended that any argument as to whether a provision in an Act of the Scottish Parliament related to a reserved matter was to be decided by reference to its "pith and substance" or its purpose and if its purpose was a devolved one it was not to be outside legislative competence merely because it affected a reserved matter. The intention of the United Kingdom Parliament was that the devolutionary settlements should be stable and workable (*In re Agricultural Sector (Wales) Bill* [2014] 1 WLR 2622)." This approach was followed by the Inner House: *Christian Institute v Scottish Ministers* [2015] CSIH 64, 2015 SLT 633, at paras 104-105. The UKSC heard an appeal in March 2016, though the judgment is still awaited at the time of writing.

1.59 Matters cannot be left quite there. A further point requires to be considered.[112] By paragraph 2(1) of Schedule 4 to the Scotland Act 1998, "[a]n Act of the Scottish Parliament cannot modify … the law on reserved matters". If, for the sake of argument, contracts of employment are a reserved matter, then their modification is beyond competence. Just as with section 29 above, however, there is a qualification: subparagraph (3) states that the rule just quoted applies in relation to "a rule of Scots private law … only to the extent that the rule in question is special to a reserved matter".[113] Would a general law on third-party rights be "special" to the reserved matter of employment contracts? It seems hard to see that it would be, given its broad application across all contracts.[114]

1.60 To sum up, it seems to us that any application of the recommended general third-party rights rule to employment contracts would not fall within the reservation in Section H1 of Schedule 5 to the Scotland Act 1998. It would therefore be within the Scottish Parliament's competence to create a general regime which applied equally to such contracts and others. If we are wrong about that, the boundaries of legislative competence as set out in section 29 of that Act, and the restrictions in its Schedule 4, are such that the way in which the regime would apply to employment contracts would mean that it fell within the competence of the Scottish Parliament.[115]

1.61 This leaves the question as to whether, as a matter of policy, we wish the general rule to include contracts of employment. As already mentioned, this is, in the main, a common law area and, in relation to statutory third-party rights regimes, we have decided that the general rule is to be without prejudice to them.[116] Those who responded to our Discussion Paper considered that our draft legislation should seek to exclude employment contracts from its scope. They did not, however, advise us of any difficulties with the current application of the JQT doctrine in the employment context in Scotland, and indeed we have noted some situations in which it may perform a useful function.[117] On further consideration, we are not persuaded that there is any general reason for a limitation of third-party rights in this area. It is very unlikely, in most contracts of employment, that there will be any question of a third-party right arising impliedly; but there seems to be no reason to prevent parties to such contracts from providing for third-party rights should they so wish. In any event

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[112] For a summary of the steps which are to be taken, see Lord Hope's analysis in *Martin v HMA* (see note above) at para 22. The decision was given by a majority (Lords Rodger and Kerr dissenting). Although that case involved a provision of the criminal law, the consideration of the devolution settlement is very similar to what is required in the present situation.

[113] There is a further test – that the rule does not deal with specified matters such as taxes or pensions – but it is not relevant here. In passing, the meaning of "special to a reserved matter" was the subject of some controversy in *Martin* (see previous note), with Lord Rodger saying, at para 149: "Until now, judges, lawyers and law students have had to try to work out what Parliament meant by a rule of Scots criminal law that is "special to a reserved matter." That is, on any view, a difficult enough problem. Now, however, they must also try to work out what the Supreme Court means by these words. It is a new and intriguing mystery."

[114] There is a further possible argument, which is that any modification of employment rights and duties would be incidental or consequential. In such a case, para 3 of Sch 4 to the Scotland Act 1998 might provide an argument that the legislation is not beyond competence.

[115] Indeed, were it otherwise, it is difficult to see how any general reform of the law of contract could be carried out in the Scottish Parliament, since such reform will apply not just to employment contracts, but to many others which fall within reserved matters, such as consumer and insurance contracts, and commercial contracts for the supply of goods and services. It seems clear from the inclusion of "obligations arising from contract" within the definition of Scots private law that the Scottish Parliament is empowered to legislate generally in this area.

[116] See paras 1.48-1.50 above.

[117] See para 1.21 above, in relation to restrictive covenants. It is also worth noting that an employee subject to such a covenant already receives protection against abuse because the covenant must be reasonable in relation to his/her interests as well as those of the employer, and also as regards the public interest generally.

contracting parties who are concerned about the possibility of an unanticipated third-party right will be able to exclude the legislation by express contractual provision to that effect.

1.62 We therefore recommend:

2. The legislation should apply generally to contracts involving third-party rights, with no express exclusions (in particular, for employment contracts). This would, however, leave existing specific third-party rights regimes (such as that governing the carriage of goods by sea) intact.

Business and Regulatory Impact Assessment ("BRIA")

1.63 In line with the Scottish Government's requirements for regulatory impact assessments of legislation, codes of practice and guidance, we have prepared a BRIA in relation to our recommendations. It is published on our website. It considers the merits of introducing the draft Bill set out in Appendix A, which gives effect to our recommendations, in comparison with the option of either leaving the current law as it is or, alternatively, of a change to the law being made by the courts.[118]

1.64 We think that our recommendations have no relevant financial impacts, in that they will not make any call upon the Scottish Consolidated Fund or require government expenditure beyond what is needed to complete the legislative process. Likewise, as the recommendations make a facility available in law but do not compel anyone to use it, we think that the financial impact on individuals and entities will be neutral where it is not positive in saving costs and resources that might otherwise be required to achieve the same effects.

1.65 A law firm has publicly declared that our proposals on third-party rights are "business friendly".[119] We certainly believe that they are not unfriendly to business, and indeed to the ability of the courts and lawyers to do justice to their customers in general, as third-party rights can be important in many non-business as well as business contexts. It was the same law firm which in fact first drew our attention to the problems with the law on third-party rights,[120] and – on the basis of consultation we have done in the course of this review – we are confident that our proposals will go a long way to eliminating these problems.

Acknowledgements

1.66 We are very grateful to the practitioners, academics and others who have generously assisted us in the course of this project. In order to come up with proposals in this area we needed to gain an understanding of the problems currently faced in practice. The Advisory Group, whose members are listed in Appendix C, provided invaluable assistance in this regard. We were also greatly helped on particular points by a number of individuals, also listed in Appendix C.

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[118] As explained in Ch 2, this will involve the UKSC modifying or over-ruling the effect of the House of Lords' decision in *Carmichael v Carmichael's Ex* 1920 SC (HL) 195. Such an outcome is subject to a number of variables; in our view, this makes it unsuitable as a means of law reform when compared with the option of legislation.

[119] http://www.brodies.com/blog/technology/slc-proposes-formal-third-party-rights-scots-law-contracts/.

[120] https://brodiestechblog.wordpress.com/2010/08/26/third-party-rights-%E2%80%93-scots-law-stuck-in-the-17th-century/.

Chapter 2 Summary of current law

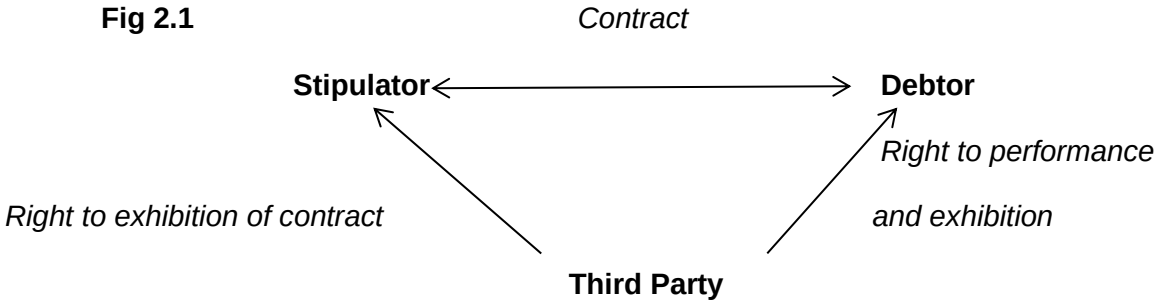
Third-party rights in Scots law

Origins

2.1 Scots contract law has long recognised rights in favour of third parties. Writing towards the end of the seventeenth century, the institutional writer Stair recognised that a contract might create a *jus quaesitum tertio* if it included clauses conceived in the third party's (or *tertius*') favour. The third party might compel either of the contracting parties to 'exhibit' the contract and then seek performance of the 'article' in its favour from whichever of them was bound to make it.[1]

2.2 The term *jus quaesitum tertio* ("JQT") is still used in Scots law today. This Commission's Consultative Memorandum on the subject published in 1977 refers to the parties to the contract conferring the right on the third party as the debtor (the party bound to make a payment or other performance to the third party) and the stipulator (the other party to the contract, who requires the debtor to perform).[2] Following that terminology for the moment allows us to represent the basic relationship between these three parties thus:

Fig 2.1



2.3 A detailed account of the present law was presented in Chapter 2 of the Discussion Paper, and it is not necessary to reproduce that in full here. The present Chapter offers a summary of that discussion, elaborating only on those points which seem in the light of our consultation to call out for reform.

2.4 A JQT can only arise when two or more parties *contract t*o confer a benefit on a third. Contracting parties can only confer *rights* upon a third party. Contracts cannot impose *duties* upon third parties without that party's consent;[3] if such consent has to be given, the result again seems to be the making of a second contract between the parties to the original

[1] Stair, *Institutions* I, 10, 5.
[2] Constitution and Proof of Voluntary Obligations: Stipulations in favour of Third Parties (Consultative Memorandum No 38, 1977), available at http://www.scotlawcom.gov.uk/publications/discussion-papers-and-consultative-memoranda/summary-table-of-discussion-papers-and-consultative-memoranda/.
[3] See e.g. *Howgate Shopping Centre Ltd v GLS 164 Ltd* 2002 SLT 820.

arrangement and the third party, not a JQT.[4] The essence of JQT is the third party's acquisition of a personal right under a single contract between two (or more) others.

Identification of the third party

2.5 For a third-party right to arise, the contract must identify the third party in some way. Identification may be of a particular individual or through membership of a class of persons. It is well settled that the third party need not be in existence at the time the contract in its favour is formed.[5] In such a case the analysis is that the obligation in favour of the third party does not arise at all until a person meeting the description of the third party, be that an organisation such as a company, or a natural person, comes into existence.[6] The implication of this is that in such cases the contracting parties may change their mind and cancel or modify the putative right until a person (natural or legal) falling within the specified class of third parties comes into existence. In private law, at least, the existence of a personal right is dependent upon the existence of a creditor who may enjoy and enforce that right.[7] It should make no difference that the existence of such a person is wholly dependent upon later actions by one or more of the contracting parties: for example, the creation of a new company within a company group.[8]

2.6 There may be a JQT if the provision in favour of a third party is expressed in a form such that *any* person fulfilling certain conditions would acquire a right against the contracting parties.[9] The case of *Thomson v Thomson* provides an example where the identification was by a contracting party, namely that the third party be a person nominated as such by one of the contracting parties, by will or otherwise.[10] But the identification may arise through the occurrence of events outside the control of any of the parties: for example, a benefit to a party arising on the illness or death of another, as in *Love v Amalgamated Society of Lithographic Printers of Great Britain and Ireland*.[11] This issue may be especially important when a third-party right is expressed in favour of a class of persons the membership of which may vary over time, depending on whether and when persons satisfy the conditions for joining the class.[12] Indeed, a set of conditions may be a way of describing a class: for example, all those injured by the negligent driving of a car are entitled to recover from the

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[4] In the DP we identified the Master Policy for Professional Indemnity Insurance provided through the Law Society of Scotland as an example of this situation; see paras 2.52 and 3.32 of the DP.
[5] See paras 2.29-2.32 of the DP.
[6] See e.g. *Morton's Trs v Aged Christian Friend Society of Scotland* (1899) 2 F 82. The rule has undoubted practical utility, e.g. for yet-to-be incorporated companies: see Macgregor, *Report on the Draft Common Frame of Reference*, Appendix, 5.2.1.
[7] See para 2.30 of the DP; note too the question of the child *in utero* discussed there at para 2.31. For further discussion of the general point see D N MacCormick, *SME Reissue General Legal Concepts* (2008), paras 29, 35-39 and 73 ("Rights necessarily belong to or 'vest in' persons") and in *Institutions of Law: An Essay in Legal Theory* (2007), 76-82, 114-115, 120. MacCormick quotes a passage found in all editions of Gloag & Henderson until the 12th of 2007: "Taking an obligation in the narrower sense of the word … [it is] a legal tie by which one is bound *to a specific creditor or body of creditors*" (emphasis supplied). It is understood the passage will be reinstated in the forthcoming 14th edition of Gloag & Henderson. See also Gloag, *Contract*, 1 (preferring to confine the use of the word "obligation" to "those obligations where the creditor is a specific person, or definite group of persons, and where the counterpart, from the point of view of the creditor, is a right *in personam*"); SME, Vol 15, para 7.
[8] For discussion of this situation see above para 1.19.
[9] See e.g. *Kelly v Cornhill Insurance Company Ltd* 1964 SC (HL) 46, discussed further below at paras 2.33 onwards.
[10] *Thomson v Thomson* 1962 SC (HL) 28.
[11] 1912 SC 1078, discussed below at paras 2.29 onwards. See also McBryde, *Contract*, para 10.31; *SME* Vol 15, para 830; and MacQueen & Thomson, *Contract*, para 2.78.
[12] See e.g. the North Sea oil situation described at paras 1.23-1.24 above.

driver's insurer under his insurance policy.[13] Again it seems clear in principle that there can be no specific third-party right in existence until at least one person satisfying the necessary conditions has emerged as its creditor, with the implication then being that until then the contracting parties remain free to cancel or modify the putative right.

2.7 In the Discussion Paper we considered the possibility that a third party who benefited from performance of a contract between others but was not identified or identifiable from the contract terms might in some cases be impliedly identified as a third party who could have rights if the contracting parties could be taken as having so intended.[14] The law is clear, however, that the mere fact of a benefit from the performance of a contract between others does not mean that a third party has a right to enforce that benefit. There is no authority in Scots law for anything akin to the German idea of the contract's 'protective umbrella' or the French *action directe*.[15] The question is always the intention of the contracting parties to confer a right upon the third party.[16] Thus for A and B to contract that A shall pay B's debts does not without more confer any right upon B's creditors as third parties.[17] But that raises another, different, question which the Scottish courts have often addressed. That is whether the intention of the contracting parties to create an enforceable right for a third party can be implied. It is to that issue which we now turn.

Contracting parties' intention to create third-party rights

2.8 As Gloag remarked, "The most unequivocable indication of an intention that a third party should have a *jus quaesitum* under a contract is an express provision that he should have a title to enforce it, and it is conceived that there is no principle of the law of Scotland which should prevent a stipulation of this kind having the effect intended."[18] Professor McBryde cites as an example the clauses at issue in *Denny's Trustees v Dumbarton Magistrates*, where the relevant provision read: "We [*the contracting parties*] agree that the Provost and Magistrates of Dumbarton [*third parties*] for the time shall have the right to enforce implement of these presents within two years after the date when the residue of the estate of the said deceased Peter Denny shall become available for division in the event of the obligations undertaken by us respectively not having been discharged earlier."[19] Further examples of express provision may be cited from the construction sector,[20] the oil industry,[21] and the Network Rail Track and Station Access Agreements in Scotland,[22] where the clause in use in 2014 conferring third-party rights upon Scottish Ministers and the Office of Rail and Road (ORR) read as follows:

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[13] The possible commercial significance of this is discussed further in Ch 3 of the DP.
[14] See in particular paras 5.16-5.21 of the DP.
[15] See para 1.20 of the DP, which refers to DCFR Vol 1, p 617 (Comment C); and LC No 242, 1996, paras 7.17-7.51. In both jurisdictions, where there is a chain of contracts of supply the law provides a contractual claim for the ultimate buyer against the original supplier, or any subsequent seller, in respect of latent defects in the material supplied. So e.g. the buyer of a house can sue its architect in respect of defects in design, despite there being no direct contractual relationship. In each case the law of contract developed to meet what appeared to be gaps in the law of delict.
[16] McBryde, *Contract*, para 10.17.
[17] *Henderson v Stubbs Ltd* (1894) 22 R 51.
[18] Gloag, *Contract*, p 236.
[19] *Denny's Trs v Dumbarton Magistrates* 1945 SC 147, cited in McBryde, *Contract*, para 10.12.
[20] See the SBCC example cited at para 4.6 below.
[21] See *Diamond Offshore Drilling (UK) Ltd v Gulf Offshore NS Ltd* [2005] CSIH 4, 2005 SLT 589, particularly the quotation from the contract at para 7 of the Court's opinion; and see also para 4.26 below.
[22] See further paras 2.26 and 3.3 below.

> "Network Rail and the Train Operator agree that the ORR shall be entitled to directly enforce such rights as have been granted to it under this contract. Furthermore, Network Rail and the Train Operator agree that this provision is intended to create a *jus quaesitum tertio*, or third-party right, in favour of and for the benefit of ORR and that they shall notify ORR of the creation of this right in accordance with Clause 18.9."[23]

2.9 But, Professor McBryde also observes, "[f]ull express terms have probably been uncommon".[24] The difficulty on this subject in many of the reported cases has thus been over when, in the absence of such an express and deliberate statement of the contracting parties' intention, but where the contract nonetheless identifies a party or class of parties to be benefited by its performance, it can be held that the contracting parties intended these third parties to have a *right* to that benefit.[25] The question has to be taken with the rule just mentioned that the mere existence of a third party benefit from, or interest in, the contract is insufficient for the creation of a right.

2.10 Gloag proposed a rule that a third-party right could be implied "where A by contract obliges B to do something for C, when his own interest in the fulfilment of these obligations is non-existent or negligible."[26] He gave several examples, starting with the case of *Lamont v Burnett* in which, when Mr A sold his hotel to B in a contract including an undertaking by B to pay Mrs A £100 'as some compensation for the annoyance and worry of the past few days and for kindness and attention to me on my several visits to Crieff', it was held that Mrs A had a direct claim for the £100 even though her husband's interest in the contract had been discharged by the successful completion of the sale of the hotel.[27] But Professor McBryde does not state an equivalent rule, although he gives this and further examples of similar cases (many of which have already been cited in this Chapter) in discussing implied intention.[28]

2.11 It does not follow from Gloag's rule, however, that ongoing obligations between the contracting parties themselves as well as in relation to the third party prevent the latter having an enforceable right. In *Mercedes-Benz Finance Ltd v Clydesdale Bank plc*,[29] Mercedes-Benz (MB) supplied cars to Glen Henderson (Stuttgart) Ltd (GH) for re-sale to customers in Scotland. When GH sold a car, the proceeds were lodged in an account held with the Clydesdale Bank (CB). GH and CB had agreed that appropriate transfers should then be made to MB by CB. GH went into receivership indebted to both CB and MB but with

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[23] Clause 18.7.1; note that Clause 18.9 (headed "Notification of third-party rights") is also relevant. The contract was accessible at http://orr.gov.uk/__data/assets/pdf_file/0006/12021/consolidated-agreement-first-scot-rail.pdf, but the clause seems no longer to be used in the most recent versions of the Scottish versions of the contract (see http://orr.gov.uk/what-and-how-we-regulate/track-access/track-access-process/forms-model-contracts-and-general-approvals, 'Model connection contract for Scotland').

[24] McBryde, *Contract*, para 10.12.

[25] In certain cases (e.g. those involving international shipping documents) the question of whether or not the contracting parties intended to benefit a third party will be answered "robustly and in a straightforward way": *Great Eastern Shipping Company Ltd v Far East Chartering Ltd, Binani Cement Ltd* [2011] EWHC 1372 (Comm) at para 43. This applies in particular to documents "issued and relied upon by those for whom English is not their first language and whose opportunities for close textual analysis before committing to a wording are in the real world very limited".

[26] Gloag, *Contract*, p 236.

[27] *Lamont v Burnett* (1901) 3 F 797. Gloag's other cases are *Wood v Moncur* 1591 Mor 7719; *Rose Murison & Thomson v Wingate Birrell & Co's Trs* (1889) 16 R 1132; *Clan Steam Trawling Co v Aberdeen Steam Trawling Co* 1908 SC 651; *Dryburgh v Fife Coal Co* (1905) 7 F 1083.

[28] McBryde, *Contract*, para 10.14 (additionally citing *Thomson v Thomson* 1962 SC (HL) 28; *Wallace v Simmers* 1960 SC 255; *Beta Computers (Europe) Ltd v Adobe Systems (Europe) Ltd* 1996 SLT 604; and *Kelly v Cornhill Insurance Co* 1964 SC (HL) 46).

[29] *Mercedes-Benz Finance Ltd v Clydesdale Bank plc* 1997 SLT 905.

funds sitting in GH's account with CB which had been due to be transferred to MB. Lord Penrose found that the agreement between GH and CB could give a third-party right to MB; he rejected CB's argument that such a right could only arise where the third party alone had a substantial interest in the performance whereas, in this case, CB clearly also had an interest in ensuring the payment to themselves of the debt which they were owed by GH.

2.12 Implied rights of third parties were perhaps chiefly significant in the line of "community of interest" cases which began in the nineteenth century. The findings of third-party rights in these situations were not in any way dependent upon the naming of third parties, either as individuals or as a class. The third-party right to enforce common real burdens resulted rather from other evidence of a specified nature, contained in the relevant title deeds. It was possible to speak of the right arising by implication, however, because it could be excluded by other inference or express provision in the relevant documents: in particular, the implication of enforcement rights for co-vassals or co-disponees would not be made where the superior or disponer had reserved the right to waive or vary the burdens. In our view the precedential value of the old co-feuar and co-disponee cases as instances of the implication of an intention to confer third-party rights and, indeed, of who may be an entitled third party, may therefore now be limited outside their own particular area of interest. They certainly do not provide any general test for when the intention of contracting parties to confer rights upon a third party can be implied.[30]

No requirement of third party acceptance

2.13 As already mentioned, there is no need for any acceptance or equivalent by the third party before its right can come into existence.[31] As a result it is clearly not a JQT when two parties contract and provide that a third party is to have a right only upon its acceptance by the third party. There is, however, nothing to prevent parties setting up such an arrangement if they wish.[32] In that case, the third party's right does not exist until acceptance of what is in effect an offer made by either or both of the contracting parties.

2.14 The rule that the third party is not required to accept the right conferred by the contracting parties is especially useful where the third party lacks full active capacity to carry out juridical acts (such as acceptance of an offer) but has a passive capacity to hold rights such as property or to be the beneficiary of personal rights under a contract between others. Such passively enjoyed rights may have to be enforced by the beneficiary's guardian. Examples of such passively capable persons include the child below the age of legal capacity (now 16) and the adult suffering from problems of mental health. An example of a contract with a third-party right in favour of young children might arise when a parent books a family holiday for him- or herself and the rest of the family. The children could have an independent claim to damages as third parties without any need to accept the right in their favour, albeit their actions would have to be raised for them by their guardians.[33]

2.15 This possibility of personal rights without acceptance under contracts made by others can also be important for the adult in need of care in a number of situations. While there are no particular issues with the adult who has a duly appointed attorney or guardian (who in

[30] See the discussion in paras 2.43-2.47 of the DP, and also the comments at paras 1.33-1.34 above.
[31] Stair, *Institutions*, I, 10, 4-5.
[32] An example may, we think, be provided by the Master Policy for Professional Indemnity Insurance provided through the Law Society of Scotland; see further para 3.32 of the DP and note 4 to para 2.4 above.
[33] See para 1.13 above.

that capacity may act on the adult's behalf in making contracts which not only bind the latter's estate but give the adult rights directly), difficult situations may arise for carers who have no duly authorised powers. By virtue of the incapacity an incapable adult cannot appoint the carer as an agent.[34] A carer who contracts for the benefit of the adult – for example, by arranging personal services to be rendered to him or her, or ordering repairs to the adult's property – thus undertakes personal liability under such contracts (safeguarded by also having a claim against the adult's estate for the expenses thereby incurred by reference to the doctrine of *negotiorum gestio*, or benevolent intervention).[35] But if the services or repairs are unsatisfactory in breach of the contract, the carer's damages claim may be insufficient to take full account of the interests of the adult. For example, he or she may suffer distress as a result of negligently administered services, or failure to render the services at all. Or the adult's property may be damaged by a botched repair. In each of these cases, it may be useful if the contract can be treated as one intended to give the adult enforceable rights to the service or repair in question for breach of which damages or any other appropriate remedy is available, albeit that any action will have to be brought by a guardian or representative of the adult's interests.

The requirement of irrevocability

2.16 The central issue of law reform is whether, in order to enable a third-party right to come into existence, it is sufficient that there is a term in a contract which purports to do so or whether a further step is required of the parties. At the heart of this issue is the freedom which contracting parties normally enjoy either to change the contents of the contract by agreement between themselves or to cancel it altogether.

2.17 The courts have tended to hold that, before contracting parties can be found to have deprived themselves of their ordinary freedom to adjust their relations as they wish by making provision for a third party, there must be something more than just a term to that effect. In other words, it must be clear that the contracting parties intended not only to confer a benefit upon a third party but also to give up the freedom to change their minds. In the technical language used by the courts, the contracting parties must have taken additional steps to make the term *irrevocable*; the term alone being insufficient for this purpose.

2.18 The leading case is *Carmichael v Carmichael's Executrix*.[36] Late in July 1916, Ian Neil Carmichael, who had joined the Royal Naval Air Service (precursor of the RAF) the previous October, was killed in an air accident. He was 21 years of age. There was in force a policy of assurance upon Ian's life, worth £1,000. It had been taken out with the English and Scottish Law Life Assurance Association in 1903 by Ian's father, Hugh Fletcher Carmichael, a consulting engineer in Hong Kong.[37] The policy provided that Hugh should pay the annual premiums, due on 22 October, during Ian's minority and that he was entitled to repayment thereof should the assured die before attaining majority. But once Ian attained majority, and if he took over payment of the premiums, then the sum assured was to be paid

[34] L J Macgregor, *The Law of Agency in Scotland* (2013), paras 3.12-3.14.
[35] See further *SME* Vol 15, para 143 for the (probably enrichment, certainly not contractual) claim of the contractor against the estate of the incapax, possibly subject or subrogated to the carer's claim for expenses. The leading example in the relevant case law is *Fernie v Robertson* (1871) 9 M 437.
[36] *Carmichael v Carmichael's Ex* 1920 SC (HL) 195.
[37] Today there would be a question whether, on policy grounds, parents should have an insurable interest in the life of their child: see Insurance Contract Law: Post Contract Duties and other Issues (Joint Consultation Paper LC CP 201; SLC DP No 152, 2011), paras 11.76-11.78 and 13.77-13.86; Insurable Interest: updated proposals (Issues Paper No 10, 2015), paras 3.29-3.40 and Proposal 13.

on his death to his executors. Hugh paid all the premiums due up to Ian's twenty-first birthday on 29 October 1915, and retained custody of the relevant documentation throughout this period and up to his death. Immediately after his birthday in 1915, Ian inquired of the insurance company whether his entry upon active service would affect the policy; having been told that it would not, and having declared his willingness to take over payment of the premiums, he executed a holograph will on 11 November 1915 in which he bequeathed his whole estate to his aunt, Miss Catherine M'Coll, and appointed her as his executrix. Ian never paid a premium before his death, since the next one would have fallen due on 22 October 1916. On 7 October 1916, confronted with the competing claims of Hugh Carmichael and Catherine M'Coll to the £1,000 payable under the policy, the insurance company raised an action of multiplepoinding in the Court of Session. The action proceeded to the House of Lords which, reversing a Court of Seven Judges split 5:2 in favour of the father, eventually held in favour of Ian's executrix, i.e. determining that there was in existence an enforceable third-party right under an irrevocable contract.

2.19 Lord Dunedin explained that the irrevocability of the contract can be achieved in various ways: (1) delivery of the contract to the third party; (2) registration of the contract, for example in the Books of Council and Session; (3) intimation of the contract to the third party; (4) the third party's reliance upon the contract term in its favour; and (5) the third party's knowledge of the term in its favour. Lord Dunedin did not think this list exhaustive: "in the end it is a question of evidence, and the only real rule to be deduced is that the mere expression of the obligation as giving a *jus tertio* is not sufficient."[38]

2.20 We now discuss these various heads. By delivery Lord Dunedin was referring to the general rule that where voluntary obligations are reduced to writing, whether formal or otherwise, the writing must be delivered to the creditor in the obligation for the creditor's right to come into existence.[39] Delivery means some act by means of which the debtor in the obligation puts the document beyond its control. In essence, it is a means of completing the intention to be bound by the document. There are a number of exceptions to the general requirement of delivery, of which the major example is the subscribed mutual contract, where the parties' subscriptions sufficiently indicate the intention to be bound by the document, whoever has possession of it.[40] This tends to mean that the delivery requirement applies most often where the obligation in the writing is essentially unilateral, as with a bond or a promise, and the JQT can be seen as congruent with that situation.[41]

2.21 Although delivery may typically be by the debtor physically handing over the document to the creditor, there are a number of recognised equivalents, notably registration of the document in court books.[42] Lord Dunedin saw registration for publication in the Books of Council and Session, where the original deed is retained in the registers, as akin to delivery, as "a dealing with the document in such a way as to put it out of the power of the original contractors to deal with it. … There the deed, once registered, is left, and cannot be recalled."[43] Delivery of paper documents by fax transmission or email attachment or some

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[38] *Carmichael v Carmichael's Ex* 1920 SC (HL) 195, 203.
[39] McBryde, *Contract,* paras 4.32-4.43 and 10.20.
[40] Ibid, para 4.69.
[41] Ibid, para 4.02. Under the Legal Writings (Counterparts and Delivery) (Scotland) Act 2015, where a mutual contract is executed in counterpart, delivery of the counterparts is required between the counterparties.
[42] McBryde, *Contract,* paras 4.12-4.30.
[43] *Carmichael v Carmichael's Ex* 1920 SC (HL) 195, 201. See further McBryde, *Contract*, paras 4.22-4.23, highlighting the utility of registration as delivery where a grantee is unable to take delivery personally.

other electronic means became legally effective when the Legal Writings (Counterparts and Delivery) (Scotland) Act 2015 came into force on 1 July 2015. It should also be noted that electronic documents may be delivered electronically.[44]

2.22 Intimation is the familiar means of completing an assignation, normally required for a personal right to be transferred to a different creditor.[45] It is notice by either the assignee or the cedent or both to the debtor in the obligation that performance is now to be made to the assignee. Lord Dunedin clearly has in mind an analogy between this and third-party rights as two modes of creating rights against a contracting party for someone not a party to its formation. Forms of intimation are provided for by statute, and the law also recognises "equivalents to intimation" where the notice to the debtor is as strong as those forms of intimation recognised at common law and by statute.[46]

2.23 Lord Dunedin said little about the third party's reliance as a basis for irrevocability, merely recognising it thus: "There is also the class of cases where the *tertius* comes under onerous engagements on the faith of his having a *jus quaesitum*, though the actual contract has not been intimated to him."[47] The basis for the finding that a third-party right existed in *Carmichael's* case was, however, not delivery or intimation to the third party, or registration of the contract, or the third party's reliance in entering other engagements. It was simply the third party's knowledge (however acquired) of the provision in his favour, shown by his inquiry to the insurance company as to whether his entry into active service would affect his rights under the policy.

2.24 Finally, with regard to the relevance of the contract terms, Lord Dunedin said:

> "Now, in examining the evidence, while, as I have already said more than once, the terms of the document are not conclusive, that does not mean that they are not to be considered. On the contrary, they form a very important piece of evidence."[48]

2.25 This view of the law, and Lord Dunedin's speech in general, has long been the subject of academic criticism.[49] Some thought this gained support from Lord Reid when he commented in a 1971 case before the House of Lords: "I do not think that Lord Dunedin meant to say that this intention to make the provision in favour of the third party irrevocable can never be established by the terms of the contract itself. Generally it cannot, and then other evidence of intention is required."[50] The suggestion that Lord Reid's use of the word

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[44] Section 9F of RoWSA, as inserted by the Land Registration etc. (Scotland) Act 2012. Its s 9A defines electronic documents as documents "which, rather than being written on paper, parchment or some similar tangible surface are created in electronic form".

[45] Our forthcoming Report on Moveable Transactions is likely to recommend significant changes to the law on assignation and intimation.

[46] On intimation in assignation and its equivalents see the Transmission of Moveable Property (Scotland) Act 1862; Gloag & Henderson, paras 32.05-32.07; McBryde, *Contract*, paras 12.93-12.96; Anderson, *Assignation*, paras 6.21-6.29 and 6.34-6.35. We are likely to recommend repeal and replacement of the 1862 Act in our forthcoming Report on Moveable Transactions.

[47] *Carmichael v Carmichael's Ex* 1920 SC (HL) 195, 203.

[48] Ibid.

[49] For references see MacQueen, "Third Party Rights in Contract: *Jus Quaesitum Tertio*", pp 245-250. The late Lord Rodger of Earlsferry went so far as to say extra-judicially that Lord Dunedin had "taken leave of his senses" in his speech in *Carmichael*: see "Law for all times: the work and contribution of David Daube" [2004] 2 Roman Legal Tradition 3, 16. More charitable views of the speech are taken in McBryde, *Contract*, para 4.43 ("the substance of Lord Dunedin's approach may be more accurate than his critics have allowed") and MacQueen, "Third Party Rights in Contract: Jus Quaesitum Tertio", p 244 ("a remarkable endeavour to reconcile two seemingly irreconcilable branches of the law").

[50] *Allan's Trs v Lord Advocate* 1971 SC (HL) 45, 54.

'generally' here left open the possibility that exceptionally the terms of the contract might be enough to constitute a third-party right without delivery or an equivalent has been doubted;[51] but it seems to be at least implied in his preceding sentence, whether or not it is a correct interpretation of the meaning that Lord Dunedin had intended to convey in *Carmichael*.

2.26 Lord Dunedin's formulation of the JQT has also created considerable difficulties for practitioners who wish to draft contracts containing enforceable third-party rights. An example can be seen in the provision of the Network Rail Track and Station Access Agreements in Scotland quoted above, where the drafter had to use and translate the Latin phrase *jus quaesitum tertio* and provide for an undertaking of the contracting parties to notify the third parties.[52]

Revocation of a third-party right: conditionality

2.27 The case law also shows that third-party rights may be made dependent in various ways upon the occurrence or non-occurrence of external events.[53] First, an obligation may be *future* in nature: that is to say, it becomes enforceable on a fixed date (*dies*) or upon the occurrence of some event which is certain to happen but the date of which is uncertain (for example, the death of some person). Here the obligation exists but cannot be enforced until the date in question arrives (*dies statim cedit, sed non venit*). A life assurance policy may provide an example: it is payable either on a certain date in the future or on the death of the assured.[54]

2.28 A third-party right may alternatively be *contingent* or *conditional*, meaning that its existence or enforceability is dependent upon the occurrence of some event the occurrence of which is uncertain (the contingency or condition). Contingencies or conditions may be categorised as either *suspensive* or *resolutive*. The effect of a suspensive condition may be either to prevent the obligation coming into existence at all (as for example with a provision in an oral agreement that there will be no contract between the parties until the agreement is reduced to formal writing)[55] or, more commonly, to prevent an obligation which has come into existence being enforceable until the condition is fulfilled (as for example a sale of land being subject to the purchaser obtaining satisfactory planning permission for development of the site).[56]

2.29 Where the effect of the condition is to suspend the obligation coming into existence at all, the parties are free to resile or withdraw from the arrangement during the period of

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[51] McBryde, *Contract*, para 4.36, note 82.
[52] See para 2.8 above. Contrast the provision still in use in clause 18.7 of the contract for England and Wales (http://orr.gov.uk/__data/assets/pdf_file/0018/2934/model-passenger-contract.pdf), set out in para 3.3 below.
[53] See generally Stair, *Institutions* I, 3, 7-8; Bankton, *Institute*, I, IV, 16 and 22; Erskine, *Principles*, III, I, 3; Erskine, *Institute*, III, I, 6; Bell, *Commentaries,* I, 332; Bell, *Principles*, I, I, 46-50; Gloag, *Contract*, pp 271-272; J M Thomson, "Suspensive and Resolutive Conditions in the Scots Law of Contract" in A J Gamble (ed), *Obligations in Context: Essays in Honour of Professor D M Walker* (1990), pp 126-140; McBryde, *Contract*, paras 5.35-5.40; Wilson, *Scottish Law of Debt*, para 1.10. An obligation which is neither future nor conditional is "pure" and presently due and can be exacted immediately. We have also been much helped by advance sight of two draft discussions of this subject by Professor Martin Hogg; one forthcoming in *SME Reissue Obligations*, the other in chapter 2 of a book entitled *Obligations: Law and Language* to be published by Cambridge University Press in 2016.
[54] As in *Carmichael v Carmichael's Ex* 1920 SC (HL) 195, just discussed.
[55] As in *WS Karoulias SA v The Drambuie Liqueur Co Ltd* 2005 SLT 813.
[56] As in *Ellis Properties Ltd v Pringle* 1974 SC 200. This condition may also be seen in at least some circumstances as resolutive, which is discussed in para 2.31 below.

suspension.[57] We have already discussed the case of the third-party right drawn in favour of a party who does not yet exist as an example of this kind of condition.[58] Another example is the third-party right which will arise if and when a specific third party is subsequently identified or nominated under a contract procedure or provision for that purpose.[59] In *Love v Amalgamated Society of Lithographic Printers of Great Britain and Ireland*,[60] for example, the society operated a scheme which provided certain benefits for the dependants of members who fell sick. The third-party right of a dependant under the scheme came into existence when a relevant member of the society became ill. But individual dependants had no rights at all until the specified event, i.e. the illness of a relevant member, took place.

2.30 Where it is merely enforceability that is suspended, the obligation exists and the party subject to it cannot withdraw. So for example if Aileen and Blair agree in their divorce settlement that Blair will pay their child, Catriona, an allowance should she enter higher education, Catriona cannot enforce any right prior to going to university, but there is meantime clearly an inchoate obligation upon Blair to pay. The significance of the existence of the obligation is that Blair may not act in such a way as to frustrate the fulfilment of the condition by Catriona.[61] It may be implied that the obligation is discharged if the suspensive condition is not fulfilled within a reasonable time:[62] perhaps if Catriona has not gone to university by the time she turns twenty-five.

2.31 The effect of a resolutive condition, on the other hand, is that an obligation comes into existence but may be brought to an end upon the fulfilment of the condition. Here, clearly, a party may perform lawful acts in order to bring about the fulfilment of the resolutive condition. In *Love*, the society's scheme providing benefits for the dependants of sick members also provided that the rules of the scheme could be changed by the members. In other words, the scheme which was constituted by the contract amongst all the members of the society was subject to a resolutive condition and was accordingly revocable by the contracting parties, i.e. the members. But when a particular relative claimed a benefit under the scheme, the court found a JQT in her favour since the rules had not in fact been changed or revoked at the time the claim was made.[63] The possibility of a right could, however, have been eliminated altogether during the suspensive period provided that the resolutive condition – a proper procedure under the society's rules to change the rule on dependant benefits – was followed. That would not have been a case of the contracting parties frustrating the fulfilment of the suspensive condition but rather their exercising a contractual entitlement in good faith.[64] Indeed, the provision on rule changes could be taken

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[57] J M Thomson, "Suspensive and Resolutive Conditions in the Scots Law of Contract" in A J Gamble (ed), *Obligations in Context: Essays in Honour of Professor D M Walker* (1990), pp 126-129; cf McBryde, *Contract*, paras 5.35-5.40 who suggests a threefold distinction of suspensive conditions: those which prevent any contract at all until fulfilment, with the parties free to resile meantime; those under which a contract comes into existence but while none of it is enforceable the parties cannot resile; and those under which the contract comes into existence but only some part or parts of it are suspended.

[58] See above, para 2.5.

[59] See above, para 2.6.

[60] 1912 SC 1078.

[61] See for another example *Park's of Hamilton (Holdings) Ltd v Holmes Mackillop LLP* [2015] CSOH 6 per Lord Doherty at para 20, citing Gloag, *Contract*, pp 276-277.

[62] See *T Boland & Co Ltd v Dundas's Trs* 1975 SLT (Notes) 80.

[63] Gloag, *Contract*, p 242 notes, in contrast to *Love*, the rule in the co-feuar cases already referred to (see para 2.12 above), namely that the reservation by the feudal superior of a right to dispense with the building restrictions imposed in the feu-contracts he or she has granted (i.e. to alter or revoke the contract) prevents there being any right in the co-feuars to enforce the restrictions in their own right as third parties.

[64] See para 2.9 of the DP.

as some sort of commitment only to change the rules for dependant claims in the way laid down.

2.32 Further, it is suggested, the crystallisation of one relative's right, such as happened in *Love*, would not prevent the members thereafter changing the rules of the scheme so that lesser (or, indeed, greater) payments fell to be made under it to future claimants, or even cancelling it altogether. Likewise, if Mr Love recovered but then fell ill again after the members had changed the rules of the scheme, Mrs Love would not be entitled to make a new claim on the old terms. Possible future creditors have no right at the point where the members of the association agree to the change. A similar outcome could apply in company groups, where one or more companies come into existence within the group and enjoy their third-party rights, but it is then decided within the group to change the arrangements: companies coming into existence in the group thereafter would not be able to claim under the prior agreement setting up the possibility of third-party rights.

2.33 Another, significantly different, instance of the combination of suspensive and resolutive conditions in third-party rights is found in the case of *Kelly v Cornhill Insurance Company Ltd*.[65] A motor insurance policy insured any person driving the motor car on the order of or with the permission of the owner. A condition suspensive of any third-party right to the benefit of the insurance policy was thus the owner's permission to drive the insured vehicle; there was no right at all in any third party prior to permission being granted. When the owner gave his son unlimited permission to drive the car, the son's third-party right came into existence. Given, however, the father's ownership of the car, he was still clearly entitled to withdraw that permission; that is, the insurer's liability was subject to a resolutive condition, namely the owner's permission continuing at the time of any casualty covered by the policy. The question in the case was whether the permission was terminated by the owner's death, the son having continued to drive the car after that event and then having had an accident. The House of Lords held by a narrow majority that the son could still enforce the policy against the insurers. Although his right could have been revoked by his father, it had not been; on construction, the policy (and the father's permission to drive the car) continued in force despite the father's death, and for as long as the car continued to be an asset in the father's estate.[66]

2.34 *Love* and *Kelly* show that it is possible for parties to draw up a contract providing for a third-party right subject to a resolutive condition under which upon the occurrence of an event the right, or the possibility of a right, ceases to exist. Another example may be provided by employment contracts with death-in-service benefits for a deceased employee's nominated dependant, as in the English case of *Braganza v BP Shipping Ltd*.[67] There the benefit seems to have been payable without the interposition of a trust in favour of the beneficiary;[68] but the employer was apparently entitled to withhold the benefit if the deceased had committed suicide. The Supreme Court held in favour of the nominated dependant by a 3-2 majority, on the basis that the employer's decision on whether the employee had killed himself had to be reasonable in the public law sense that all relevant factors, and no irrelevant ones, must be taken into account.

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[65] 1964 SC (HL) 46.
[66] The minority view was that death terminated the right. See further McBryde, *Contract*, ch 26, pt 1.
[67] *Braganza v BP Shipping Ltd* [2015] UKSC 17, [2015] 1 WLR 1661.
[68] Unlike the scheme in *Fox v British Airways plc* [2013] EWCA Civ 972, [2013] ICR 1257, discussed in para 2.76, note 152 of the DP.

Reconciling *Carmichael* with *Love* and *Kelly*

2.35 How *Love* and *Kelly* may be reconciled with Lord Dunedin's decision in *Carmichael* that to exist at all a third-party right must have been made irrevocable has never been very clear. *Love* was not disapproved in *Carmichael*, and there is no reference to *Carmichael* in *Kelly*. Professor McBryde argues that *Carmichael* was concerned with the creation of a right embodied in a document, whereas *Love* is about whether a right undoubtedly created can be revoked, which depends upon the terms upon which the right has been granted. *Kelly* is another case of this kind. But Professor McBryde's suggested distinction has yet to receive judicial endorsement.

2.36 Viewing the matter from the perspective of principle, we think that Lord Dunedin's approach can be criticised for confusing the steps necessary for creating or completing a right in Scots law (delivery of obligatory documents, intimation of assignations, registration) with the question of how to make a right irrevocable. As Professor McBryde explains:

> "[A] right once created may be revoked. There are many instances of revocable rights in Scots law, eg rights under some contracts of mandate or deposit, the contract created between a company and its members by … s.33 of the Companies Act 2006, or the revocable promise to keep an offer open.[69] In Stair's time donations between man and wife, *stante matrimonio*, were revocable by the giver during life.
>
> Nor should we be surprised if a legal system recognises revocable rights. Many contractual rights are only exercisable if certain conditions are satisfied, and there is no reason why one of these conditions could not be the absence of prior revocation. Similarly, a law which recognises resolutive conditions or irritancies, surely recognises the concept of a right which may vest, but which can in certain circumstances be revoked."[70]

2.37 Other examples of revocable rights can be given. A donation *mortis causa*, under which the donee's right to the gift does not survive his or her predeceasing the donor (the resolutive condition), is one such.[71] The rights of a child *in utero* under the *nasciturus* principle will not survive a still-birth or death in the womb.[72] Parties commonly agree terms under which their contracts may be brought to an end or be altered by one of them acting unilaterally. In *Kinch Ltd v Adams*, for example, missives for the sale of property were concluded on the basis that the buyer could give notice of withdrawal by a certain date and time subject to liability for the pursuer's reasonable legal fees. The question in the case was not whether this was competent (the sheriff gave several examples of other terms of the kind

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[69] The observation here about the promise to keep an offer open is slightly puzzling. Such a promise is usually seen as making the offer irrevocable (McBryde, *Contract*, para 6.57). The offer lapses upon expiry of the period for which it was stated to be open rather than being revoked, i.e. it is obligatory only until a given day and time. McBryde also notes, however, that "an offer made on condition that it is accepted within three days may be withdrawn prior to the expiry of the three days" (ibid), citing *Heys v Kimball & Morton* (1890) 17 R 381 and *Effold Properties v Sprot* 1979 SLT (Notes) 84. The quoted phrase may be referring to this. But the offer in such a case is not any sort of promise at all, at least according to the cited decisions.

[70] McBryde, *Contract*, paras 10.27-10.28.

[71] *SME Reissue Donation*, para 40. Section 25 of the Succession (Scotland) Act 2016 (which, at the time of writing, was not yet in force) provides that: "The customary mode of making a conditional gift in contemplation of death known as making a donation mortis causa is abolished." But it also provides that this "… does not prevent the making of a conditional gift other than in that customary mode".

[72] *SME Reissue Child and Family Law*, paras 4-6.

commonly encountered in practice), but whether or not the notice given amounted to withdrawal (it was held not).[73]

2.38 Professor McBryde argues, in our view correctly, that the law on JQT "is in confusion because of the failure to recognise that revocation can arise on two occasions and each poses a different theoretical problem … Are we concerned with whether a right has been created (*inter alia* has there been delivery?) or the terms of a right which has been created (a problem of construction with the possible answer that the right may be terminated)?"[74] We would prefer to put it in another way, however. It is not that there are two occasions for considering revocation, but rather that the first question is whether or not a right has been constituted (which is when delivery, intimation and registration may fall to be considered), and that revocation is the second question: can a right, once constituted, be cancelled or modified without the consent of the right-holder?

2.39 A further question must also be whether one of delivery or intimation or registration is always required even for the constitution of a JQT. None of these is apparent in *Love* or *Kelly*, or indeed in a number of other decisions recognising the existence of JQT.[75] While in *Love* and *Kelly* the third party clearly knew of the existence of the contractual provision in its favour (otherwise the claim could not have been brought), what seems to have mattered in each case was that the contractual conditions on which the claims were based had been fulfilled. It is not clear from the reports when the third parties learned of their possible claims. In *Carmichael* itself the third party's knowledge, whenever and however obtained, was held enough to make the right irrevocable (that is, on the approach we prefer, constituted), the other conditions (of his reaching the age of 21, and being ready to take over payment of the premiums on the insurance policy when they fell due) also being fulfilled.

2.40 In the end, it is suggested, the central question is the intention of the contracting parties to confer a right upon, or to become bound to, a third party. Delivery, intimation or registration of a third-party right are strong methods of showing that intention; but not the only ones. In general contract law, communication between the parties is another important way of constituting their mutual obligations. Any form of communication – written, oral or by conduct – will do for this purpose. But for JQT there may also be at least a useful analogy with the unilateral promise, which does not necessarily even have to be communicated to the promisee to be binding. What matters in many cases is instead the fulfilment of a condition in the promise, such as the provision of information to the promisor or the location of property belonging to the promisor. For example, the promise of reward to any person who finds a lost cat may be enforced by a party unaware of the promise at the time of locating and returning the cat to its owner.[76] The concept of a conditional undertaking is, as we have seen, also highly relevant to third-party rights, especially where the third party emerges, for example from previous non-existence, or as a person becoming a member of a class of persons designated as the third parties to be benefited.

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[73] *Kinch Ltd v Adams* 2015 GWD 5-105, especially at paras 19 onwards.
[74] McBryde, *Contract*, paras 10.27-10.28.
[75] See e.g. *Melrose v Davidson and Robertson* 1993 SC 288; *Beta Computers (Europe) Ltd v Adobe Systems Ltd* 1996 SLT 604 (although note that in other respects this case is not a satisfactory example of third-party rights in contract); *Mercedes Benz Finance Ltd v Clydesdale Bank plc* 1997 SLT 905.
[76] See *Regus (Maxim) Ltd v Bank of Scotland plc* [2013] CSIH 12, 2013 SC 331, paras 33-34 (Lord President Gill).

2.41 An example of the practical importance of this point can be given from the contracts in use in the North Sea oil industry where, as already noted, contracting parties have 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.[77] It would seem quite impracticable to require formal notifications to all these parties of their third-party rights, but sufficient (especially perhaps against the background of general industry understandings of how risks are distributed in the sector and the use of standard forms of contract) for a right to be claimed that the third party in question meets the description of those intended to have a right at the time it is claimed and that any other conditions for the existence and enforcement of the right have been fulfilled.

2.42 Of course, as Lord President Hamilton remarked in the context of a case where a promise was alleged to have been made, "the presence or absence of communication to the other party may be an adminicle of evidence in the question whether the statement amounts to a promise in law".[78] Likewise in JQT, communication to the third party could be significant as to whether or not the contracting parties intended to give that party an enforceable right. But the absence of such communication may not be quite as fatal as it tends to be with alleged unilateral promises, if it is established that the contracting parties succeeded in establishing a binding contract between themselves which also included a provision evidencing their intention to confer a right on a third party. There seems less reason then to suppose that the term cannot in law be enforced by the third party once it comes to that person's notice.

2.43 A final point in this vein, however, is that if the contracting parties reserve to themselves the power to change or remove altogether the third party's right in a more absolute way than is apparent in *Love*, or indeed in *Kelly* or *Carmichael*, there may well be a question as to whether they ever intended to give the third party a right at all. In his discussion of promises, Professor Hogg gives the example of a promise to pay next Monday if the promisor has not changed her mind by then, where the condition effectively undermines the notion of any commitment. But a promise to pay by a certain date in the more distant future, subject to the promisor retaining a power to revoke should the changing nature of his relationship with the promisee so warrant, "is not so sweeping as to be suggestive of a lack of an original intention to be bound at all". Professor Hogg states that the second example "might be argued to be a permissible condition.[79]

2.44 We think, however, that the *Love* and *Kelly* cases clearly fall well within the second category of conditional promise identified by Professor Hogg. It is also arguable, we would suggest, that his first example is actually a wholly suspended promise, i.e. one where the right does not exist until the Monday when the promisor has not in fact changed his mind. But the matter strikes us as above all a question of construing what is said in the contract in order to determine whether or not a third-party right is intended, and to what conditions, suspensive or resolutive, the existence and enforceability of that right has been subjected by the contracting parties.

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[77] See paras 1.23-1.24 above.
[78] *Cawdor v Cawdor* [2007] CSIH 3, 2007 SC 285, para 15.
[79] M Hogg, *Promises*, pp 33-34. *Kinch Ltd v Adams* 2015 GWD 5-105 (see para 2.37 above) provides another possible example.

Third party's rejection or refusal of the right or benefit

2.45 A person cannot be forced to take up a right. In principle, therefore, the third party may reject the right or refuse any attempt of the debtor to perform.[80] There is, however, no example of such rejection or refusal in the case law, and it is not clear what might constitute it beyond direct communication to the contracting parties, or what the effect of such rejection or refusal might be. In the Discussion Paper we noted Stair's view, in relation to unilateral promise, that "as the will of the promisor constitutes a right in the other, so the other's will, by renouncing, and rejecting that right, voids it and makes it return",[81] and that this would also seem likely to be the effect of a rejection of a third-party right.[82]

Effect of invalidity, unenforceability or frustration of the contract on the third party

2.46 Although there is little authority directly in point, it also seems correct in principle to suppose that, if there is a defect in the contract's formation rendering it void or voidable, the third party's right may be equally void or voidable.[83] The lack of authority makes it difficult to determine the scope of the principle. Scots law recognises a concept of partial invalidity, with some but not all the terms of a contract being affected by the invalidity.[84] It is thus conceivable that invalidity affecting the contracting parties would not necessarily have the same impact upon the third party's right. Third-party rights are not the same as the rights of an assignee in this regard. Where under the principle *assignatus utitur iure auctoris* the assignee steps into the shoes of one of the contracting parties in whole or in part, and is thus subject to all the invalidities pleadable against its cedent, the third-party right stands on its own footings.

2.47 There is virtually no authority on the effect on a third-party right when the contract in which it is contained is frustrated by supervening events or illegality. The institutional writer Bankton provides the sole (if in some respects out-dated) guidance that we have from authority on the question of the effect of frustration: "[I]f the contract becomes void, by supervening accident, betwixt the parties contracters, the third parties interest, that depended upon it, ceases".[85] The passage is out-dated at least in the sense that frustration is no longer held to make a contract void. It is the obligations of future performance that are frustrated by supervening events, not the contract itself; so the question should be—what is the impact of those events upon the performance of the third-party right?—not about the remainder of the contract.[86] Again, if only part of a contract is illegal but the part containing the third party's right is not in itself, is the latter enforceable?[87] The existing doctrine of severability,[88] in which illegality may be held to affect only part of a contract, leaving the remainder fully enforceable, suggests that the answer to this question should be Yes. The case of *Love*, in which the Amalgamated Society of Lithographic Printers of Great Britain and

[80] McBryde, *Contract*, para 10.09; *SME* Vol 15, para 839; Sutherland, "Third-Party Contracts", pp 225-228.
[81] Stair, *Institutions*, I, 10, 4.
[82] See para 2.79 of the DP.
[83] McBryde, *Contract*, para 10.09; *SME* Vol 15, para 839; Sutherland, "Third-Party Contracts", pp 225-228. See also paras 2.82-2.83 of the DP.
[84] *SME* Vol 13, para 63; McBryde, *Contract*, para 13.12, citing PECL art 4:116 (see now DCFR II.-7:213 and Proposed CESL art 54(2); see also PICC art 3.16).
[85] Bankton, *Institute*, I, 11, 7.
[86] McBryde, *Contract*, para 21.04 (also pointing out that some terms of a contract may survive frustration).
[87] See para 2.82 of the DP.
[88] See McBryde, *Contract*, paras 13.35-13.39, 19.37, and 19.106-19.107.

Ireland was an illegal combination, but the third-party right was held to be nonetheless enforceable, is a useful illustration of the point.[89]

2.48 Parties may decide to try to meet this uncertainty with appropriate contractual provision. For example, the Scottish Building Contracts Committee style contains, in respect of third-party rights for purchasers and tenants, the following:

> "The Contractor shall be entitled in any action or proceedings by the Purchaser or Tenant to rely on any term in this Contract and to raise the equivalent rights in defence of liability as he would have against the Employer under this Contract."[90]

Third party remedies

2.49 A third party may raise an action for payment or performance of the benefit due by the debtor under the contract. But some doubt exists about whether or not the third party can claim damages for the debtor's breach, whether through non-performance, partial or defective performance, or delay.[91] The view that a damages claim is competent, however, is the direction which the law is apparently taking.[92] As in the previous paragraph, the SBCC contracts provide an example of this, with an apparent assumption that a third party can recover damages from the contractor.[93] The most significant judicial discussion is by Lord Clyde in the Outer House, when he reviewed the cases and writings upon the subject and concluded that there was: "no reason why a third party should not be entitled to sue for damages for negligent performance of a contract under the principle of *jus quaesitum tertio*, but whether he is so entitled must be a matter of the intention of the contracting parties".[94] Lord Clyde thus laid more stress upon the intention of the parties than upon any general right to claim damages for breach of a voluntary obligation, and left open the question of liability not based on negligence – for example, in respect of the quality of goods or services supplied to the third party. The overall position on damages accordingly remains in a state of some uncertainty.

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[89] *Love v Amalgamated Society of Lithographic Printers of Great Britain and Ireland* 1912 SC 1078.
[90] At para 1.4 of Schedule Part 5 (Part 1) (2011). There is an equivalent clause for third-party rights for funders, at para 1.2 of Schedule Part 5 (Part 2).
[91] Gloag, *Contract*, pp 239-241.
[92] *SME* Vol 15, para 837; McBryde, *Contract*, paras 10.23-10.24; Sutherland, "Third-Party Contracts", pp 221-225.
[93] Albeit with some limitations: see para 1.3 of Schedule Part 5 (Part 1: purchasers and tenants) and para 1.1 of Schedule Part 5 (Part 2: funders).
[94] *Scott Lithgow Ltd v GEC Electrical Projects Ltd* 1989 SC 412, 438-439.

Chapter 3 Terminology

3.1 In Chapter 4 of our Discussion Paper we asked for views on a number of issues which might be thought of as laying the ground for the more substantive issues which follow. In summary, they are:

- How should the various parties in contracts in favour of third parties be described?
- Is it preferable to refer, in legislation on such contracts, to the third party's *rights* or *benefits*?
- Is formal writing required for the valid creation of a third-party right?
- Would it be useful for legislation to state that the right (or benefit) in favour of a third party is analogous to the position under another legal institution?
- Should there be statutory provision that the right (or benefit) in favour of a third party may be made future and/or conditional?

We set out our recommendations below, taking account of the responses we received on consultation.

3.2 In discussion following the formal consultation period, we were struck by a further, practical reason for terminological as well as substantive reform. Clear, readily comprehensible terms are likely to benefit, not only those reading and using the proposed new statute, but also the many people who draft and interpret contracts. The same terms can be used in contracts with confidence that they are not only readily comprehensible in themselves but also that they form part of a clear, statutory framework. Thus the drafting can be at the same time more precise and more concise: there is no need to use, and explain, terms and legal concepts which are not generally familiar, such as '*jus quaesitum tertio*', 'stipulator' and '*tertius*', nor is there any need for elaboration where there are more than two contracting parties or where more than one of the contracting parties is under a duty to perform to the third party.

3.3 This came out particularly in discussion with Louise Harrison, at the time Legal Counsel to Network Rail Infrastructure Limited, who drew our attention to redacted copies of two Track Access Contracts between Network Rail and track users, one under the law of England and Wales and one under Scots law.[1] A comparison between the third-party rights provided for the Office of Rail and Road (ORR) under these contracts is instructive. The one subject to the law of England and Wales read (and still reads):

[1] These and other contract forms are available on the website of the Office of Rail and Road (ORR) at http://orr.gov.uk/what-and-how-we-regulate/track-access/track-access-process/forms-model-contracts-and-general-approvals.

"ORR shall have the right under the Contracts (Rights of Third Parties) Act 1999 to enforce directly such rights as have been granted to it under this contract."[2]

The equivalent clause under the Scots law contract was, as we have already seen, much longer, and used the phrase '*jus quaesitum tertio*' which then had to be translated.[3] That phrase also remains in common if often inappropriate use in contracts involving "community of interest" considerations.[4] It will be much clearer if a drafter can simply refer to the Contract (Third Party Rights) (Scotland) Act instead. A further advantage, of course, is that should the wish be to *prevent* any question of third-party rights arising from a contract it is very simple to do it by a reference to the Act as that which is to be excluded.

The parties

3.4 We deal first with the actors in contracts in favour of third parties.[5] The terms generally used in recent discussions of Scots law to describe the parties involved in such contracts are *stipulator*, *debtor* and *tertius*, the debtor being the person due to perform to the third party (*tertius*), and the stipulator being the other contracting party.[6] By contrast, the comparator instruments and the 1999 Act use none of these terms; instead, they all refer to the right-holder as 'the third party', but some speak of 'the parties to the contract' or 'the contracting parties', while others use 'promisor' and 'promisee' for the contracting parties (the promisor being the party due to perform to the third party and the promisee the other contracting party). After noting some disadvantages of the promissory terminology, our proposal was as set out in the table below. This received broad support on consultation:

Currently used term	Recommended reformed term
Debtor	Contracting party
Stipulator	Contracting party
Tertius	Third Party

3.5 We therefore recommend:

3. The principal persons involved in a contract containing a third-party right should be described as the 'contracting parties' and the 'third party'.

(Draft Bill, section 1)

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[2] Clause 18.7.2.

[3] See para 2.8 above. The clauses are not used in the now current Scots law form of the contract: see http://orr.gov.uk/what-and-how-we-regulate/track-access/track-access-process/forms-model-contracts-and-general-approvals, 'Model connection contract for Scotland'. This leaves it unclear what will happen in Scotland should Network Rail become for any reason unable to enforce the track access contracts.

[4] See paras 1.32-1.34 above.

[5] See paras 4.7-4.13 of the DP for more detail. The new French Ordonnance n° 2016-131 (see note 5 to para 1.2 above), arts 1205-9, refers to *le stipulant, peut faire promettre à l'autre, le promettant, d'accomplir une prestation au profit d'un tiers, le bénéficiaire*.

[6] See SLC Consultative Memorandum No 38 Constitution and Proof of Voluntary Obligations: Stipulations in Favour of Third Parties (1977); *SME* Vol 15, para 825; MacQueen and Thomson, *Contract Law*, para 2.71.

Rights or benefits?

3.6 We now turn to the name to be given to what is acquired by the third party as a result of the contracting parties' agreement. The traditional term in Scots law is *jus quaesitum tertio*, commonly abbreviated to 'JQT' and translatable as 'right acquired by a third party'. The right involved is personal rather than real. While the term *jus quaesitum tertio* (if not its correct pronunciation) is well-known amongst Scots lawyers, it will be obscure to most others, and it contributes to the perception of Scots law on this subject as being "somewhat archaic".[7] By contrast, our aim in this project is to produce a modern terminology capable of being readily understood by those without a high level of legal knowledge (or Latin). This is in line with our commitment to producing law which is easily comprehensible.

3.7 But, if the term *jus quaesitum tertio* is to be retired, what should replace it? We pointed out in our DP that, while the *jus* in *jus quaesitum tertio* is most readily translated in this context as 'right', this may not take us very far.[8] We considered two additional aspects of the current JQT rules in Scots law, namely where the third party acquires what is most naturally termed a benefit, or, secondly, an immunity. These each raise particular questions in relation to terminology.

3.8 It is not uncommon for a contract to confer a benefit upon a third party.[9] This can be traced back to early times: the late sixteenth-century case of *Wood v Moncur* concerned an excambion (or exchange) of land, which expressly obliged the new owner not to remove the tenants from it.[10] That obligation was upheld by the court, even after a new tenant had succeeded to the tenancy. While this can be analysed in terms of either a right (to a continued tenancy) or an immunity (from eviction), it would also be accurate to speak of a benefit, namely the benefit for the tenant of being able to assert the continued existence of the tenancy after the excambion (as was indeed done before the court).

3.9 However, not all benefits on a third party fall within the current JQT regime, but only those intentionally conferred by the contracting parties and which they intend to be enforceable against them by the third party.[11] It is possible to confer benefits intentionally without that necessarily entailing direct enforceability.[12] The mere fact that a third party benefits from a contract should not be by itself enough to create a right in the sense in which we are using that term; the contracting parties' intention that the third party have a right to that benefit, discerned in the usual way from the interpretation of the contract, must be present. (We discuss this in greater detail below.[13]) In our view, this is a simpler way to deal

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[7] See para 4.1 of the DP. The terminological difficulties are only compounded when the phrase is put in the plural: *jura quaesita tertio* (e.g. in Bell, *Dictionary and Digest of the Law of Scotland* (7th edn, 1890), p 622) or, for multiple third parties, *jura quaesita tertiis* (e.g. in W G Dickson, *Treatise on the Law of Evidence in Scotland*, vol 1 (3rd edn, 1887), para 980). The fact that the abbreviation 'JQT' is capable of referring to both the singular and plural is not, in our view, a point in its favour.

[8] See para 4.2 of the DP. Although the meaning of *jus quaesitum tertio* as a matter of Scots law no longer depends in any significant way (if it ever did) on the meaning of the individual Latin words, the translation of *jus* as 'right' is not without difficulty: it also lies behind a wide range of English words in the legal field such as *justice*, *jurisprudence*, and *jurisdiction*. A word with so many possible usages is not a handy tool for a lawyer. Note too the use of the phrase '*jus quaesitum*' in trust law.

[9] The commentary to the DCFR favours the use of *benefit*, as discussed in para 4.5 of the DP.

[10] *Wood v Moncur* (1591) Mor 7719. It is the first of a substantial number of cases listed in Morison's Dictionary under the heading "*Jus Quaesitum Tertio*".

[11] See paras 4.2 and 4.4 of the DP; see also Gloag, *Contract*, p 235; McBryde, *Contract*, paras 10.10-10.11; *SME* Vol 15, para 835.

[12] See e.g. *Allan's Trs v Inland Revenue Commissioners* 1971 SC (HL) 45.

[13] See paras 4.16-4.24 below.

with the issue in that it focuses on the parties' intention as may be derived from their contract, rather than on whether or not the third party benefit was incidental.

3.10 Secondly, a third party might acquire an immunity under a contract between other parties. Again, there is long-standing authority for this. In the mid-seventeenth century it was held that a claim of immunity from liability to pay a greater rent than that agreed between the pursuer and other parties was good.[14] *Magistrates of Dunbar v Mackersy* is in a somewhat similar vein.[15] There the defender, as owner of a property for which the Magistrates sought the payment of rates, successfully relied in 1930 on a letter dated 30 January 1777 in which the pursuers' predecessors entered a commitment to the then-owner of the property, to "free you and your successors in the said tenement and garden of all cess, feuduty and other publick taxations payable for the same to the Town from the date hereof for ever". More recently, it was held that a disclaimer contained in a mortgage application form with contractual effect between a building society and prospective borrowers could, on the principle of JQT, be invoked by the property valuer whom it was designed to protect.[16]

3.11 Further, in relation to immunities we noted that a Hohfeldian analysis of rights allows for the characterisation of immunities such as are provided by exclusion or limitation clauses in contracts as rights, alongside the claims which a right-holder makes against another party for payment of money or some other kind of performance.[17] In order to show clearly the wide scope we give to the word "rights" in this exercise, it may be helpful to reproduce the table of Hohfeldian rights which we included in a footnote in our Discussion Paper:[18]

Rights	**Jural correlative**	**Jural opposite**
Claims	Another's duty	No right
Privileges/Liberties	No right of another	Duty
Powers	Liability of another	Disability
Immunities	Disability of another	Liability

3.12 To ascertain views, we asked whether any legislative recommendations on third-party rights should be expressed in terms of rights, or benefits, or both. Most of those who

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[14] *Renton v Ayton* (1634) Mor 7721.
[15] *Magistrates of Dunbar v Mackersy* 1931 SC 180.
[16] *Melrose v Davidson and Robertson* 1993 SC 288 (Lord President Hope). Section 16 of the Unfair Contract Terms Act 1977, regulating non-contractual notices excluding or limiting liability for breaches of a duty of care, could then be applied.
[17] See paras 2.25 and 4.6 of the DP. The former mentions the following cases as ones in which the Scottish courts have referred approvingly to the Hohfeldian analysis of rights: *Anton v South Ayrshire Council* 2013 SLT 141, para 49 (Lady Clark of Calton); *Liquidator of the Ben Line Steamers Ltd, Noter* 2011 SLT 535, para 19 (Lord Drummond Young); *City Inn Ltd v Shepherd Construction Ltd* [2007] CSOH 190, para 146 (Lord Drummond Young), commented upon on appeal to the Second Division: 2011 SC 127, paras 67-75 (Lord Osborne), para 102 (Lord Carloway); *Glasgow City Council v Morrison Developments Ltd* 2003 SLT 263, para 19 (Lord Eassie); *Scottish Environment Protection Agency v Joint Liquidators of The Scottish Coal Co Ltd* [2013] CSIH 108, para 98 (LJC Carloway). It may be coincidental that all the Outer House judges who are mentioned in this footnote were at the time of the opinion cited, or became subsequently, Chairman of the Scottish Law Commission.
[18] Note 48 to para 2.25 of our DP.

responded favoured rights, though Greg Gordon brought to our attention the importance of contractual immunities and the use of term "benefit" in oil industry contracts intended to create third-party rights.[19] We consider, though, that, properly understood from a broadly Hohfeldian perspective, rights will encompass not only positive, active claims to another's performance of some kind but also immunities, indemnities, and other, more negative, benefits.[20]

3.13 We are also reassured in this conclusion by an analysis of rights from the perspective of the third party's patrimony. While more commonly used in other areas of law, such as that of trusts or succession, a person's patrimony can be seen as meaning the totality of his or her economic rights.[21] One way of examining what is contained at any given moment in a person's patrimony is to consider what would be transmitted to their trustee in sequestration on bankruptcy.[22] Generally speaking, both "active claims" and also immunities, indemnities and so on would transmit to the trustee, who would be able to exercise them as universal successor to the third party's whole estate.[23] It therefore makes sense to regard them as forming part of a unitary bundle of assets, for which we recommend the term "rights". We use it as encompassing (and not in contradistinction to) benefits, immunities and indemnities.

3.14 Further, it is notable that in the more recent legislation of other Anglophone jurisdictions the phrase 'third-party rights' is commonly used for the legal concept which, in essence, we are aiming to provide.[24] We consider that using a different phrase in Scots law might cause unnecessary and unhelpful confusion. Accordingly, we recommend:

4. The statutory replacement for *jus quaesitum tertio* should be termed 'third-party right'.

(Draft Bill, section 1)

3.15 It does not follow from this, however, that the legislation need avoid any reference to the concept of benefit to the third party, and our draft Bill does not do so. It speaks of the contract committing "one or more of the contracting parties [to] do, or not do, something for the person's benefit".[25] The wording is intended to emphasise the point that the contracting parties must direct their minds towards the interests of the third party in making the relevant provision in their contract, rather than to provoke analysis of whether that for which they have provided is or is not beneficial to the third party. We say this for a variety of reasons. First, it is quite clear that contracting parties cannot impose duties, or obligations, upon third parties. The existence of a right is, we suggest, by definition a benefit for the right-holder, in

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[19] Mr Gordon cited an agreement used in the oil industry for the allocation of risk under which parties grant and receive indemnities relative to personal injury, property damage and consequential loss: the Industry Mutual Hold Harmless Deed, which can be downloaded at http://www.logic-oil.com/imhh (see especially cl 6).

[20] For further discussion of the Hohfeldian analysis of "rights", see MacCormick, *SME Reissue General Legal Concepts* (2008), paras 73-114.

[21] G L Gretton, "Trust and Patrimony" in H L MacQueen (ed), *Scots Law into the 21st Century: Essays in honour of WA Wilson* (1996), 182 at 189.

[22] Or to the liquidator, for a corporate third party.

[23] A universal successor is a person who succeeds to a deceased person's entire estate, rights and liabilities, to be contrasted with the "singular successor" who acquires heritable property other than by succession on another's death, e.g. as purchaser, donee or creditor.

[24] The example closest to home is the Contracts (Rights of Third Parties) Act 1999 (England & Wales); note too its followers in Singapore, Hong Kong and the Cayman Islands. See also Vogenauer, *PICC Commentary*, pp 662-3.

[25] Draft Bill, s 1(1)(a).

either increasing its entitlements (whether as claims, privileges/liberties, or powers), or limiting or eliminating possible liabilities. Also, as we recommend later, the third party will be entitled to renounce or reject the right conferred upon it;[26] the judgement of whether the right is actually beneficial or not is for the third party to make, not a court.

3.16 We have considered possible examples of contracting parties seeking to confer what is really a detriment for the third party in the guise of a third-party right. For example, contracting parties who have environmentally sensitive waste material to dispose of but who do not wish to incur the expense of proper disposal might agree to provide a right for an unsuspecting third party landowner to have the material on a certain date, and then proceed to dump it on the land in question while insisting that they were merely implementing the landowner's right to delivery. There may be several answers to this scenario: for example, whether the third party "right" is constituted if the landowner knew nothing about it before the material appeared on the land;[27] in any event, whether the existence of a third-party right entitles the contracting parties to implement it without the third party claiming or permitting this;[28] whether the "right" in question really imposes duties on the landowner to have the material disposed of properly; and, of course, as already mentioned, the third party's power to renounce or reject the right.[29] We do not think, therefore, that a court would need to draw upon the word "benefit" in order to deny effect to contracting parties imposing what is really detriment upon a third party.

Juristic characterisation of the third-party right?

3.17 Another question we asked in the Discussion Paper is whether consultees agreed that it would be better to avoid any specific juristic characterisation of the third-party right in any proposed legislation. We had in mind a long-standing academic debate as to whether the *jus quaesitum tertio* is an application of the concept of unilateral promise, or something *sui generis*.[30] Consultees favoured side-stepping such issues in the legislation.

3.18 We also had our attention drawn to a difficulty with the 1999 Act, which speaks of the third party having the right to enforce 'a term of the contract'.[31] This replaced an original Law Commission Bill provision under which the third party's right was to enforce 'the contract'. The latter was clearly too wide: the third party should only be able to enforce whatever right is conferred upon it in the contract. But referring to 'term' may be ambiguous, even if the singular word may be read as extending to the case where the third-party right is embodied in more than one contract term. As Professor Beale points out, "'term' … may refer to a particular obligation (for example, to use materials of satisfactory quality) or it may refer to a particular clause in the document which may impose more than one obligation … some [being] enforceable by the third party but not others."[32] Professor Beale's preference would

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[26] See below, paras 6.2-6.8.
[27] See further below, paras 4.17-4.18.
[28] This might involve consideration of whether there is a unilateral right to perform a contract where the performance in question requires the co-operation of the creditor in the obligation: see e.g. *White & Carter (Councils) Ltd v McGregor* 1962 SC (HL) 1; *AMA New Towns Ltd v Law* [2013] CSIH 61, 2013 SC 608.
[29] Non-contractual issues may also be relevant, e.g. the dumper's activity might be encroachment or possibly trespass: see G L Gretton and A J M Steven, *Property, Trusts and Succession* (2nd edn, 2013), paras 17.10ff, 18.30ff.
[30] Hogg, *Promises*, pp 305-7, provides an overview of the debate, favouring the promissory analysis (see further on the comparative position, ibid, p 313). The French Ordonnance n° 2016-131 (see note 5 to para 3.4 above), arts 1205-9, refers to the party due to perform to the third party as the *promettant*.
[31] 1999 Act, s 1(1).
[32] Beale, "Review", p 226.

have been for the 1999 Act to speak of the third party's entitlement to require performance of the obligation owed to it under the contract rather than even hint that a third party might be able to enforce other obligations to which it was not actually a creditor.

3.19 We therefore asked in the Discussion Paper whether it should be made clear on the face of the proposed statute that the third party can enforce only its own rights in the contract.[33] There was broad agreement with this proposition amongst consultees, with only the Judges dissenting on the basis that a specific provision would be un-necessary. In our view, framing the whole legislation in terms of third-party rights under contracts made by others should avoid any difficulty arising. It will, however, be important for the statute to be as clear as possible on the matter if it is to be used. Commercial parties will want to be sure that it does not allow third parties to exercise influence over terms which have no direct relevance to them. We also think that there is much to be said for pointing up in the legislation the need to refer to the contract's content, express and implied, in order to determine what it is that comprises the third party's right.

3.20 The solution reached in our draft Bill is to speak of the 'undertaking' contained in the contract that one or more of the contracting parties will do, or not do, something for the third party's benefit. That undertaking may be found in one or more terms of the contract, express or implied. The possibility that it may be found as part only of a single term also providing for other obligations of the contracting parties is not, however, precluded. The substance of the undertaking must also be determined from the context of the whole contract in which it is made, including the possibility that it runs alongside and is even related to the rights and duties of the contracting parties between themselves under the contract.[34] The word 'undertaking', however, avoids direct characterisation of the third-party right as a promise (although in context it may have many promissory characteristics, notably the absence of any requirement of acceptance by the third party for the right's constitution).

3.21 We therefore recommend:

5. The provisions in a contract which are intended to comprise the third party's rights thereunder should be referred to as the 'undertaking'.

(Draft Bill, section 1(1)(a))

Enforcement or invocation of the third-party right

3.22 We have so far used the language of 'enforcement' by the third party. But this is not entirely apt where the right takes the form of an immunity of some kind for the third party, or the exercise of a power or privilege by the third party. The 1999 Act meets this difficulty by saying that "[w]here a term of a contract excludes or limits liability … references in this Act to the third party enforcing the term shall be construed as references to his availing himself of the exclusion or limitation."[35] It is unattractive, however, to make words mean things other than what they usually mean, as well as using slightly antiquated words like "avail" in

[33] At paras 7.32-7.33 and question 47 of the DP.
[34] An illustrative example of the approach we think appropriate can be found in the English commercial case of *Laemthong International Lines Co Ltd v ARTIS and Fahem (No 2)* [2004] EWHC 2738 (Comm), aff'd [2005] EWCA Civ 519, [2005] 1 CLC 739. See also *Bizspace (NE) Ltd v Baird Corporatewear Ltd* [2007] 1 EGLR 55.
[35] 1999 Act, s 1(6).

legislation in the process. Moreover, we think that the issue is not limited to terms excluding or limiting liability.

3.23 The approach in our draft Bill is thus to speak of the third-party right as being one of enforcing or otherwise invoking the undertaking, as appropriate to the substance of that undertaking. At one time, we thought that the formula might be "enforcing or otherwise relying on" the undertaking; but we do not think that a person exercising a privilege/liberty or power can at that moment be said to be relying on it. Reliance on the privilege/liberty or power happens when the person who has exercised it then has to justify having done so in the face of challenge from someone else. In any event the draft Bill also has, quite separately, provisions about the third party's detrimental reliance on its right in certain circumstances preventing the contracting parties from cancelling or modifying the undertaking;[36] so the phraseology of the third party "invoking" its right avoids any possible confusion arising from terminological overlap.

3.24 We therefore recommend:

6. The third party should be entitled to enforce or otherwise invoke the right comprised in the undertaking.

(Draft Bill, section 1(2))

[36] See further paras 5.39-5.51 below; draft Bill, s 5.

Chapter 4 Formation: identification and intention

4.1 In this Chapter we begin by discussing two major issues concerning the formation of third-party rights:

- the identification of the third party; and
- the intention of the contracting parties to confer the third-party right.

In the next Chapter we consider a further issue relating to formation under the present law, which is the vexed question of whether a third-party right must be irrevocable.

Identification of the third party

4.2 In the Discussion Paper we began by examining the general requirement to identify the third party. We then turned to three particular scenarios, namely those involving: (i) a third party who is not yet in existence at the time when the right is conferred, (ii) a third party who, while in existence, is not within the specified class of third parties at that time, and (iii) a third party who is identified other than by or from the contract.[1] We asked questions in relation to each of these issues, and we discuss each of them in what follows in the same order. To avoid undue repetition, though, we refer back to the Discussion Paper for fuller detail.

4.3 As a preliminary, at a general level, it is already the law in Scotland that the third party must be identified in the contract.[2] Such a party may be identified specifically[3] or it may be as a member of a class of persons, all as provided for in the contract.[4] The third party need not be in existence at the time the contract is made.[5] The comparator instruments take broadly the same approach.[6] A third party may possibly also be identifiable otherwise than through contractual provision,[7] including by means of a clause permitting one of the contracting parties to name a nominee in respect of a contractual benefit.[8]

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[1] See paras 5.3-5.15 of the DP.
[2] See paras 2.26-2.37 of the DP.
[3] As in *Lamont v Burnett* (1901) 3 F 797. See also *Blumer & Co v Scott & Sons* (1874) 1 R 379, 387, in which it was stated that only identification was required.
[4] As in *Wood v Moncur* (1591) Mor 7719 (tenants) or *Love v Amalgamated Society of Lithographic Printers of Great Britain and Ireland* 1912 SC 1078 (dependants of members). See also McBryde, *Contract,* para 10.17, and the SBCC example quoted in para 4.6 below.
[5] See para 4.9 below.
[6] See paras 5.4-5.5, and the table above para 5.3, of the DP.
[7] E.g. a third party for whom a gift is purchased by the donor, or to whom services are provided under a contract between two others: see paras 2.35-2.36 of the DP and paras 4.13-4.15 below.
[8] E.g. where X (the seller) contracts with Y for the sale of a property, the missives may permit Y to designate a nominee, Z, as the person in whose favour the disposition is to be granted. We understand that this is not uncommon in commercial missives. On an effective nomination, Z has the right to delivery of a disposition in its favour. This sort of issue has been explored by the courts in New Zealand in the context of the NZ Contracts (Privity) Act 1982, as nominee clauses used to be common in residential sales: see *Laidlaw v Parsonage* [2010] 1 NZLR 286 and *Rivette v Atrax Group New Zealand Limited* [2011] 11 NZCPR 723.

4.4 In practice, there are many instances in which it is useful to allow parties to conclude a contract without knowing exactly who will be the third party actually enforcing the right. One example involves company groups, where the contracting company wishes to confer rights upon other companies in the group, some of which may not yet exist, or to achieve the settlement of a claim against it which may also involve other group members.[9] Another example may be the situation in which collateral warranties are currently used: at the time the initial contracts are made, the parties know that they will have to provide rights for third parties in relation to the project's end-product but they cannot at that stage know exactly who these third parties will be. Further examples include a contract for the payment of a pension providing for the possibility of the pensioner nominating another party to receive the benefit of the pension in the event of the pensioner's death; an employer who rents accommodation for workers but does not know the names of the particular tenants until after the contract has been concluded; and an insurance company contracting with a policy holder to pay the insurance proceeds to any future owner of the goods insured.[10]

4.5 It seems clear that Scots law already accepts the possibility that a third-party right may be created in relation to a class of existent and/or not yet existent persons even though it is not certain which member or members of that class will ultimately enforce that right. We think that this should continue to be the law. We asked whether identifying third parties as members of a class of persons is a mechanism which is frequently employed and practically usable in contracts, but did not receive any specific responses on this point, although several responses to other questions made clear the common use of reference to classes in third-party right terms.

4.6 We thought it useful to follow the 1999 Act in referring to the third party as a person who corresponds to a description given in the contract. We note that the Scottish Building Contract Committee style contract contains a part entitled "Third-party rights and Collateral Warranties" for purchasers or tenants in which the first column to be completed is headed "name, class or description of person". This therefore permits a person to be identified either by name, or by way of a class (such as "purchaser", or "tenant"), or by meeting some other description (e.g. it might be stated that a person may be nominated by a contracting party).

4.7 In response to a question on this issue,[11] all respondents agreed that the third party must be identified by, or be identifiable from, the contract. The qualification that the identification might, for instance, be as a member of a particular class of persons or as a person fulfilling or meeting conditions laid down in the contract was considered unnecessary by one of the respondents. As the Comments to the DCFR observe:

> "It goes without saying … that before a third party could enforce or assert a right under the contract the third party would have to be identified or identifiable under the contract. It also goes without saying that the third party need not be a single individual or legal person but could be several persons or a class of persons identified as such."[12]

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[9] See paras 3.7 and 3.33-3.34 of the DP.
[10] DCFR Vol 1, p 617. See too the example of *Laemthong International Lines Co Ltd v ARTIS and Fahem (No 2)* [2004] EWHC 2738 (Comm), aff'd [2005] EWCA Civ 519, [2005] 1 CLC 739, where the third-party right was conferred upon those who were "agents" of the other contracting party.
[11] Question 12 in para 5.11 of the DP.
[12] Article II.-9:301, Comment D.

4.8 Accordingly, we recommend that:

7. The third party must be identified or identifiable from a description in the contract.

(Draft Bill, section 1(3))

(i) Third party not yet in existence

4.9 The situation where the third party is not yet in existence at the time of the contract is really a sub-set of the category of identifying who may be a third party by means of a general description – children yet to be born, companies yet to be formed within a particular company group, and so on. It is currently clear in Scots law that the third party's lack of existence at the time of the contract is no bar to its providing for a third-party right. The right can only be effective once the party exists, however. It is subject to the wholly suspensive condition that the third party does subsequently come into existence; until then, there can be no right at all (and the undertaking can therefore be cancelled or modified by the parties).[13] This is perhaps of special value where a third-party right is created in favour of a class such as companies yet to be formed within a company group. Where there is a class some of whom exist while others have yet to come into existence, the existent ones enjoy whatever rights the contracting parties may have conferred upon them, regardless of whether or not further entitled persons come into existence.

4.10 In relation to this topic, Scots law seems to be in line with the comparator instruments and the 1999 Act. Our proposal was that the current rule should continue. It eliminates any question of the undertaking in favour of a non-existent person being found void for uncertainty. In answer to a question eliciting views on this,[14] there was universal agreement from those who responded. We therefore make the following recommendation:

8. It should continue to be the case that a right in favour of a third party who is not in existence at the time that the right is set up is valid and enforceable by any such third party on subsequently coming into existence.

(Draft Bill, section 1(4)(a))

(ii) Third party in existence but not a member of the class in question

4.11 The next question is whether it is possible to create a third-party right for a person who was in existence at the time the contract was formed but who was not then a member of the class of persons in whose favour the third-party right was created. Examples of such a class are the sub-contractors to be appointed by a named principal contractor, or the employees of a particular company, or the owner of a specified building.[15] So, if a contract between client and contractor grants rights to the latter's subcontractors who are engaged during the course of the project (whose identities may well not be known at the outset), the intention is that any future subcontractor who meets that description is to enjoy the third-party right.

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[13] See para 2.5 above.
[14] Question 13 in para 5.11 of the DP.
[15] See paras 2.27-2.28 and 3.16-3.18 of the DP.

4.12 We thought that in principle there is nothing in the present law to prevent such a conclusion.[16] The third-party right has been created subject to certain suspensive conditions and becomes enforceable upon fulfilment of those conditions. In response to a question on this topic,[17] there was unanimous agreement that this is a desirable policy, but there was no consensus as to whether a statutory provision was needed or whether the common law already made such provision. Accordingly, we recommend:

> **9. When a third-party right is drawn in favour of a class, a person who was in existence at the time the relevant contract is formed, but was not at that time a member of the intended class, may become entitled to benefit from and to enforce the third-party right upon joining the class if the contracting parties so intend.**
>
> (Draft Bill, section 1(4)(b))

(iii) Third party identified other than by or from the contract

4.13 A final question arising from study of the comparator instruments is whether a third party may be identified otherwise than by or from the contract.[18] One example might be where A buys goods from B with the declared intention of giving them to C (or, more powerfully, with an instruction to B to deliver them to C). Or A might contract with B for the provision of services by B at C's property.[19] Indeed, the 'community of interest' cases in commercial developments, such as shopping centres, might be analysed in this way too.[20]

4.14 A wider approach to identifiability should, however, not become a back-door to creating enforceable third-party rights unless this accords with the parties' clear intentions. There would also be issues about what might constitute relevant evidence about third parties not mentioned in the contract itself.[21] Suppose that Plank & Pole Ltd enter into a written contract with a property factor to erect scaffolding around a building at a particular address: would it be clear from the contract and the surrounding circumstances which the court may examine that the owners of the building are to be regarded as right-holding third parties? Might some evidence on the matter, for example as to pre-contractual negotiations or post-contractual conduct, be inadmissible under the present law on the interpretation of contracts?[22]

4.15 We asked two questions on this topic.[23] Various respondents mentioned that it would be preferable to identify the third party from the terms of the contract only, for fear of

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[16] Indeed, it would be perverse if the law permitted rights to vest in third parties who did not exist at the time the contract containing the right was concluded, as described in the previous section, but not to do so in the case of a person who happened to be in existence when the contract was formed but did not, at that time, answer to the description of the prescribed third party. Such a distinction would serve no useful purpose, and would be liable to give rise to fruitless disputes.

[17] Question 14 in para 5.11 of the DP.

[18] See the fuller discussion in paras 5.3 and 5.12-5.15 of the DP.

[19] These scenarios can give rise to what is sometimes termed "transferred loss" or "black hole" damages: C cannot sue B in contract for any loss as there is no contractual relationship between B and C.

[20] It does not seem to be, or have been, the norm to state in the relevant contracts that there may be other parties upon whom the developer or landlord is imposing the same or similar duties with regard to other occupiers or tenants in the property: see paras 2.43-2.47 and 3.37-3.47 of the DP, and para 1.33 above.

[21] See our DP on Interpretation of Contract (No 147, 2011) where we note that claims for rectification may give rise to certain exceptions (which are discussed in particular at paras 5.23-5.27 and 7.43-7.46).

[22] See DP No 147, cited immediately above, especially at paras 7.12-7.15 and 7.18.

[23] Questions 15 and 16 in para 5.15 of the DP.

generating too much uncertainty otherwise. Beyond that, there was broad agreement that the current law, especially that on the interpretation of contract, was sufficient to determine, in particular cases, whether or not a third party was intended to have a right under the contract. We agree, and accordingly we make the following recommendation:

10. The current law, including the rules on contractual interpretation, should continue to be used to determine the identity of any third party with a right under a contract, but no legislative provision to this effect is needed.

Intention of contracting parties to confer a right

4.16 The intention of the contracting parties to confer a right upon a third party is as crucial to the reform that we propose as it is in the existing law. This is not only as the platform upon which the right rests, but also as something the *absence* of which may be expressed by the parties in their contract: for example, with a provision that the Contract (Third Party Rights) (Scotland) Act is not to apply to the contract.[24] We therefore make the following recommendation:

11. The intention of the contracting parties as determined from their contract that a person who is not a party to the contract should be legally entitled to enforce or otherwise invoke the undertaking in its favour should continue to be the basis for the existence of a third-party right.

(Draft Bill, section 1(1)(b))

4.17 We have already explained in Chapter 2 our view that, notwithstanding what Lord Dunedin said in the *Carmichael* case, even under the current law, delivery, intimation or registration of any document embodying the undertaking in favour of a third party are simply strong means of showing the requisite intention of the contracting parties to create a third-party right. As even alternative *requirements* for the constitution of a third-party right, however, they would pose a serious obstacle in the way of regular and in particular commercial exploitation of third-party rights. We have also expressed the view that the intention of the parties to create an enforceable right can be manifested in other ways: for example, informal oral communication to the third party, or some appropriate form of publicity for the undertaking such as publication on a website.[25] In contexts like the North Sea oil and gas sector, it may even be the case that the existence of third-party rights is simply widely known amongst participants in the industry. By analogy with the established law of unilateral promises, it may also be enough that a third party fulfils the necessary conditions without any knowledge at all of the right for it to become effective and enforceable by that person (albeit that knowledge will have somehow to be acquired subsequently by the third party).[26]

4.18 While we think that this the present law, we also believe that it would be useful to have legislative provision to indicate that a third-party right may arise without any need for delivery or equivalent (such as registration), intimation or other less formal communication to the third party. This would make clear the legislation's departure from *Carmichael*, and is

[24] See further paras 6.46-6.49 below.
[25] For an example see *Cavanagh and others v Secretary of State for Work and Pensions* [2016] EWHC 1136 (QB), where relevant terms of employees' contracts were published on the staff intranet.
[26] See for all this paras 2.27-2.44 above.

also in line with our recommendation below that there should be no general requirement of formal writing for the constitution of a third-party right.[27] There may be cases, of course, where one or other of delivery, intimation or communication is needed as a matter of the general law applying in a given state of facts; perhaps especially delivery of a relevant document to the third party to have the right. But this should be left to the courts to determine as necessary in the circumstances of these particular cases. The effect of our suggested provision would be that nothing in the draft Bill makes delivery, intimation or communication necessary for the constitution of a third-party right. We therefore recommend:

12. There should be legislative provision to the effect that neither delivery, intimation or communication of the undertaking to the third party is necessary for the constitution of a third-party right. This is, however, without prejudice to the application of any other legal rules imposing requirements for the creation of an enforceable obligation.

(Draft Bill, section 2(4)(b) and (7))

4.19 Another issue is whether a third-party right may be created by the *implied* intention of the contracting parties, or whether their intention must always be express.[28] Some of the comparator instruments expressly state that implied intention will suffice, while in some others this appears to be implicit.[29] The 1999 Act deserves particular mention here as it distinguishes between third-party rights that arise because a contract expressly provides for third-party enforcement of a term in it; and those that arise because a term "purports to confer a benefit" on the third party unless it appears from the contract that the parties did not intend the term to be enforceable by the third party. The 'purported benefit' provision can be read as suggesting that the existence of 'benefit' leads impliedly to a third-party enforcement right unless the contract otherwise provides.[30] This seems to be so even though, for a term to 'purport' to benefit a third party, that party must be identified in the term by name, as a member of a class, or as a person corresponding to a description, and despite the careful proviso in section 1(2) that such a liability cannot arise "if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party".

4.20 We understand that one of the major reasons for excluding the 1999 Act in commercial contracts is fear that some unanticipated third party will appear and will point to a benefit purportedly conferred on it by a contractual term. If the court upholds this purported conferral, the party will have an enforceable right unless there is some other express contrary term (which, given that the third party was unanticipated by the contracting parties, is unlikely). In other words, the Act still leaves contracting parties with undesirable uncertainty about their potential liabilities. We are inclined to think, however, that such

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[27] See paras 4.35-4.37 below.

[28] For written contracts, this will be determined by examining the relevant documentation; for oral contracts, evidence as to intention will require to be led in order to determine the issue. In the latter case, the boundary between what qualifies as express and what as implied may not be at all easy to see.

[29] See discussion in Vogenauer, *PICC Commentary*, pp 663-5.

[30] This is how the section was read in *Nisshin Shipping Co Ltd v Cleaves & Co Ltd* [2003] EWHC 2602 (Comm); *Prudential Assurance Co Ltd v Ayres* [2007] EWHC 775 (Ch) (subsequently reversed [2008] EWCA Civ 52, [2008] 1 All ER 1266); *Laemthong International Lines Co Ltd v ARTIS and Fahem (No 2)* [2004] EWHC 2738 (Comm), aff'd [2005] EWCA Civ 519, [2005] 1 CLC 739. Note also *Broughton v Capital Quality Ltd* [2008] EWHC 3457 (QB) and *Cavanagh and others v Secretary of State for Work and Pensions* [2016] EWHC 1136 (QB).

uncertainty could be avoided in Scotland if any legislation on third-party rights were to be expressed in terms of the contracting parties' intention (express or implied) to create an enforceable right for the third party rather than in terms of a third party benefit from the contract.[31]

4.21 This leads us back to the question of whether the contracting parties' intention requires to be express. Two considerations appear relevant to us in this regard. First, it is already possible in Scots law to create a third-party right by means of an implied intention to do so, and there is no suggestion of which we are aware that this has caused problems in practice. In the past, it allowed the enforcement of real burdens by co-feuars and co-disponees; and it may still allow tenants in commercial leases where there is the 'community of interest' to enforce common obligations where landlords are, for whatever reason, unwilling or unable to do so.[32] The evidence of the intention to create rights in such cases might be indirectly from other express terms,[33] along with the commonality or inter-connectedness of the duties undertaken by the enforcing and defaulting tenants or their knowledge of or reference to the existence of some plan or scheme of development which was to be implemented by the tenants' performance of their duties.

4.22 Second, there are policy considerations. We consider that considerable uncertainty would arise if it were only possible to create third-party rights by way of an express provision. Most of the reported cases are about whether or not the intention to confer a right can be implied. If it were made clear in statute that the intention to confer a right had always to be express, it would not necessarily herald an end to litigation in this area; indeed, there might well be as many expensive arguments that a right was expressly provided for as there are now that a right is to be implied. The brunt of this is likely to be felt in contracts drafted without proper legal advice: while professionally advised contracting parties wishing to create third-party rights would no doubt have suitable terms included in their contracts, others who are less well supported might find their intentions defeated by the inadequacy of their drafting or their oral statements.

4.23 Our provisional view was, therefore, that it should continue to be possible for the contracting parties' intention to create a third-party right to be implied as well as expressed in the contract. When we asked for views,[34] there was universal agreement with this position. We do not think it necessary, however, to create any particular rules on when the implication of an intention to confer a third-party right may be made, such as the one suggested by Gloag,[35] or the ones developed in the "community of interest" cases from the nineteenth century on.[36] There is a risk of artificiality and unpredictable applications. We think the matter better left to the ordinary rules of interpretation and implication.[37]

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[31] See paras 3.6-3.14 above.
[32] See paras 3.37-3.47 of the DP and paras 1.32-1.35 above; it will of course be possible for the leases themselves to provide expressly for co-lessees to have enforcement rights.
[33] E.g. *Williams v Kiley (t/a CK Supermarkets Ltd)* [2002] EWCA Civ 1645; see para 3.40 of the DP.
[34] See question 17 in para 5.21 of the DP.
[35] See para 2.10 above.
[36] See para 2.12 above.
[37] For these see McBryde, *Contract*, chs 8 and 9; our DP No 147 on Interpretation of Contract (2011); and more recent decisions of the UK Supreme Court such as *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50, [2011] 1 WLR 2900; *Aberdeen City Council v Stewart Milne Group Ltd* [2011] UKSC 56, 2012 SC (UKSC) 240; *Arnold v Britton* [2015] UKSC 36, [2015] AC 1619; *Marks & Spencer plc v BNP Paribas Securities Services Trust Company (Jersey)* [2015] UKSC 72, [2015] 3 WLR 1843; and *Trump International Golf Club Scotland Ltd v*

4.24 Accordingly, we recommend:

> **13. The current rule in Scots law, that the intention of contracting parties to create a right by their contract for an identified or identifiable third party can be express or implied, should remain. No special rules are needed on when an intention to create a third-party right is to be implied.**
>
> (Draft Bill, section 2(3))

Should a third-party right taking the form of an exclusion of liability be competent?

4.25 This question is essentially about whether an exclusion or limitation of a third party's liability to one or more of the contracting parties can be classed as a third-party right.[38] All the comparator instruments have an express provision to this effect. In this way, they avoid any need for Hohfeldian analysis of whether any such provision can be treated as a right of the third party.[39]

4.26 Although there are some authorities indicating that a term excluding or limiting liability of a third party is enforceable as a third-party right in Scots law, it is not completely clear how far such terms are recognised.[40] There is, however, support for the enforceability of such terms: for example, they are particularly useful in business contexts involving multiple actors, such as construction projects,[41] and our Advisory Group confirmed that such clauses should be enforceable as third-party rights. We have also received information about the ubiquity and utility of immunity and indemnity clauses in the oil industry. In his consultation response, Greg Gordon drew our attention to the oil industry's Industry Mutual Hold Harmless (IMHH) Deed as "an example of the kind of highly ambitious and complex contractual solution to the economically-efficient allocation of accident risk that would be simply impracticable without a clearly enforceable and trusted system for conferring third party benefits or rights". Mr Gordon's response continued:

> "This Deed addresses the 'contractual gap that traditionally exists between contractors working on the UKCS with regard to the allocation of liability. On an offshore installation an operator will award contracts to a contractor who may sub-contract to its sub-contractors. This provides a vertical relationship between some of the parties but no relationship across contractors and sub-contractors.' Each party to the Deed (at the present time the number of signatories runs into the hundreds) contracts grants and receives indemnities relative to personal injury, property damage and consequential loss on a grouped basis. Third Party benefits are dealt with in Clause 6, which provides,
>
> > 'The signatories intend that, in accordance with the 1999 Act, a member of the signatories group shall be entitled to enforce the benefit of the indemnities, but parties intend that no provision of the deed shall confer any benefit on or be enforceable by any person not a signatory.'"[42]

Scottish Ministers [2015] UKSC 74, 2016 SLT 9, paras 31-37 (Lord Hodge), 41-44 (Lord Mance) and 66, 70 (Lord Carnwath).

[38] See the fuller discussion in paras 5.22-5.25 of the DP, where we also trace the background to the relevant provision in the 1999 Act.

[39] See para 3.11 above, and para 2.25 of the DP.

[40] See para 2.24 of the DP.

[41] Macgregor, *Report on the Draft Common Frame of Reference*, Appendix, 5.2.1.

[42] See http://www.logic-oil.com/imhh for the quotations.

4.27 In answer to a question as to whether there should be express provision to make the Scottish position clear, there was universal assent. As we refined our thinking in the preparation of this Report with its draft Bill, we came to the view that it would be helpful to make express mention, not only of clauses excluding or limiting a third party's liability to any contracting or fourth party, but also of agreements that third parties should not be liable at all or should be entitled to be indemnified against any liability.[43]

4.28 Accordingly, we recommend:

14. It should be expressly provided that (i) an exclusion or limitation of the third party's liability to one or more of the contracting parties, or to a fourth party; (ii) agreements that a third party should not be liable at all; and (iii) agreements that a third party is to be indemnified against any liability, can constitute a third-party right.

(Draft Bill, section 2(5) and (6))

No need for third party's acceptance

4.29 Under the present law there is no requirement that the third party accept the right for it to be enforceable. This is obviously most important where the right is initially at least couched in favour of a person or persons yet to come into existence or to be more specifically identified in some way or who lacks the active capacity to make any acceptance but has the passive capacity to hold a right.[44] In the Discussion Paper we saw no need to change the rule, which is also found in the comparator instruments. Consultees agreed. The contrary position might also create practical difficulties for the creation of the third party immunities discussed in the preceding paragraphs. Concerns about third parties having rights thrust upon them may be met by giving them a clear power of renunciation, as we recommend below.[45] The rule does not involve any prohibition on contracting parties if they so wish imposing a requirement of acceptance by the third party before the latter can have a claim against them; but in that scenario, we think that the result of the third party's acceptance is the creation of another contract between that party and the other contracting parties, not one of a third-party right properly speaking.[46] We therefore recommend:

15. There should be no requirement of acceptance by the third party for the constitution of a third-party right.

Two kinds of case?

4.30 The case law and text writers on irrevocability and *jus quaesitum tertio* have been pre-occupied with a supposed division of the topic into two kinds of case.[47] This emerged in particular in the judgment of Lord Dunedin in *Carmichael* (emphasis added):

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[43] For examples of agreements that third parties should not be liable at all (as distinct from exclusions or limitations of a liability e.g. to pay damages) see *New Zealand Shipping Co Ltd v A M Satterthwaite & Co Ltd (The Eurymedon)* [1975] AC 154 (Himalaya clause); *Melrose v Davidson & Robertson* 1993 SC 288. For an example of an indemnity in favour of a third party see *Laemthong International Lines Co Ltd v ARTIS and Fahem (No 2)* [2004] EWHC 2738 (Comm), aff'd [2005] EWCA Civ 519, [2005] 1 CLC 739.

[44] See paras 2.13-2.15 above.

[45] See paras 6.2-6.8 below.

[46] See para 2.13 above.

[47] See e.g. SLC Memorandum No 38 (1977); McBryde, *Contract*, para 10.04.

> "I think it very necessary to begin by pointing out that the expression "*jus quaesitum tertio*" is, *in different cases and different circumstances, used in a varying sense*, or, perhaps I might better say, is looked at from a different point of view. The one sense is meant when the question being considered is simply whether the *tertius* C has the right to sue A in respect of a contract made between A and B to which contract C is no party. The controversy then arises between C, who wishes to sue, and A, who denies his title to do so... . In *Scotland, if the provision is expressed in favour of C, he can sue, and this is often designated by saying "He has a jus quaesitum tertio"*... . [I]n all this class of cases the controversy is between A and C: B is either no longer existent or is, so far as he is concerned, quite willing that C should exact his rights... The other sense of the expression is when the emphasis is, so to speak, on the *quaesitum* and when the controversy arises not between C and A but between C and B. In such a case A is willing to perform his contract, and the contract in form provides that A shall do something for C, but B, or those who represent B's estate, interfere and say that B and not C is the true creditor in the stipulation."[48]

4.31 *Carmichael* illustrates the second category. The issue between the parties to the action was whether the stipulator father or the third-party son's estate should receive the pay-out on the policy, the insurance company being ready to pay whichever party had the right to the money. Unfortunately, Lord Dunedin's speech did not elaborate further on the consequences of the distinction.[49]

4.32 In 1961 the late JT Cameron (subsequently Lord Coulsfield) demonstrated that the second group of cases were all concerned with situations where the stipulator transferred money to the debtor with the aim of creating an obligation of repayment enforceable by the third party. If the terms of the obligation were sufficient to infer donation from the stipulator to the third party, a further step was necessary (for example, delivery of the deed to the third party) to constitute the right.[50] The classic cases concerned deposit receipts, where the depositor required the bank to pay out to a third party. It was held that the third party had a title to demand performance from the bank but this did not settle the question of ownership of the money against the depositor.[51]

4.33 It has been suggested, however, that this is not really so much about the existence of a third-party right under a contract as the competing claims of two parties to some thing – usually a pot of money:

> "This … is not truly a question of the personal rights which a third party may enjoy under a contract between two others but rather, as Gloag suggested in 1929, about the quite distinct rights which the stipulator may nonetheless have in the fruits of the performance which the third party has a title to demand from the debtor. Typically the issue in the cases has been about whether or not there is donation between these parties and whether, therefore, against the background of the presumption against donation, there has been both the intention to donate and delivery or an equivalent sufficient for the transfer of property. The fact that the mechanism of donation involves a triangular relationship, and not just donor and donee, should

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[48] *Carmichael v Carmichael's Ex* 1920 SC (HL) 195, 197-198.
[49] See para 2.18 above for a summary of the facts.
[50] J T Cameron, "*Jus Quaesitum Tertio*: The True Meaning of Stair I. x. 5" 1961 JR 103. The cases offered in Cameron's analysis are: *Stonehewer v Inglis* (1697) Mor 7724; *Hill v Hill* (1755) Mor 11580; *Balvaird v Latimer* 5 December 1816 FC; *Walker's Ex v Walker* (1878) 5 R 965; *Crosbie's Trs v Wright* (1880) 7 R 823; *Jamieson v M'Leod* (1880) 7 R 1131; *Jarvie's Tr v Jarvie's Trs* (1887) 14 R 411; and *Hadden v Bryden* (1899) 1 F 710.
[51] See especially *Dickson v National Bank of Scotland plc* 1917 SC (HL) 50.

leave intact, not only these basic principles, but also the quite separate doctrine of *jus quaesitum tertio*."[52]

4.34 In the Discussion Paper we suggested, therefore, that it is not necessary in the present exercise to deal with the specific question which arose in the *Carmichael* case, so long as our proposals make clear how a third party's personal right to a performance of some kind from one or more of the contracting parties may be created under a contract. Consultees were unanimous in their agreement with this suggestion. We are not concerned with what other rights may be created or exist within the triangle of parties, or whether the third party's right is but a bare title to sue (for example, to collect, uplift or manage money for someone else), or a right with more substantive results for the party's patrimony. We think that it is not practical to attempt to formulate any rules on how to deal with inconsistencies between the rights of other persons and those of the third party. That is probably best left to interpretation of the contract and the application of other rules which may be relevant, such as those on donation. We accordingly conclude:

16. There is no need in the present exercise to deal with competing claims between the third party and the contracting parties, and these should be left as matters for the interpretation of the contract and/or the application of other relevant rules of law such as donation.

Is formal writing necessary?

4.35 Is formal writing needed to create third-party rights? As we stated in the Discussion Paper, there has been a long tradition, from Stair onwards, of analysing JQT in terms of a promise (i.e. gratuitous unilateral obligations) or set of promises made to the third party by the contracting parties.[53] Under the current law, and subject to two exceptions, promises require to be in formal writing in order to be valid.[54] The two exceptions to this rule concern a promise made in the course of business,[55] or a promise on the strength of which there have been actings such as to bar the promising parties from withdrawing it.[56] While these exceptions might be sufficiently broad to limit, in practice, many of the difficulties that might otherwise flow from a requirement that third-party rights are valid only if constituted by formal writing, they would not prevent that requirement arising in certain cases.

4.36 In order to obtain views on this topic, we asked a trio of questions.[57] The first was whether it was preferable to avoid, as far as possible, any specific statutory juristic characterisation of the right of the third party. There was universal agreement on this. Secondly, we asked whether the interests of flexibility meant that a requirement that third-party rights needed to be constituted in writing was undesirable. Again, there was universal agreement on this. Lastly, we asked if it should be made clear in statute that formal writing was *not* required. On this, there was a divergence of views: Professor Clive thought that such a provision would be unnecessary, whereas others considered that express clarification would be useful.

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[52] MacQueen, "Third Party Rights in Contract", p 250; commented upon by Sutherland and Johnston, "Contracts for the Benefit of Third Parties", p 225.
[53] See paras 2.16-2.17 of the DP for more detail.
[54] See paras 2.4-2.5, 2.53-2.56 and 4.14 of the DP. Formal writing in this context is writing subscribed by whichever of the contracting parties is undertaking duties to the third party.
[55] RoWSA, s 1(2)(a)(ii).
[56] Ibid, s 1(3) and (4). See E C Reid and J W G Blackie, *Personal Bar* (2006), paras 7.12-7.20.
[57] Questions 7-9 in paras 4.14-4.15 of the DP.

4.37 We see the value of the statute being clear and offering 'signposts' for users, but in the end we agree with Professor Clive that it would be preferable to remain silent ion this point. As a matter of policy, we favour the view that formal writing should not be required; were we to have taken the opposite view, we can see the force of making that requirement plain by express provision in the statute. It does not follow, though, that our favoured policy should be accompanied by a negative provision to the effect that formal writing is not required. There may be circumstances in which it *will* be required: for example, where the third-party right involves the creation, transfer, variation or extinction of a real right in land, or is a unilateral gratuitous obligation not in the course of business.[58] Accompanying commentary on the statute might, for example, be a more appropriate method of making the general point. For these reasons, we make the following negative recommendation:

17. It is unnecessary to enact a rule that a third-party right may be validly constituted other than in formal writing.

Conditional obligations

4.38 We have already seen that a third-party right in Scots law may currently be future in nature, dependent on some event certain to occur (such as the death of an individual or the arrival of a particular date or time), or conditional upon some uncertain future event, whether or not that be based upon the power of the contracting parties to vary or cancel the right, or the requirement of an onerous performance by the third party, or something else beyond the parties' control.[59] We also noted that the DCFR and the PICC take a similar approach. The question we asked in the Discussion Paper is whether there should be any statutory provision to that effect.[60] We considered that there may be no need, as it follows as a matter of the general law of obligations of which third-party rights clearly form part. On the other hand, we said that it is a crucial aspect of the law in this field and so a statutory provision may be a useful reminder to users of the legislation.

4.39 On consultation, there were divergent views but a number of respondents favoured something along the lines of the relevant provision in the DCFR, which provides that "[t]he nature and content of the third party's right or benefit are determined by the contract and are subject to any conditions or other limitations under the contract."[61] We consider that this would be appropriate and we therefore recommend:

18. There should be express but general provision that a third party's right may be future or conditional in nature.

(Draft Bill, section 2(2))

4.40 This has given rise to a further point, namely whether there is any need to define what is meant by 'future' or 'conditional' in this context. Clearly, this is an important matter. However, we prefer to leave this to the general law, which is readily discernible from the standard works on the subject.[62] Our draft Bill, however, captures the key ideas when it

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[58] See RoWSA, s 1(2)(a); note also s 1(2A).
[59] See paras 2.27-2.34 above, and also paras 2.6-2.9 and 4.19-4.20 of the DP.
[60] Question 11 in para 4.20 of the DP.
[61] DCFR II.-9.301(2).
[62] See Gloag, *Contract*, p 272; McBryde, *Contract*, paras 5.35-5.40; Wilson, *Scottish Law of Debt*, paras 1.10-1.11; *SME*, Vol 15, paras 5-6; D M Walker, *The Law of Contracts and Related Obligations in Scotland* (3rd edn, 1995), paras 18.4-18.9; also Stair, *Institutions* I, 3, 8; Bell, *Principles of the Law of Scotland* (10th edn, 1899) I, I,

refers to the right being dependent upon the occurrence of some event, whether or not that event is certain to happen.[63]

47; and Erskine, *Principles of the Law of Scotland* (21st edn, 1911) III, I, 3. See also paras 2.6-2.10 and 4.19-4.20 of the DP, and paras 2.27-2.34 above.

[63] See s 2(2) of the draft Bill.

Chapter 5 Irrevocability

5.1 The Discussion Paper preceding this Report suggested that requirements of irrevocability give rise to the most significant difficulty in the Scots law of third-party rights, viewed from both a theoretical and a practical perspective.[1] As we have reiterated in Chapter 2,[2] there are two inter-linked issues.

5.2 One is the question of *formation: how to bring the right into existence in the first place*. The case of *Carmichael* is generally seen as laying down the rule that before any third-party right can even come into existence the contracting parties must have taken steps to deprive themselves of their normal freedom to agree the modification or cancellation of their contract, at least with regard to the provisions in favour of the third party.[3] This requirement of initial irrevocability poses significant barriers to the use of third-party rights in legal practice and commercial situations.[4]

5.3 The second issue is the consequential question of *bringing the right to an end, or varying it, before its enforcement is sought by the right-holder*, when by definition the right may need to be irrevocable to exist at all. This plainly conflicts with the need to provide flexibility for parties dealing with the uncertainty of future events. While rights that come into existence under contracts should be respected, it should not be made impossible to adjust them, or even bring them to an end altogether, by ways and means provided for in the contract itself.

5.4 There was general agreement amongst consultees that the rules on irrevocability required reform. The Senators of the College of Justice stated that in their view "this is the necessary springboard for the proposed revision of the law". This conclusion is also supported by the DCFR, PICC, CESL and the 1999 Act, all of which reflect instead the policy drivers of facilitating business transactions and providing commercial flexibility.[5] Our further comparative researches have revealed no modern system which imposes a requirement that a third-party right be irrevocable as a matter of either its formation or to prevent its possible cancellation or alteration before performance falls due. There is accordingly powerful support from both home and abroad that an initial requirement of irrevocability is not necessary for a modern law of third-party rights.

Abolition of irrevocability as a requirement of constitution

5.5 The comparator instruments and the 1999 Act, indeed comparative law in general, suggest that there is no need to impose a requirement of irrevocability before the right can exist at all. The Discussion Paper showed the problems which a requirement of initial irrevocability poses for the use of third-party rights in legal practice and commercial settings.[6] Indeed, as Professor Clive observed, "it makes no sense to say that only an irrevocable right

[1] See the DP, at paras 2.57-2.78 and 3.1-3.5.
[2] See paras 2.35-2.44 above.
[3] *Carmichael v Carmichael's Ex* 1920 SC (HL) 195.
[4] See the DP, at paras 3.3 and 3.5.
[5] See texts in Appendix B.
[6] See paras 3.3 and 3.5 of the DP.

can be conferred on a third party". None of our consultees suggested that the rule in *Carmichael's* case should be retained. We have shown again in Chapter 2 that the approach in *Carmichael* is inconsistent with basic principle. A right may be constituted even though it is subject to cancellation or modification, whether by voluntary acts of the contracting parties or as the result of the occurrence of some other event.[7] We accordingly recommend:

19. Any requirement that a third-party right cannot be constituted in a contract unless the right has first been made irrevocable by the contracting parties should be abolished. Instead, it should be made clear that a third-party right may be constituted even although it is subject to cancellation or modification, whether by the contracting parties or through other circumstances, and that contracting parties may cancel or modify a third-party right unless prevented by some other provision in the proposed statute.

(Draft Bill, sections 2(4)(a) and 3(1))

May a third-party right become uncancellable or unmodifiable?

5.6 The next issue is, however, if and when the contracting parties may cancel or modify the third party's right *after* it has been constituted. Should there be a point at which a third party's right crystallises and at which the contracting parties are no longer entitled to bring the right to an end (cancellation) or vary it (modification)? In what follows, for ease of reading we sometimes use the words 'revocable' and 'irrevocable' to refer as appropriate to modification as well as cancellation of the third-party right, although most often we speak of cancellation or modification.

Fulfilment of conditions and other terms

5.7 The starting point is the freedom of contracting parties to cancel or modify their contract in whole or in part even if it provides for a third-party right. We think that this freedom exists unless expressly given up in some way, and that it applies to undertakings in favour of third parties made in contracts. So the first question is, when, if ever, is that freedom lost in relation to the third party if the contract provides for such a right?

5.8 As we have shown in Chapter 2, the parties clearly retain their freedom to cancel or modify the terms providing for a third-party right where conditions about the existence or identification of the third party or parties have not yet been fulfilled, since there can be no right before a third party is in existence or other conditions for identification of the creditor in the right have been met.[8] We propose no change to that position.

5.9 The comparator instruments and the 1999 Act provide a variety of rules restricting the circumstances in which the third party's right, once created or formed, may be cancelled or modified by the contracting parties. Modification of the third party's right, as distinct from its outright cancellation, has not been much discussed in Scots law, perhaps because irrevocability has been seen as both condition and consequence of a third-party right. But it

[7] See paras 2.33-2.38 above, and note especially the quotation at para 2.36 from McBryde, *Contract*, paras 10.27-10.28.
[8] See paras 2.5 and 2.27-2.34 above.

seems clear that a modern law of third-party rights should cover the questions of both cancellation and modification by the contracting parties.

5.10 It seems to us that the first and foremost consideration in the question of irrevocability ought to be the terms in which the third-party right is expressed or from which it can be implied. If the requirement of irrevocability for constitution is removed, it then becomes clearly possible for contracting parties to create third-party rights that are nonetheless subject to resolutive conditions and other terms enabling change to these rights, including outright cancellation. *Kelly v Cornhill Insurance Company Ltd*[9] provides an excellent example in the existing case law, where the third party's right to insurance protection while driving the car belonging to the policy-holder could have been cancelled altogether by the latter withdrawing his permission for the third party to drive the vehicle.

5.11 With this perspective, we think the approach in some of the comparator instruments may put the cart before the horse, insofar as the third-party right becomes uncancellable or unmodifiable, unless the contract otherwise provides, upon the occurrence of certain events involving the third party. If the contracting parties provide in some way for a power to modify or cancel the third-party right that their contract otherwise sets up, then we think that in general that power should remain exercisable except in the circumstances illustrated by the *Love* case. If the suspensive conditions upon which a third party became entitled to a benefit from the contracting parties are fulfilled, while the resolutive conditions enabling the contracting parties to vary or eliminate the possibility of a third-party right have not been, then the third party can claim its entitlement and in general no cancellation or modification is possible thereafter in respect of that claim.[10]

5.12 The contract may, however, have no provision for modification or cancellation of the third-party right by the contracting parties. An example can be found in the third-party right forms provided by the Scottish Building Contracts Committee. In the Discussion Paper we considered various possible approaches to this kind of case.[11] The appropriate starting point seems to us to be through the basic principle of contract law that contracting parties may unmake or vary their contract as much as they make it in the first place; that is, by agreement.

5.13 If that is accepted, the approach already taken to the case where the parties *do* provide in some way for the cancellation or modification of the contract seems applicable once again. If at the point the third party otherwise meets the conditions upon which the right becomes enforceable the contracting parties have not modified or cancelled the term, there seems to be no compelling reason why the third party should be unable to claim its benefit as apparently provided for by the contracting parties. Such a rule is at least implied in the comparator instruments, and the Californian Civil Code provides expressly that "[a] contract, made expressly for the benefit of a third person, may be enforced by him at any time before the parties thereto rescind it."[12] So, if the partners of the firm Justitia & Quaestio agree that, subject to the profits of the business achieving a given level in any year, a certain share will be paid annually over the next three years to Tertia, a daughter of one of the partners, who is about to undertake doctoral research for the period in an expensive institute

[9] 1964 SC (HL) 46; for a summary of the facts see para 2.33 above.
[10] We discuss further below (paras 5.32-5.38) whether the undertaking itself may otherwise provide.
[11] At paras 6.7-6.18 of the DP.
[12] Californian Civil Code §1559.

of higher education in the USA, and there was no statement of irrevocability but also no revocation, and the relevant profit level was achieved in a particular year, then Tertia would be entitled to claim the money on that occasion.

5.14 This suggested approach was supported by almost all consultees. We accordingly recommend:

> **20. Where a contract sets up a third-party right, the fulfilment of conditions for the third party's entitlement to enforce the right will prevent any subsequent modification or cancellation by the contracting parties in respect of that third-party entitlement.**
>
> (Draft Bill, section 4(1))

5.15 Our example of the postgraduate student Tertia can be elaborated further to show as clearly as possible what we wish to achieve here. Depending on the way in which the relevant agreement has been drafted, Tertia may be seen as having a unitary right to all three payments, or (perhaps more likely) as three different rights to payment each arising in successive years. Whichever, her rights are subject to the suspensive condition of the firm's profitability in each of the years in question. If we suppose that the second analysis of three separate successive rights applies, and all goes well for the firm in year 1, Tertia's right to claim payment in that year crystallises. But her rights in years 2 and 3 are still vulnerable to the partners' decision to cancel or modify the content of the right prior to the crystallisation in those succeeding years.

5.16 Similarly, in the *Love* case, Mrs Love's claim is indefeasible once the condition of her husband's insanity is fulfilled; but that does not prevent the Society changing its rules for future claims by other dependants of members, whether to increase or diminish or eliminate altogether the amounts payable under the scheme. In the *Kelly* case, the driver son must be indemnified against liabilities incurred while he had permission to drive the car; but nothing prevents either his father or the father's executors withdrawing his permission after the accident has occurred. Any cancellations or modifications made by the contracting parties, however, cannot retrospectively affect actual claims existing under the provisions before the change was made.

5.17 We think, however, that this basic position should be a default one, in the sense that it should be possible for the contracting parties to provide in their undertaking to the third party for them to have a continuing power to cancel or modify the undertaking even after the third party's right has crystallised into an entitlement, as happened in *Love* or *Kelly*. Clearly if the parties retained an absolute discretionary power to do this, it would most probably mean that actually no third-party right was created in the first place.[13] But we think it possible to envisage less extreme clauses under which a right might be constituted and a third party entitlement become crystallised, yet the contracting parties had a power to cancel the undertaking and perhaps even to draw back previously rendered performances.

5.18 In the *Love* case, for example, the undertaking might be phrased on the basis that a right to monthly payments over the year was subject to the beneficiary continuing to live with her husband and support him in his illness throughout that time. It might also be possible to

[13] See paras 2.43-2.44 above.

provide that payments already made could not be retained after cohabitation ceased. The drafter of the contract would have to be careful, however, to ensure that the beneficiary's retention of payments made was conditional on her continuing cohabitation rather than creating a duty on her to return the money, since liability cannot be imposed on a third party.

5.19 Another example may be as follows. Jura Contractors and Quaesitum Contractors agree that neither will pursue the other, or one another's sub-contractors, for any damage caused in the course of a joint enterprise. They also expressly reserve to themselves a power to cancel or modify their agreement, including with retroactive effects. Tertius, a sub-contractor of Jura, seriously damages property belonging to Quaesitum, who thereupon wants to sue Tertius. Jura, which has its own reasons to be disgruntled with Tertius, is happy to let that happen. So Jura and Quaesitum exercise their power to modify their agreement to say that the immunity undertaking does not apply in relation to any claim that Quaesitum may bring against Tertius.

5.20 We think that situations of this kind will be rare for contracting parties whose objective is to create enforceable third-party rights. But we also understand the commercial desire to have as much flexibility as possible to deal with changing circumstances, and that we should not limit freedom of contract more than is absolutely necessary. We therefore recommend:

> **21. Where a contract sets up a third-party right, the contract may expressly reserve to the contracting parties a power to cancel or modify the undertaking with retroactive effect notwithstanding the fulfilment of any conditions for the third party's entitlement to enforce the right or the rendering of performance under the right. The power must, however, be consistent with the constitution of a third-party right.**
>
> (Draft Bill, section 4(2))

5.21 The factors mentioned in the comparator instruments as making a duly constituted third-party right uncancellable or unmodifiable have included notification to the third party; the third party's acceptance of the right; or the third party's reliance upon the right. Only the DCFR and the 1999 Act go on, however, to say that notwithstanding the presence of one or more of these factors the contract may still give the contracting parties entitlements to modify or cancel the third party's right. The 1999 Act also enables the contracting parties to provide for the third party's consent to any variation or rescission of its right as necessary in circumstances other than those mentioned in the statute. While there is nothing to parallel this in the DCFR, it does provide that the third party may, despite the contract term enabling the contracting parties to modify or cancel its right, be able to claim the benefit if the contracting parties led it to believe that the right was irrevocable and the third party acted in reliance upon that.

Notification to the third party

5.22 For the reasons set out in Chapter 2,[14] we see delivery and intimation as *potentially* (but not invariably) relevant to the *constitution* of the third-party right. In Chapter 4 we recommended that there should be legislative provision to the effect that neither delivery,

[14] See paras 2.39-2.42 above.

intimation or communication of the undertaking to the third party is *necessary* for the constitution of a third-party right; but this is without prejudice to the application of any other legal rules imposing requirements for the creation of an enforceable obligation.[15]

5.23 In the Discussion Paper we said that it also seemed entirely consistent with the general principles of Scots law that delivery and intimation of the contract (or the relevant terms thereof) to the third party (or its representative) by or on behalf of the contracting parties should be grounds for *thereafter* regarding that right as irrevocable or unmodifiable where the contract containing the provision in favour of the third party had nothing express on the matter on way or another; that is, was unconditional. This view was supported generally by consultees responding to the Discussion Paper on the point.

5.24 On further reflection, however, we have concluded that the concepts of delivery and intimation are at once too formal yet also too uncertain (in the present state of the law) and probably not relevant to accomplish that which we think needs to be achieved here.[16] Delivery is really of significance only to documents; but we are not imposing any requirement of writing for the existence of a third-party right. Intimation is normally notice to a debtor that it has a new creditor, rather than notice from a debtor to one who is already the creditor. That situation does not require the same level of formality as the former, where priority as between competing rights against the debtor may be in issue.

5.25 What needs to be recognised as making an unconditional third-party right un-cancellable or un-modifiable is action by the contracting parties to bring the undertaking to the third party's attention. We think this may be better captured if the legislation uses the concept of "notice" or "notification" rather than "delivery and intimation". The action by the contracting parties is what matters – it is they who will be deprived by it of their power over the undertaking – rather than whether or not the third party actually reads or receives the notice. But what the contracting parties do must be at least objectively capable of being understood as a notification of the undertaking. That might be by delivery of a document containing the undertaking, or by way of a communication either akin to intimation or less formal. But the mere fact that the third party knows about the undertaking (as in the *Carmichael* case) would not be enough to make it irrevocable by the contracting parties; the latter must be the source of the third party's knowledge.

5.26 Finally on this point, we think, in line with our general policy that the statutory rules in this area should be default in nature,[17] that the contracting parties should be free to provide that the notification of an unconditional right will nonetheless leave them free to cancel or modify that right; or, to put it another way, to give notice of an unconditional right subject to a reservation of the power to modify or cancel it.

5.27 Our recommendation is therefore:

22. Where a contract provides for an unconditional third-party right, the contracting parties will have no entitlement to modify or cancel the right if the undertaking conferring the right has been notified to the third party by

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[15] See recommendation 12 in para 4.18 above.
[16] For difficulties with delivery and intimation see McBryde, *Contract*, ch 4 and paras 12.93-12.96; Anderson, *Assignation*, ch 6.
[17] See paras 1.8 (final bullet), 1.38, and 1.44 above.

the contracting parties. This rule is subject to the freedom of the contracting parties to provide otherwise in the contract or the notification.

(Draft Bill, section 5)

Registration of the contract

5.28 In the Discussion Paper we asked whether registration of the contract (or at least of the undertaking in favour of the third party) in the Books of Council and Session or the sheriff court books should have the effect of making the undertaking uncancellable or unmodifiable unless the contract otherwise provided. The registered document could be seen as in effect a public commitment by the contracting parties and if it contains the appropriate consent to registration for execution, it will also be a basis for enforcement by summary diligence.[18] Clearly, as Lord Dunedin pointed out in the *Carmichael* case, the document on the register cannot be altered by anybody. This might seem a good basis for saying that the effect of such registration is that the contracting parties can no longer modify or cancel the third party's right. The suggested approach received general support from consultees.

5.29 We have, however, come to the view that there should be no provision on registration making the third-party right uncancellable or unmodifiable. While it is true that there can be no alteration to the document on the register, it does not follow that the parties to that document are unable to adjust the terms of their legal relationship as embodied in the document. The parties' rights are constituted, not by the registration, but by the document. Minutes of variation of registered documents are common in practice, we understand. Further, in its present non-electronic form the Books of Council and Session is "public" only in the sense that it can be accessed by the public; a document can be located in it, however, only by those searching with prior knowledge of the date of registration or other relevant information enabling them to reach it, such as party names and designations. In no practical sense can registration by itself be seen as equivalent to notification to the third party.

5.30 Our general policy as already outlined earlier in this Chapter is that contracting parties should remain free to cancel or modify their contract in respect of any third-party undertaking therein, until the conditions upon which the right becomes enforceable by the third party are fulfilled, or there has been notification to the third party of an unqualified undertaking in its favour. That, we think, should apply whether or not the document containing the contract and the undertaking in favour of the third party is registered. This leaves open the possibility under the present law that registration in the Books of Council and Session can sometimes be treated as a form of delivery or intimation by virtue of the document passing beyond the control of the parties through the process, and the publicity deemed to be given to a document thereby.[19]

5.31 We accordingly now recommend:

23. There should be no provision to the effect that any registration of the contract containing the undertaking in favour of the third party has the effect of making that party's right uncancellable or unmodifiable.

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[18] The execution may, however, be stopped by way of suspension or interdict.
[19] McBryde, *Contract*, paras 4.22-4.23.

Declarations of irrevocability by the contracting parties

5.32 A further question is, so to speak, the converse of the one just discussed: what if the parties specifically state in their contract that the third-party right for which it provides is to be irrevocable? While we are not aware of any case in which this has been considered in the context of third-party rights in contract, we do note the law's recognition of the firm offer which cannot be revoked because it contains a promise by the offeror not to do so.[20] This suggests at least the possibility of an effective declaration of irrevocability on one side only of an obligation.

5.33 Given the emphasis of our suggested reform upon the intention of the contracting parties, it is consistent to propose that an express declaration of irrevocability in the contract should be decisive for third-party rights, at least if the contracting parties make clear their intention to undertake such a commitment and that the other conditions for the existence of an obligation of this type have been fulfilled, e.g. as with the third-party right itself, the statement is directed towards an existing or identified third party, or is couched, as with the third-party right itself in many cases, in terms of a third person at some future point fulfilling conditions stated in the provision itself. So, for example, if the parties to a contract in favour of a named and existent third party (as in *Carmichael*) include in the contract a declaration of irrevocability, that should become binding upon them at the same time as the third-party right itself. But if the third-party right was of a conditional nature, as in the *Love* case, any declaration of its irrevocability in the contract would only become an effective source of obligation when a third party came into existence or was identified to be its creditor. A declaration of irrevocability without a creditor is itself revocable in the sense that no obligation exists at all until there is someone with the entitlement to enforce it.

5.34 Two other points about contractual statements seem worth making, although neither of them need be embodied specifically in our draft Bill. One is that while in general the third-party right and the declaration of irrevocability will come into effect simultaneously as sources of obligation for one or more of the contracting parties, it will also be possible for the parties to provide for a delayed effectiveness of the declaration. For instance, in the example of the postgraduate student Tertia, the partners might agree that their commitment to her would only become irrevocable after successful completion of her first year of study on the doctoral programme at the US university.

5.35 The second point draws on an analogy with the law of unilateral promises, under which it is possible for the promise to be made 'to all the world' by some sort of public statement: for example, the written promise of a reward, tied around a lamppost in the street, to any person who finds a lost cat, which may be enforced even by a party unaware of the promise at the time of locating and returning the cat to its owner. In the context of third-party rights, the publication on a publicly accessible website of the text of the contract including a commitment to an irrevocable third-party right would perhaps, as Professor Clive put it, "sufficiently externalise" the contract to justify the protection of resultant third party expectations.[21]

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[20] McBryde, *Contract*, para 6.57. It is unclear whether withdrawal of the firm offer is absolutely prohibited or gives the offeree merely a claim for damages: MacQueen & Thomson, *Contract*, para 2.21.

[21] For examples of third party contracts published on the Internet, see the Network Rail contracts (at paras 2.8, 2.26 and 3.3 above) and the oil and gas contracts (at note 46 to para 1.24 above). Neither of these included a statement of irrevocability, however.

5.36 Consultees were in broad agreement with the suggestion that contracting parties should be able to declare their conferral of a third-party right as irrevocable, although Professor Clive warned of possible confusion if the point was put in legislative form. We have sought to guard against this in our draft Bill simply by providing that nothing in it precludes contracting parties from providing for the irrevocability of their undertaking to the third party. We recommend:

24. An express statement in the relevant contract that a third-party right conferred by the contract is uncancellable and/or unmodifiable should be given effect.

(Draft Bill, section 3(2))

5.37 Where post-contract the contracting parties make a promise that the contract will not be cancelled or modified, and they have taken whatever steps may be needed to make that promissory statement effective and enforceable, there seems to be no difficulty in holding that the third party's right is indeed uncancellable or unmodifiable, as the case may be.

5.38 Consultees were in general agreement with this understanding, but Professor Clive pointed out that once the basic legislation on third-party rights is in place, it will not be necessary to include a provision to this effect, since it will follow logically from the general law on promises.[22] We accept this observation and, bearing in mind our preference for legislative economy in the current project, think that there is no need to make any legislative recommendation on the matter.

25. There is no need to provide for the enforceability of a post-contract promise to the third party by the contracting parties that a third-party right conferred by the contract is uncancellable or unmodifiable.

Reliance and personal bar

5.39 In the Discussion Paper we gave much attention in different contexts to the possible effects of representations of irrevocability by the contracting parties outside the contract, and of reliance upon its putative right by the third party, and more generally on the possible application of personal bar to prevent modification or cancellation of the third-party right by the contracting parties.[23] We now think, in the light of consultation responses, that these matters may be treated in a more unified way: we consider that there is no general need to differentiate between the situations where, on the one hand, the contract makes provision for modification or cancellation by the contracting parties and, on the other, it does not.

5.40 Furthermore, for the reasons we develop below, we consider that it would be preferable to develop a bespoke ground on which irrevocability is founded rather than make any use of the doctrine of personal bar. In that regard, we note that the Senators of the College of Justice, in their response, cautioned against reference to personal bar in any legislation on third-party rights because of the "imprecision of that principle". While we think that recent writing has done much to clarify the law of personal bar,[24] we believe that – in the

[22] For which see McBryde, *Contract*, chapter 2; *Regus (Maxim) Ltd v Bank of Scotland plc* [2013] CSIH 12, 2013 SC 331 paras 33-34 (Lord President Gill).
[23] See paras 6.7-6.30 of the DP.
[24] See in particular E C Reid and J W G Blackie, *Personal Bar* (2006).

present context – the best approach may be that which the Senators in effect recommend. Personal bar has a statutorily defined role in respect of contracts where formal writing is required, but what is much less certain is its role in other types of contract. Given that our recommendations are to cover all contracts, however formed, it therefore appears to be preferable to specify, by means of a special rule, what is to happen where, for example, a contracting party learns about a third party's reliance on its putative right and does nothing to prevent that reliance. To require the doctrine of personal bar to undertake this work might produce outcomes which are not always those we would intend, and that would not be a useful piece of law reform.

5.41 The comparator instruments give an indication of what measure might be needed, although, in at least one aspect,[25] we consider that it would be beneficial to go further than they do. The DCFR protects the third party's reliance upon any statement of irrevocability emanating from the contracting parties but not forming part of the contract.[26] Under the 1999 Act the detrimental reliance of the third party on the existence and enforceability of its right under the contract is a basis for making that right uncancellable and unmodifiable. This differs from the DCFR in that the reliance is not necessarily based upon any prior statement or representation by the contracting parties. Rather, the third party acts to its detriment thinking that it can do so as a result of having the right; the role of the contracting parties is simply to know that the reliance is taking place, or that the reliance ought reasonably to have been foreseen. In our example of paying for Tertia's study in the USA,[27] it would be enough under the 1999 Act to make her right uncancellable or unmodifiable if she knew of the partners' agreement and thereupon embarked upon her doctoral research; and the partners knew of this. Tertia would not also have to show that she had either sought or received any statements from the partners about cancellation or modification. On the other hand, if to Tertia's knowledge the partners' agreement contained an express clause reserving their right to dissolve the partnership by agreement at any time during her period of study, we think that she would have to show some further statement by the partners that this right would not be exercised before any subsequent reliance could be effective to prevent its use against her.

5.42 A further requirement for there to be reliance is that the third party previously knows about the existence of the right. Actings in ignorance of the right cannot be reliance on that right. It would not be appropriate, however, to require that the third party become aware of the provision in its favour by something as formal as intimation.[28] In the scenario of *Lamont v Burnett*, for example, the husband seller might pass over to his wife at the breakfast table the buyer's letter saying that the latter intended to make a payment to her, so that she could read it for herself.[29] We would be inclined to leave it to the courts to determine whether there are any means of a third party acquiring knowledge of a right – for example, by way of another person's breach of confidence - which should prevent that person relying on the right so as to make it irrevocable.

5.43 There are limits on the extent to which reliance can make a right irrevocable. If we return to the Tertia example once again, her reliance in going to the USA would leave her

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[25] See para 5.47 below.
[26] DCFR II.-9:303(2) and (3); see also PICC Art 5.2.5. Contrast CESL art 78(5), which was confined to situations in which the contracting parties have given the third party notice of its right.
[27] See paras 5.13 and 5.15 above.
[28] Another example of third party reliance being held relevant in establishing the existence of the right is *Rose, Murison and Thomson v Wingate, Birrell & Co's Tr* (1889) 16 R 1132.
[29] *Lamont v Burnett* (1901) 3 F 797; see para 2.10 above.

irrevocable right still subject to the suspensive condition of the partnership achieving certain levels of profit in each of the years of her studies; and indeed the condition of her continuing her studies throughout the relevant period. Further, the right might be frustrated altogether if the partnership was dissolved upon insolvency during the period of Tertia's studies. Also, no act of the third party before the right exists can be reliance on that right. This is most obviously true where the third-party right is in favour of a class of persons but no specific member of the class has yet been identified. No activity of Mrs Love prior to the illness of her husband could constitute reliance by her on the third-party rights of members' dependants as set up by the Amalgamated Society of Lithographic Printers of Great Britain and Ireland.[30]

5.44 It also seems to us that if reliance is to form any sort of basis for making a third-party right irrevocable there needs to be also some protection for the contracting parties, at least along the lines set out in the 1999 Act, and possibly going further, to deal with such matters as what kind of knowledge, how much reliance and how much detriment are necessary to deprive these parties of any entitlement to modify or cancel the right. As we pointed out in the Discussion Paper,[31] a model lies readily to hand in the statutory *rei interventus* formulation of the Requirements of Writing (Scotland) Act 1995 ("RoWSA") which, paraphrased to fit the context provided by the example of Tertia the postgraduate student, would provide that where she acted or refrained from acting in reliance on her right with the knowledge and acquiescence of the partners, the latter would not be entitled to modify or cancel her right, provided that her position (1) had been affected to a material extent by her actings or refraining from acting and, further, (2) would be adversely affected to a material extent by the contracting parties' cancellation or modification of the undertaking. Thus Tertia would have to show that she had indeed incurred significant expense in entering the programme of study in the US institution, and also that there would be adverse consequences for her if the partners did not fulfil the obligation: for example, that she would not be allowed to continue her studies because her fees were unpaid.

5.45 While a provision like this would not eliminate all uncertainty about third party reliance and detriment (as some consultees pointed out, there will be difficulties of proof), it would make clear that the contracting parties had to know about, *and acquiesce* in, the third party's behaviour; further, not only must the third party's interests have been *materially* affected by its own conduct but they must also be further materially affected by the proposed cancellation or modification. We think that it would be clear that the right rendered irrevocable would still be subject to any suspensive conditions for its enforceability, such as the profitability of the firm in Tertia's case; while if the partners' agreement reserved a power to dissolve the partnership during Tertia's period of study it would be at least open to question whether they could be held to have acquiesced in her subsequent reliance unless there had been some further statement by them to show that this was indeed the case.[32]

5.46 The use of the formula derived from RoWSA would have the additional benefit of making relevant the case law under that Act (admittedly not extensive, but that may confirm the value of the formulation). Consultees were supportive of such an approach. In our view, it is preferable to pair this approach with an express displacement of the rules of personal

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[30] *Love v Amalgamated Society of Lithographic Printers of Great Britain and Ireland* 1912 SC 1078.
[31] See para 6.26 of the DP. The relevant provisions are s 1(3) and (4) of RoWSA.
[32] On whether acquiescence is more than mere failure to object under RoWSA, see E C Reid and J W G Blackie, *Personal Bar* (2006), paras 7.17-7.20; cf McBryde, *Contract*, para 5.77(3).

bar, in so far as they would otherwise be available to found a claim by a third party. In this way, there would be clarity as to what the relevant test was, and there would be no confusing duplication between the new law and the current personal bar rules. We accordingly recommend:

> **26. A third-party right becomes uncancellable or unmodifiable where, to the knowledge, or with the acquiescence, of the contracting parties, (i) the third party acts (or refrains from acting) in reliance on knowledge of its right, and (ii) the third party's position is thereby affected to a material extent, and (iii) subsequent cancellation or modification of that right by the contracting parties would adversely affect the third party to a material extent. In so far as the rules of personal bar or waiver might otherwise be available in such a situation they are to be expressly disapplied.**
>
> (Draft Bill, section 6)

5.47 This would, however, not reach the 1999 Act's case of reliance that was reasonably foreseeable by, but not at the time it took place actually known to, the contracting parties. Consultees broadly agreed that this case should be covered as well while again foreseeing difficulties of proof. We agree that there may be some difficulties in establishing reasonable foreseeability, though the objective assessment and evaluation of evidence which would be needed in such situations is something at which the courts are practised in many other areas. We therefore recommend:

> **27. In addition, such third party reliance as is reasonably foreseeable by the contracting parties (although they had no actual knowledge of it at the time it happened) should also have the effect of making the third-party right uncancellable or unmodifiable.**
>
> (Draft Bill, section 6(1)(d)(ii))

5.48 Consultation on the draft Bill as it gave effect to the two preceding recommendations raised the question of whether the contracting parties should be able to restrict or exclude the third party's reliance making its right uncancellable or unmodifiable by way of advance provision in the contract. Karen Fountain of Brodies offered us two possible examples where such restriction or exclusion might be desirable for the parties concerned. The first is akin to our own earlier in this Chapter, that of the postgraduate student Tertia and the partnership.

> [Suppose] there is a financial payment right granted by contracting parties in a family business partnership or shareholders agreement, to their adult child and that child's grown up (but irresponsible) children but the contracting parties want to be able to change the arrangements freely without the grandchildren's consent so long as the parent agrees. So long as the grandchildren are positively told they can't rely on the right not being withdrawn at any time (either absolutely or if their mum/dad agrees) why not allow certainty? Otherwise if Irresponsible Oaf 1 goes out and buys a Rolls Royce in joyful anticipation there may be questions about whether this should have been foreseen and whether showing an interest amounts to acquiescence.[33]

[33] Email dated 29 January 2016.

5.49 The second example runs as follows:

> In a fund doc you might have an indemnity covering the Manager and the Manager's staff and you want any changes just to need the consent of the Manager (the Manager's staff will know that as regards the fund they are subject to whatever the manager agrees from time to time and they need to rely on the Manager's discretion). Once you introduce reliance into this it gets tricky as it invites questions about whether you have relied simply by continuing to do your job in a way which may expose you to risks. Sometimes you want to tweak indemnities to reflect commercial arrangements with investors and if you would need to go back to all current and former employees who may have potential claims relating to past acts depending on how things pan out, you have an issue.[34]

5.50 In line with our general approach that the legislation should give rise only to "default" rules, and in the light of Karen Fountain's examples, we take the view that it should be possible for the contracting parties to contract out of the irrevocability effects of third-party reliance.[35] We note in this regard that the 1999 Act makes its reliance provision subject to the express terms of the contract.[36] Further, the DCFR specifically provides that while in general contracting parties may not remove or modify the TPR once the third party has been given *notice* of its right, the contract may otherwise still determine whether and by whom and in what circumstances the right can be revoked or modified after that time.[37] Having already expressly provided in our draft Bill for the same position with regard to the effect of the fulfilment of suspensive conditions, it follows that there should also be an express provision on the exclusion of third-party reliance. But given that the reliance rule rests essentially on considerations of fairness for the third party, it must be necessary for any exclusion thereof in the contract to have come sufficiently to the attention of the third party so that it knows or ought to know that any act of reliance is at its own risk.

5.51 We therefore recommend:

> **28. The contracting parties may provide in their contract that third party reliance in terms of recommendations 26 and 27 will not have the effect of making the third-party right uncancellable or unmodifiable. But to be effective such an exclusion must be known to the third party before any act of reliance by that party.**
>
> (Draft Bill, section 6(3))

[34] Email dated 29 January 2016.

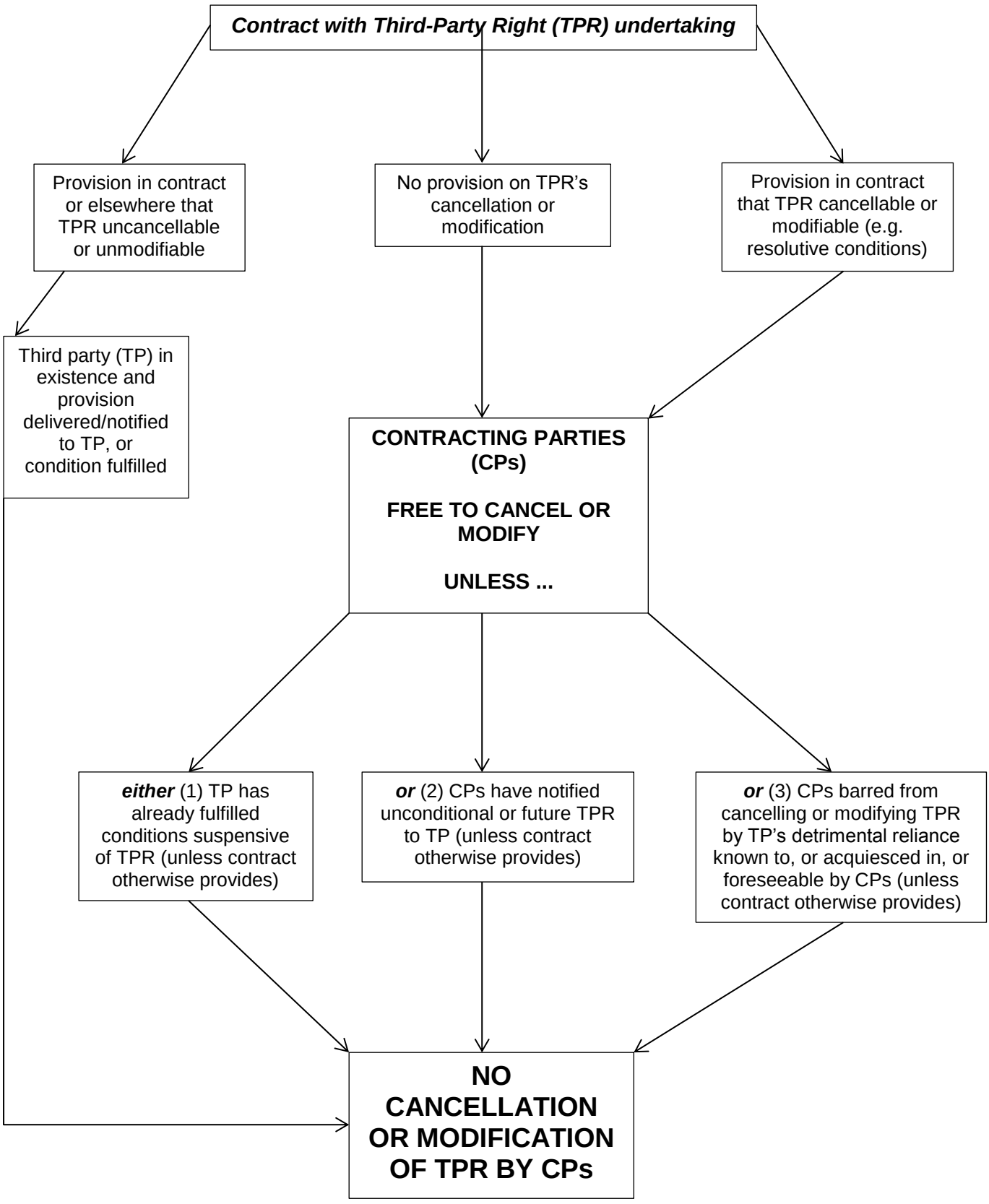
[35] Another possible example that has been put to us where such a power to exclude the possible effects of third-party reliance would be useful is a construction project in which some sub-contractors are nominated by the employer while others are "domestic" to the contractor. The employer may wish to have the freedom under the main contract to change the position of the nominated sub-contractors without any barriers being posed by their or any other party's reliance on any third-party right there may be in that contract.

[36] 1999 Act, s 2(3).

[37] DCFR II.-9:303(2). For the more general provisions of the DCFR (and the PICC) making their third-party rules "default" in nature, see para 1.38 above.

Figure 5.1

This diagram illustrates the recommendations made in this chapter on when third party rights become incapable of cancellation or alteration by the contracting parties.



5.52 It may be useful to pause here and consider how the scheme on reliance just outlined will interact with that on notification of the third party by one or more of the contracting parties of an unconditional third-party right. Both schemes set up exceptions to the general position that contracting parties are free to modify or cancel a third-party right. With regard to the first of them, however, if the contract expressly provides for cancellation or modification, then the undertaking is not unconditional, and the scheme does not apply. A conditional undertaking cannot be converted into an unconditional one by mere notification to the third party. The third party is simply notified of the undertaking as it is, so to speak.

5.53 With this understanding of the scope of the notification scheme, we can see that the reliance scheme will be relevant to the following situations:

> (1) an *un-notified unconditional undertaking* about which, however, the third party has learned and upon which it has relied with the acquiescence of the contracting parties (i.e. they know about the third party and what the third party is doing but do nothing to stop it), or in a manner that was reasonably foreseeable by the contracting parties;
>
> (2) a *notified unconditional undertaking where the contracting parties have in their notice reserved their entitlement to cancel or modify*; but then later on acquiesce in third-party acts of reliance on the undertaking or ought reasonably to have foreseen that happening, their reservation notwithstanding, the third party would act in reliance on the undertaking (this last will, we think, be very unusual but not impossible);
>
> (3) a *conditional undertaking*, whether notified to the third party or not, upon which there is the appropriate third-party reliance. Such reliance must necessarily be based upon the third party's knowledge of the undertaking, however acquired. The contracting parties are protected generally against loss of their power to cancel or modify through unknown third-party acts by the requirements of their acquiescence or the reasonable foreseeability of the acts in question. But any exclusion of the effect of reliance must be expressed specifically in the contract, and the third party must know or ought to know of the exclusion. This might be by way of notice from the contracting parties. But the third party who gets to know about the favourable aspects of the undertaking other than through the contracting parties can also be reasonably taken to know about its unfavourable aspects as well. For this reason no more than a contractual exclusion of the reliance scheme is required to protect the contracting parties against it.

5.54 One further question has occurred to us in our consideration of third-party reliance. Can the same set of facts both constitute a third party right under RoWSA *and* make the third party right in that contract irrevocable? For the question to arise at all, there will have to be an informal agreement that includes an undertaking in favour of a third party. Further, and whether or not the agreement is one that requires formal writing to be a contract, the third-party right will need to be one which in its own right requires formal writing as a gratuitous unilateral obligation not undertaken in the course of business (and not concerned with a real right in land).[38] An example might run as follows:

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[38] Note that section 1(3) and (4) are inapplicable to any document (including a unilateral one) for the creation, transfer, variation or extinction of a real right in land: RoWSA s 1(3) as interpreted in *Advice Centre for Mortgages Ltd v McNicoll*, 2006 SLT 591; *Gyle Shopping Centre General Partners Ltd v Marks and Spencer plc* [2014] CSOH 122, 2015 SCLR 171.

> Julia agrees with Quintilian to sell a cottage at a price determined by a valuer. They also agree that, once the valuation is made, the property should be offered first to Terence at that price. Only if Terence does not accept that offer can Quintilian proceed to purchase. The agreement is not reduced to formal writing.

5.55 Here the lack of formal writing means that there is not yet a concluded contract of sale between Julia and Quintilian. But their agreement also sets up a putative third party right in favour of Terence as a result of which, and if there was compliance with all necessary formalities, Terence could seek implement or damages if the property was not offered by Julia to him once the valuation is reached. Further, even in the absence of completed formalities, any acting by Terence which amounts to relevant reliance under section 1(3) and (4) of RoWSA means that, despite their agreement not having been reduced to writing, Julia and Quintilian cannot withdraw from their obligation to Terence; which, further, cannot be regarded as invalid.[39] It therefore seems to us that when section 1(3) of RoWSA says that the debtor in the obligation is not entitled to withdraw from the obligation after the creditor's reliance, it achieves a kind of irrevocability of that obligation. In our example, only with the consent of Terence could Julia and Quintilian cancel or modify the obligation in his favour.

5.56 There is accordingly no need for the scheme set out in section 5 of our draft Bill in this context. The section's presuppositions are that a third-party right has *previously* been constituted, but that it remains subject to cancellation or modification by the contracting parties. To be relevant, the third party's reliance must take place only *after* constitution of the revocable right. But the constitution which is achieved under section 1(3) of RoWSA *already* entails the inability of the debtor contracting party or parties to withdraw, so that the presuppositions of draft section 5 are not engaged. This seems to us to be the appropriate outcome. It does not require any provision in our draft Bill to be achieved, however, since it follows from the existing wording of RoWSA. We therefore need make no recommendation on the matter.

Assignation of the third-party right

5.57 A further issue is the effect of assignation of the third party's right. We see no reason to doubt that in general, and subject to the usual rules of *delectus personae* and any contractual prohibition, a third-party right is assignable.[40] This is especially straightforward when irrevocability is a pre-condition for the right's existence. But if a third-party right may exist while being at the same time cancellable or modifiable, as proposed in this Report, assignability may be a more complex question. If there is an assignation by the third party while the right remains uncancelled or unmodified, to what extent is the assignee's right subject to the contracting parties' power to cancel or modify? Can the assignee claim the benefit of the suggested rules on fulfilment of the conditions upon which the third party's right becomes enforceable?

5.58 We think that in principle if the third-party right has become irrevocable before the assignation takes place, then the third party's assignee receives the same irrevocable right, the assignation being completed by its formal intimation to the contracting parties (in which

[39] It is also to be noted that the invalidity of the contract is not necessarily a barrier to the existence of a third-party right thereunder: see paras 2.46-2.47 above and paras 6.19-6.20 below.

[40] Note the SBCC provisions on assignment of collateral warranties and third-party rights (in para 6 of Schedule Part 5 (Part 1) for purchasers and tenants, and in para 10 of Schedule Part 5 (Part 2) for funders).

process, it must be remembered, they are entirely passive recipients of notification and which cannot therefore constitute any sort of personal bar against them).[41] It could, however, be suggested that the assignation is a form of reasonably foreseeable reliance by the third party, and detrimental because as cedent it comes under contractual duties to the assignee.[42] This should therefore make a previously revocable right irrevocable. On this argument, assignation and irrevocability would be concurrent events.

5.59 If we suppose, however, that the right remains or continues to be cancellable or modifiable by the contracting parties at and after the time the third party assigns, the question becomes first one of whether a cancellable or modifiable right can be assigned. We think that since there is a right in existence, this is a stronger case than that of an attempt to assign a *spes successionis* or an unvested right of a beneficiary under a will or a trust, and the assignation is accordingly competent.[43] The assignation will be completed by intimation to the contracting parties, and the assignee takes the risk that they will exercise the power to cancel or modify. Must subsequent acts by the contracting parties relate to the assignee rather than the third party, either to cancel or modify the right, or to make it irrevocable against the assignee? Should the reliance of the assignee upon the right be relevant to prevent cancellation or modification by the contracting parties?

5.60 The problem was considered by the Law Reform Commission of Hong Kong in its Report on Privity of Contract. In a system where intimation is not necessary to complete an assignment, they thought that the answer would depend upon whether or not the contracting parties had received notification of the transaction between the third party and the assignee. After notification, actions either to revoke the contract or to make it irrevocable would have to be by the contracting parties and/or by/to the assignee.[44] It might be argued that the assignee's undertaking the assignation was a form of detrimental reliance (since it would presumably have paid the third party for the transfer). So there could be an argument once again that assignation and irrevocability are concurrent events. But the assignee's act of reliance could have occurred, or at least begun, before the assignation is complete.

5.61 The 1999 Act contains no provision on the assignment of third-party rights: the Law Commission for England & Wales saw no good reason why such assignment should not be possible but thought no legislation was needed to make the position clear. Section 12 of the Hong Kong Contracts (Rights of Third Parties) Ordinance 2014, by contrast, contains a general provision permitting third party assignment of its right "in the same way as a party to the contract may assign a right under the contract". But it does not deal with the issue identified by the Law Reform Commission of Hong Kong in its 2005 Report.

5.62 We do not think that there is any need in Scots law for legislation to make clear that in general a third-party right can be assigned. On the further question whether it is necessary to make some provision about the effects of assignation by the third party in

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[41] Anderson, *Assignation*, para 6.02.

[42] Implied warrandice that the claim assigned subsists and that the cedent has conferred on the assignee everything necessary to make the claim effectual (see Wilson, *Scottish Law of Debt*, para 27.8).

[43] See discussion in Wilson, *Scottish Law of Debt*, para 1.1 (*inter alia* quoting J G Stewart, *A Treatise on the Law of Diligence* (1898), p 81: "Where, however, the right has vested in the common debtor, although it is not yet prestable, or is liable to be defeated by the occurrence or non-occurrence of some event before payment, arrestment will be sustained for what it may ultimately prove to be worth"); G L Gretton, "The Assignation of Contingent Rights" 1993 JR 23, 26-37; McBryde, *Contract*, para 12.30.

[44] Law Reform Commission of Hong Kong, Report on Privity of Contract (2005), para 4.189.

relation to making its right irrevocable, consultees in general responded negatively, although Greg Gordon thought that a provision could dispel un-necessary doubt on the matter.

5.63 On balance, we think that the third party's assignation of its right can be seen as an act of reliance which might in appropriate circumstances – i.e. those described in recommendations 26 and 27 – make the right not cancellable or modifiable by the contracting parties. So we agree with the majority of consultees that no further provision is needed on this issue. We therefore recommend:

29. No provision is needed about the effects of assignation in relation to making a third-party right uncancellable or unmodifiable. Where appropriate the proposed rules on third party reliance may provide routes to solutions in problem cases.

Third party's acceptance

5.64 We also do not think that the third party's 'acceptance' should be borrowed from the PICC or the 1999 Act as a relevant consideration to make a third-party right irrevocable where the contract has made no provision on the matter. This would seem inconsistent with the view that third party acceptance is unnecessary for the constitution of the right (revocable or otherwise) in the first place,[45] and to be a recipe for confusion. Consultees were in universal agreement with this view as expressed in the Discussion Paper. A declaration of acceptance is not by itself an act of detrimental reliance by the third party, even if made to the contracting parties, although it might be relevant to whether acts of reliance by the third party were thereafter known to or reasonably foreseeable for the contracting parties.[46]

5.65 We accordingly now recommend:

30. There should be no provision to the effect that any purported acceptance of the right by the third party has the effect of making the right uncancellable or unmodifiable.

5.66 The question of the third party's remedy should contracting parties cancel or modify its right despite irrevocability having arisen is a matter that we deal with in the next chapter. By way of foretaste, however, it can be said here that while the remedy of specific implement is available to the third party, that remedy is subject to the usual constraints; accordingly the third party may in at least some circumstances have only a claim for damages when contracting parties act contrary to the irrevocability of the right.[47]

Other issues

5.67 A number of further questions raised in the Discussion Paper also produced a clear consultation response that no legislative action was needed upon them provided that the core reforms already set out were implemented.

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[45] See para 4.29 above.
[46] See paras 5.39-5.47 above.
[47] See further para 6.13 below.

5.68 The Discussion Paper noted that in current Swiss law death of the third party with its right unrevoked by the contracting parties means that the latter lose any power to revoke the right, presumably with the effect that it transmits to the deceased's estate,[48] and asked whether there should be a similar provision for Scots law. Consultees thought that the answer to the problem would vary according to the facts of the case, and that a general rule would not work.[49] The Senators of the College of Justice asked why the estate should be placed in any better position than the deceased third party. We therefore recommend:

31. There should be no legislative provision on whether the third party's death prior to any cancellation or variation of the contract containing its right has the automatic effect of making the right uncancellable or unmodifiable so that it becomes enforceable by the deceased's executors.

5.69 The Discussion Paper raised a question about the third party declaring a trust over its right, noting various different factual permutations: the third party (TP) might be sole trustee for the benefit of a fourth party,[50] or the TP might transfer the right to a fourth party trustee to be held for its own (i.e. TP's) benefit, or the TP might transfer it to a fourth party trustee for the benefit of a fifth party. To gauge views on how such scenarios might affect the contracting parties' ability to revoke or modify the third party's right, the Discussion Paper asked if there should be some provision about the effect of a third party declaring a trust over its right. Consultees were unanimous in their view that such provision was not needed. As with assignation by the third party, a declaration of trust over its right might be seen in at least some circumstances as a relevant act of reliance making the right uncancellable or unmodifiable. But that can be left for decision in any case where the question arose.

5.70 We accordingly recommend:

32. In relation to making a third-party right uncancellable or unmodifiable, there should be no provision about the effect of the third party declaring a trust over its right.

[48] Basler Kommentar OR I (5th edn, 2012) Gonzenbach/Zellweger-Gutknecht, Art 112, N 18 (a reference for which we are indebted to Dr R G Anderson, Advocate).
[49] For the effect of death in the law of contract generally, see McBryde, *Contract*, ch 26, pt 1.
[50] Under the conditions set out in *Allan's Trs v Lord Advocate* 1971 SC (HL) 45.

Chapter 6 Renunciation, Remedies and Defences

6.1 In the corresponding Chapter in the Discussion Paper we considered a range of significant issues, most of which concern the interaction of third-party rights with the general law.[1] The overall question that we asked was whether these matters might be left to the general law or whether there should be provision in any legislation arising from this project for the avoidance of any doubt there may be. The answers may of course vary with the topic under consideration at any point.

Renunciation or rejection of its right by the third party

6.2 Following the lead of the comparator instruments (apart from the 1999 Act), we asked whether there should be statutory provision to make clear that the third party can renounce or reject its right, with the effect of bringing the right to an end. It seems clear in principle that a third party should be able to do so: an unwilling third party could not, in practice, be forced to receive a benefit from the contracting parties. It would also be entirely unreasonable if third parties could refuse rights in their favour, communicate the refusal to the contracting parties, and then change their minds and demand their rights after all.

6.3 Consultees were broadly agreed that, in the absence of any authority on the matter in the present law, a statutory provision enabling renunciation of its right by the third party would be beneficial. In answer to the further question whether the renunciation should have to be express or might additionally be implied from a third party's conduct, most consultees answered affirmatively, although Professor Clive thought that there would be greater certainty if renunciation had to be expressed by the third party.

6.4 Since the law does not currently require acceptance on the part of the third party, and we do not propose any adjustment of that position, it follows that generally the renunciation of the right must be something more than mere passivity in response to the prospect of benefit. The third party must actively renounce the right in some way. That will commonly be by way of express words or writing but we do not think that it should be confined to such statements. An implied renunciation might take the form of, for example, the third party returning to the contracting parties delivered documents providing for the right.[2]

6.5 The Discussion Paper also considered the situation where the third party's conduct initially gives an impression of willingness to receive the benefit to the prejudice of the contracting parties before a renunciation is made. One possible solution was to allow renunciation only upon condition that the third party reimburse any out-of-pocket expenses for the contracting parties and return any part of the benefit already received. There was also the further possibility that the third party's conduct might be such as to give rise to a personal bar enforceable against it by the contracting parties. The latter would, however, be

[1] See Ch 7 of the DP.
[2] See paras 7.37-7.38 and 7.41 below for discussion of the possibility of implied renunciation of a third-party right to arbitration by the third party first raising a court action in relation to the disputed matter.

an extreme solution if its effect was to enable the contracting parties to confer, or continue to confer, a no longer wanted gratuitous benefit upon a third party.[3] A final possibility was to make it possible for a third-party right to be renounced as a whole, or in part. The latter possibility would seem to require that the right was divisible in some way.

6.6 Consultees expressed varying views on these scenarios and the need for the proposed statute to deal with them. We have come to the view that no statutory provision is necessary. In particular there seems to be no need to say anything about personal bar. Again, in principle we think it clear that an unwilling third party could not be compelled to go on receiving a benefit, and that return to the contracting parties of any part of the benefit already received by the third party could probably be achieved by way of the law of unjustified enrichment if necessary.[4] If the benefit is divisible in some way – for example, a right to a regular series of payments – then we do not think there would be any difficulty in the way of partial renunciation by the third party. Each instalment could be regarded as giving rise to a separate right for the third party, and the possibility of renouncing any one of them would be open under the statutory provision recommended above. This would, we think, be the way in which the third party barred from rejecting benefits already received could prevent further, unwanted performances by the contracting parties.

6.7 It seems clear in principle that our general preference for the legislation to provide only "default" rules capable of exclusion by express provision in the contract cannot apply to third party renunciation, since otherwise contracting parties could force rights and benefits upon persons who do not want them.

6.8 We accordingly recommend:

33. The statute should provide that a third party may renounce or reject the right conferred upon it by the contracting parties, with the effect that the right then falls.

(Draft Bill, section 10)

34. Such renunciation of a third-party right may be express or implied from the third party's conduct, although the mere passivity of the third party will be insufficient.

(Draft Bill, section 10)

35. No further provision is needed to protect contracting parties against unfairness to them resulting from the third party's renunciation of its right, or to say that the third party's power to renounce cannot be excluded by the contracting parties.

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[3] Compare the classic contract case of *White & Carter (Councils) Ltd v McGregor* 1962 SC (HL) 1 (where, however, the recipient of the unwanted performance was under a contractual obligation to pay for it).

[4] E.g. by way of the *condictio ob causam finitam* or, perhaps, the *condictio causa data causa non secuta*: see further R Evans-Jones, *Unjustified Enrichment*, vol 1, ch 4 and ch 6.06-6.11.

Remedies available to the third party

6.9 We noted above that there is no doubt amongst modern writers on the law that a third party can sue for payment due[5] or specific implement in enforcement of its right. Thanks to doubts expressed long ago in Gloag on Contract, there is some uncertainty about the scope of a third party's claim for damages against a non-performing contracting party.[6] The third party's loss, according to Professor McBryde, is the measure of the damages claim when available. The third party is further able to waive or discharge the claim.[7] The general approach of the comparator instruments on this subject is to give the third party all the remedies that are appropriate to enforce the right it has under the contract.

6.10 Although it might seem from this that the matter of which remedies should be available to third parties could be left to be determined by the general principles of Scots law on remedies, we asked whether the proposed statute should provide that third parties have at their disposal all the remedies appropriate for the enforcement of their right. Consultees were broadly agreed that there should be such statutory provision. There would be benefit in the removal of the lingering doubt as to the availability and scope of a damages remedy for the third party.

6.11 We also suggested that the approach taken to this aspect of the subject under the 1999 Act, under which third parties have the same remedies available in an action for breach of contract as if they had been a party to the contract, is inapt to the form of third-party right that will exist in Scots law if our proposals become law, and that the wording of the DCFR (which provides for the third party to have the same remedies as though a binding unilateral undertaking had been made in its favour) might be a more useful model in a system recognising the unilateral promise.[8] This was in line with an earlier suggestion in the Discussion Paper that analogies with other legal institutions might be drawn in the legislation where it was helpful to state a rule shortly rather than having to be elaborated at length in a bespoke manner.

6.12 Consultees were very largely in favour of such an analogy being drawn in the case of third-party right remedies, though some favoured an analogy with contractual remedies whereas another considered the promise to afford a preferable analogy. Professor Clive, however, urged upon us the model provided by Article 78(3)(a) of the proposed CESL, under which the third party has the same rights to performance and remedies for non-performance as if the contracting party (or parties, as the case may be) was bound to render the performance under a contract with the third party.

6.13 Upon reflection, we consider something like this to be the best approach. Unlike the 1999 Act, it does not artificially regard the third party as a party to the contract. But it draws upon the analogy of contract, in which the law of remedies is in general well-developed. In contrast, the law on remedies for breach of a unilateral promise is not given much if any coverage in the standard works. Professor Clive's suggestion is also in line with our general preference in this project for making analogies with contract law where such analogies are needed. In particular, it would be clear that in appropriate cases the third party has a right to claim damages, while the question of whether or not the third party has a right to rescind or

[5] This is the case in the majority of third-party right claims: *SME* Vol 15, para 837.
[6] See above para 2.49.
[7] McBryde, *Contract,* para 10.24.
[8] See para 2.4 of the DP.

terminate to prevent repeated unsuccessful attempts by a contracting party to perform (as distinct from the entitlement to renounce the right already discussed above), or alternatively a right to seek cure or replacement performance from the contracting party as an aspect of specific implement, could be left until the occurrence of a case actually raising the matter. Specific implement would be subject to the already existing limitations on that remedy.[9] This might become particularly important where contracting parties purport to revoke a right which has previously become irrevocable as a result of the earlier fulfilment of a suspensive condition or the preceding reliance on the right by the third party. If, for example, performance of the right had become impossible or would impose undue hardship on the contracting parties, then the third party's claims might be restricted to damages.

6.14 In line with our general policy on this point, we think that the contracting parties should be free to define the remedies with which a third party may enforce its right, whether to exclude, restrict or indeed extend them.

6.15 We accordingly recommend:

> **36. The statute should provide that the third party has at its disposal all the remedies for breach of its right to which a contracting party would be entitled were the undertaking in favour of such a party. But the contracting parties should be left free to define the remedies with which a third party may enforce its right.**
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> (Draft Bill, section 7)

6.16 We should stress that this clarification of the ability of the third party to make a damages claim is not intended to provide any solution to the problem of "transferred loss" or "black hole" damages claims for or by third parties, to which the Discussion Paper adverted briefly in a different context.[10] While third-party rights may be an aspect of the solution of that problem, it seems to us at present to be wider than that in its overall scope. Our current intention is therefore to consider it in our forthcoming work on remedies for breach of contract.

6.17 Although consultees were again broadly agreed that the remedy of rectification of the document embodying the contract under sections 8 and 9 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985 should be available to the third party claiming that a document failed to express the original parties' common intention to confer a third-party right, we think that there is no need for our proposed statute to say this, since the 1985 Act does not expressly restrict the remedy to the parties to the document to be rectified.

Defences

6.18 The 1999 Act, the DCFR, the PICC and the proposed CESL each allow the party bound to perform under the right in favour of the third party to assert against the third party all defences which the party bound to perform could assert against the other party to the contract. If, as we propose above, the statute allows the third party to use any remedies which would in general be available as though the relevant contracting party was bound

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[9] See McBryde, *Contract*, ch 23, especially at paras 23.15-23.22.
[10] See paras 3.11-3.14 of the DP.

under a contract with the third party, the logical counterpart rule on defences would be broadly similar to that expressed in the comparator instruments. We asked in the Discussion Paper whether the proposed statute needed to include some such provision. Although consultees' views were divided, the majority (including the Judges, the Faculty of Advocates and Professor Clive) thought that some general provision along these lines should be included.

6.19 In the Discussion Paper we expressed the view that it might be necessary to add to such a provision some specific protection for the third party's interest where the reason for the contract's failure does not directly affect the third-party right. Unlike the position with assignation, where the assignee steps into the shoes of a contracting party and is therefore subject to all the defences pleadable against that contracting party, the third-party right is independent from the rights of the contracting parties even though derived from their contract.[11] So, for example, if part of a contract is illegal but the part containing the third party's right is not in itself, the existing doctrine of severability, in which illegality may be held to affect only part of a contract, leaving the remainder fully enforceable, suggests that the third-party right should be unaffected.[12]

6.20 Again, if the principal contract is frustrated by supervening events beyond the parties' control, what of the third party's right under the contract? It has been said that:

> "the question of how frustration affects third-party rights must … depend on the impact which the frustrating events have had on that particular obligation of the debtor, and not upon any thesis that because the principal obligations between stipulator and debtor have been discharged, all other obligations under the contract have been also. But very often the performance of stipulator to debtor will be so closely interwoven with debtor's performance to third party that the frustration of the former will inevitably mean that the latter obligation is discharged as well."[13]

A reasonable approach might therefore be to treat the obligation to the third party as discharged if the frustrating event affects either the obligation owed to the third party, or any obligation(s) counterpart to this on the side of the other contracting party not bound to perform to the third party.

6.21 In the Discussion Paper we also discussed the question of "set off" as a defence available against the third party. This was because the 1999 Act refers to "set-off" separately from defences, envisaging two main possibilities: (1) that the contracting party from whom the third party claims performance has a set-off against the other contracting party arising from the contract and relevant to the third-party term: and (2) that the contracting party from whom performance is claimed has a set-off directly against the third party. The matter may also be dealt with by way of express term in the contract. With direct set-offs against the third party, the contracting party may also make a counter-claim.

6.22 The Scots law analogue to set-off is compensation under the Compensation Act 1592. It is normally pleadable only between liquid debts. In general, therefore, there is no right to compensate a debt payable immediately with a future or contingent one, or a claim of damages on another ground. The parties must also be debtor and creditor in the same

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[11] See Anderson, *Assignation*, chapter 8.
[12] See para 2.47 above; *Love v Amalgamated Society of Lithographic Printers of Great Britain and Ireland* 1912 SC 1078.
[13] *SME* Vol 15, para 839.

capacity. Compensation is not automatic but must be pleaded, so only arises in the context of court action. It is thus a defence in Scots law, rather than a distinct legal doctrine with its own substantive effects as in the English law of set-off. The effect of compensation is to extinguish the debts *pro tanto*, that is, leaving the creditor who is owed the greater amount still with a claim for the balance due.

6.23 We should also note here the "special" (or "equitable") retention elucidated by the late Lord Rodger of Earlsferry in *Inveresk plc v Tullis Russell Papermakers Ltd*.[14] This is the equitable power of a court to allow a party with an illiquid claim which can be made liquid quickly to set it off against another party's liquid claim. Where retention generally is an aspect of the mutuality of contracts, and so exercisable only between contracting parties,[15] special retention (as we shall henceforth dub it) is not so limited.[16]

6.24 There seems no reason to doubt that it is already Scots law that a contracting party faced with a liquid claim by a third party may plead compensation or special retention in respect of an existing liquid (or almost liquid) claim against that third party. Almost by definition, the contracting party's claim will arise from a different transaction between the parties, but that is unproblematic. We continue to see no need to make legislative provision on this point in Scotland.

6.25 But should compensation or special retention available *between the contracting parties* be capable of extinguishing *pro tanto* the liquid claim of the third party? The argument in favour of such a rule is that the third party's right derives from the contract and, just as that right is affected by the contract's invalidity or illegality or frustration, so it should be affected by the extinction of the contract by performance or its equivalent. But it seems to us that the availability of compensation or special retention between the contracting parties should not extinguish the third-party right unless the two debts involved are clearly relevant to the right. In other words, compensation and special retention are like illegality and frustration: the impact of the discharge or unenforceability must be felt specifically in relation to the third-party right.

6.26 Our colleagues in England & Wales put the matter clearly when considering the same point in their Report leading up to the 1999 Act:

> "[W]here the third party is seeking to enforce a particular contractual provision, rather than the whole contract, it would seem that the defence or set-off should have to be relevant to the particular contractual provision. Otherwise a defence or set-off relating to an entirely separate clause, having no direct relevance to the particular contractual provision being enforced, could be used as a defence or set-off to the third party's claim. For example, if C seeks to enforce a payment obligation to him contained in, say, clause 20 of a construction contract between A and B, C's right should not be limited by a defence or set-off that A has against B in respect of, say, clause 5 which has nothing to do with clause 20."[17]

This explains why the 1999 Act provides that, as with other defences, the set-off must arise from or in connection with the contract and be relevant to the term in favour of the third party.

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[14] *Inveresk plc v Tullis Russell Papermakers Ltd* [2010] UKSC 19, 2010 SC (UKSC) 106.
[15] Albeit sometimes mutuality may operate across more than one contract between the parties, so long as they form elements of one transaction (see e.g. *Claddagh Steamship Co v Steven & Co* 1919 SC (HL) 132).
[16] For further discussion see L Richardson, "Examining "equitable" retention" (2016) 20 Edinburgh LR 18-41.
[17] LC No 242, 1996, para 10.11.

6.27 Jonathan Gaskell of DLA Piper has, however, explained to us that this may not be enough to deal with current market understandings in the construction sector which are usually given effect in collateral warranties. These commonly include express prohibitions upon the warrantor invoking against the beneficiary of the warranty any rights of retention or compensation that the former has against its contract counterparty. This is because typically the beneficiary has no control over matters of non-payment between the warrantor and its counterparty. But if the collateral warranty were to be translated into a third-party right without such exclusion of retention or compensation, the third-party beneficiary would have to rely on non-relevance to the undertaking to achieve the result currently brought about by the express term in the collateral warranty. Mr Gaskell provided an example where the "relevance" approach might be inadequate to prevent a contracting party pleading retention for its employer's non-payment for faulty work or defective materials against the third party's damages claim in relation to that work or materials. Since the two claims relate to the same work or materials, they might well be seen as "relevant" to each other.

6.28 Upon reflection, therefore, we have concluded first that the statutory rule on defences should make clear that the impact of the defences available between the contracting parties is restricted to the cases where these defences are relevant to the third party's right. Thus the case of partial illegality can then continue to be dealt with satisfactorily by using the existing doctrine of severability, as mentioned above. With frustration, too, it is important to remember that it is the obligations of future performance that are frustrated by supervening events, not the contract itself; so, as already noted, the question should be, what is the impact of those events upon the performance of the third-party right?[18] The defences provided by the law on invalidity may seem the most comprehensive in terms of defeating the enforceability of a third party's right, in that generally their effect is to invalidate the whole contract. But as already noted Scots law recognises the concept of partial invalidity, with some but not all the terms of a contract being affected by the invalidity.[19] If so, then the proposed rule on defences to third-party right claims will be able to cope.

6.29 Mr Gaskell's observation is, however, important in pointing up possible issues if relevance to the third-party right is the sole possible criterion by which the availability against the third party of defences between the contracting parties can be judged. The answer to this difficulty lies in our general policy of making our proposed rules subject to the freedom of contracting parties to provide otherwise: here, the extent to which a contracting party may plead a defence which it has against another contracting party in answer to a third party's claim. That freedom might be used to restrict the availability of particular defences, such as retention or compensation; or it might be used, as we have seen above with the SBCC style in respect of third-party rights for purchasers and tenants to expand such defences beyond those strictly relevant to the third-party right in question.[20]

6.30 We accordingly recommend:

37. The statute should include a general rule to the effect that the party bound to perform under the right in favour of the third party may assert against the third party all defences which the party bound to perform could assert against the other party to the contract, so long as these defences are also

[18] See para 2.47 above.
[19] See para 2.46 above.
[20] See para 2.48 above.

relevant to the third party's right under the same contract. This rule may be varied or excluded in the contract.

(Draft Bill, section 8)

Direct defences against the third party

6.31 We consider it to be already clear that the contracting party due to perform can plead defences against the third party such as that party's use of force and fear or misrepresentation, the non-fulfilment of conditions (whether or not potestative) and, as discussed above, compensation or special retention. But a point from the 1999 Act which we did not think needed to be picked up for the Discussion Paper has come to our attention again by way of our Joint Project with the Law Commission for England & Wales on Insurance Law.

6.32 Section 3(4) of the 1999 Act (part of a section the overall heading for which is "defences etc. available to promisor") provides that "the promisor [*i.e. the contracting party due to perform to the third party*] shall also have available to him – (a) by way of defence or set-off any matter, and by (b) by way of counterclaim any matter not arising from the contract, that would have been available to him by way of defence or set-off or, as the case may be, by way of counterclaim against the third party if the third party had been a party to the contract."

6.33 The background to this provision is explained in the Law Commission's preceding Report on Privity of Contract.[21] The main concern is with the position when the third party's right is in some way conditional upon some action by the third party. The aim of the sub-section is to ensure that the failure of the third party to fulfil the condition can be pleaded by the promisor as a defence to an action by the third party. The Law Commission's discussion of the point is chiefly concerned to show that this does not impose a burden on the third party contrary to the general principle that contracting parties may only confer benefits on third parties, not obligatory burdens.

6.34 There appears to have been no case law on section 3(4), and little commentary. It arose in the Insurance project as a result of concerns about the scope of duties on insureds under the Insurance Bill laid before the Westminster Parliament in June 2014 to make fair presentations of the risks for which they seek cover.[22] Some insurance contracts provide for third parties to be covered under them, for example "key man" insurance taken out by a company in respect of a director or other senior executive whose illness or death would substantially affect the company's performance; or, in construction projects, insurance taken out by a main or head contractor covering sub-contractors as well as itself. To what extent, if at all, do these disclosure requirements apply to such third parties, and can third party failures to disclose be used to defend claims by them against the insurers?

6.35 In our view there is no *need* to have a similar provision for Scots law. Only if it is thought that the presence of an express provision allowing defences available between the contracting parties to be used against the third party coupled with silence on any defences directly available against the third party might raise doubt as to whether such defences could

[21] LC No 242, 1996, paras 10.24-10.32.
[22] See now Part 2 of the Insurance Act 2015.

be pleaded at all should provision be made. That could perhaps be along the lines of the provision on defences between the contracting parties being without prejudice to those which can be raised directly against the third party as a result of its pre-contractual and subsequent conduct. The category of "subsequent conduct" could include, for example, the incurring of a compensable debt to the contracting party due to perform under the third-party right as well as, perhaps, failure by a third party covered by an insurance policy between others to make a fair presentation of the risks involved at the appropriate time.

6.36 But if it is, as we think, already clear that the contracting party due to perform can plead direct defences against the third party, the presence of statutory provisions on a different aspect of the subject of defences should not in our view create any doubts on the general position.

6.37 We accordingly recommend:

38. No equivalent to section 3(4) of the Contracts (Rights of Third Parties) Act 1999 need be included in the proposed statute.

Prescription

6.38 We described in Chapter 2 of the Discussion Paper the application of the Prescription and Limitation (Scotland) Act 1973 to the present law of *jus quaesitum tertio*.[23] That discussion showed some very slight uncertainty about how the short negative prescription applies, related to whether the right can be said to arise from a contract or a promise. We asked if consultees thought that any uncertainty in this area should be removed by the insertion into Schedule 1, paragraph 1 of the 1973 Act of a specific provision on third-party rights in contract, subject to the existing limitations on the application of the short negative prescription (for example, that it does not apply to obligations relating to land, or to rights relating to property which are not imprescriptible or correlative to an obligation to which either of sections 6 or 7 apply).[24] Although some consultees thought that this was un-necessary, the majority favoured the inclusion of such a provision in the proposed statute.

6.39 We think that this would be useful clarification of the law, especially in the event of our proposed statute leading to greater use of third-party rights in Scotland. Given that the 1973 Act already prohibits contracting out of its sections 6 and 7, there is no need for our legislation to say anything on that aspect.[25]

6.40 We accordingly recommend:

39. It should be made clear that the short negative prescription of the Prescription and Limitation (Scotland) Act 1973 applies to third-party rights arising from a contract.

(Draft Bill, section 11)

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[23] See paras 2.86-2.89 of the DP.
[24] See para 2.87 of the DP for these restrictions.
[25] Prescription and Limitation (Scotland) Act 1973, s 13. General reform in this area may follow from our Discussion Paper No 160 on Prescription (February 2016), ch 7, but cannot be anticipated here.

Liability of one contracting party if the other defaults on the contract

6.41 The Discussion Paper did not envision any change to the basic approach of the present law as to which of the contracting parties is liable to the third party. That, it is thought, is primarily a matter of interpretation of the contract. The classical model of *jus quaesitum tertio* is of one of the contracting parties being the debtor due to perform to the third party, whether that performance is the payment of money or the delivery of goods or services, or some other, while the other contracting party is a stipulator who perhaps pays for the debtor's performance to the third party but whose only liability otherwise is to assist the third party so far as it can in the realisation of the latter's right, for example by "exhibiting" the contract. There is no question of a joint or of a joint and several liability of the contracting parties to the third party in respect of the primary performance due to the third party.

6.42 In principle, the obligation of contracting party A to perform to the third party is unaffected by the other contracting party B's breach, even if that breach is such as to entitle A to withhold its performance to B (retention) or even to terminate its obligations of performance to B (rescission). But in practice such a breach may make A's performance to the third party an impossibility; or A's obligation may be contingent upon the performance which B was to render under the contract (e.g. putting A in funds that may then be released to the third party).[26]

6.43 In such cases, it is thought likely that the third party has a remedy against B. The *SME* states that this is so because B has implicitly promised the third party not to default in rendering counterpart performance to A.[27] The result seems useful, as it allows for security on the part of the third party and ensures that a party in the position of A is not unfairly called upon to perform in favour of the third party when financially or otherwise unable to do so.

6.44 We accordingly asked whether the proposed statute should contain a rule to this effect, i.e. if one of the contracting parties defaults on the contract so that the other contracting party is unable to perform to the third party as required by the latter's right under the contract, the third party has an appropriate remedy against the initially defaulting party. Consultees expressed varying views, with the Law Society of Scotland saying that "logically" such a rule should be provided, while others took the position that the question could be left for the application of the existing rules of contract, unilateral promises and implied obligations on a case-by-case basis.

6.45 In the absence of a clear consensus on the correct approach, and lacking any information on the extent to which the question was likely to arise, we have decided that no provision should be made in the proposed statute, and that the matter may be left meantime for development by the application of common law principles. We therefore make the following negative recommendation:

40. There should be no express rule to the effect that the third party has a remedy against the initially defaulting party where one contracting party defaults on a contractual obligation with the result that another contracting party is unable to offer due performance of a third-party right.

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[26] *SME* Vol 15, para 839.
[27] *SME* Vol 15, paras 837 and 839.

Contracting out of liabilities to third parties

6.46 It is apparently "easy and common" under English law to contract out of liability to third parties under the 1999 Act, although there is no express provision in the Act to that effect.[28] Examples of such contracting out that we have seen, such as the one quoted just below, do so by stating expressly that it is not the intention of the parties to confer any rights on any third party and/or by specific reference to the exclusion of the 1999 Act. The Law Society of England & Wales presents this as beneficial, stating that "suppliers, in particular SMEs, must not be discouraged from selling abroad by having a provision giving rise to liability to third parties the extent or ambit of which they do not know." [29] We are aware that for commercial parties in particular it is important not to find themselves exposed to risks for which they have had no opportunity to prepare or take into account. One example of a method of drafting to achieve this is to be found on the website of Mauritius Foods Limited, whose terms include the following:

> "Third-party rights
>
> You acknowledge and agree that each member of the group of companies of which Mauritius Foods Limited is a part shall be third party beneficiaries to the Terms and that such other companies shall be entitled to directly enforce, and rely upon, any provision of the Terms which confers a benefit on (or rights in favour of) them. Other than this, no other person or company shall be a third party beneficiary of the Terms or any rights pursuant to the Contract (Rights of Third Parties) Act 1999 (the "Act"). Any right or remedy of a third party which exists or is available apart from the Terms and the Act is not affected."[30]

6.47 We do not feel that express provision to allow contracting out in general is necessary in the proposed statute for Scotland, since the third party's right is explicitly based on the intention of the contracting parties as derived from the contract and its interpretation. Hence if the contract provides expressly for no liability to a third party, or for an exclusion or limitation of a liability that would otherwise arise, that will be as effective as it is under the present law, subject to any application to the term or terms in question there may be of the unfair contract terms legislation.[31] The existence of a statute embodying third-party rights law will also make it easy to identify that which is to be excluded, i.e. the Act, rather than having perhaps to deploy the Latinity of *jus quaesitum tertio*, as we have seen in some examples given elsewhere in this Report.[32]

6.48 Consultees were unanimous in agreeing with these points, although some saw no harm in including a provision for the avoidance of doubt. If it would provide comfort to commercial parties and their professional advisers it would be unproblematic for the statute to say expressly that parties may contract out of the rights for which it provides.

6.49 We accordingly recommend:

41. No express provision is needed to allow contracting parties to exclude or limit a liability to third parties that would otherwise arise.

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[28] Law Society of England and Wales, *Common European Sales Law: Response to the UK Government Call for Evidence,* May 2012.
[29] Ibid.
[30] See http://mauritiusfoods.co.uk/terms-of-site-use/.
[31] See para 2.85 of the DP.
[32] E.g. at paras 2.8 and 3.3 above.

Other points arising from the 1999 Act

6.50 A number of other issues related to enforcement emerges from study of the 1999 Act, and these were canvassed in the Discussion Paper. Of these only the first seems to us to require a legislative response (how to refer to what it is in the contract that the third party may enforce or otherwise invoke), and we have already proposed such a response in Chapter 3.[33] Here we discuss the other points only briefly

6.51 These points all reflect the 1999 Act's background in a general rule of privity of contract, and a legislative policy of curbing that rule only so far as was thought to be necessary. The third-party right created was seen as essentially an addition to the rights of the contracting parties under their contract, in particular their rights to enforce it against each other. In Scots law, the background is different, and the third-party right, although dependent upon the contract, otherwise stands on its own, quite separate from the rights of the contracting parties. In general, therefore, we did not see much if any need to follow the 1999 Act on these points, and on the whole consultees agreed.

(1) Concurrency between the third party and the contracting parties

6.52 The 1999 Act provides in section 4 that section 1 of the Act does not affect the promisee's right to enforce the contract. This rule underlines that the promisor's duty to perform should be owed to *both* the promisee and the third party, and that consequently the promisee should retain the right to enforce a contract even if the contract is also enforceable at the suit of the third party, unless the contracting parties have agreed otherwise.[34]

6.53 As there is no authority in Scots law that the third party and the contracting parties may *not* have concurrent rights – indeed it has been held that the existence of continuing obligations between the contracting parties does not prevent a third-party right arising or being enforced[35] – we do not see that it is necessary to enact an equivalent term for a reformed Scots third-party right. Amongst our consultees only the Faculty of Advocates thought that such a rule might be useful, and they conceded that it was not strictly necessary.

6.54 We accordingly recommend:

42. No equivalent to section 4(1) of the Contracts (Rights of Third Parties) Act 1999 should be included in our proposed statute.

(2) Who is to sue and be served with the summons

6.55 Section 4 of the 1999 Act does not mean that the third party must sue alongside whichever of the contracting parties is not bound to render performance under the former's right. As in Scots law, and in the DCFR, the PICC and the proposed CESL, the third party may sue in its own name without involving on its side any of the contracting parties. Further, in Scots law it is not necessary that the latter have any continuing or surviving interest or claim in the main contract at the time the third party claim is made.[36] This is significantly

[33] See paras 3.17-3.21 above.
[34] LC No 242, 1996, para 11.4.
[35] See *Mercedes-Benz Finance Ltd v Clydesdale Bank plc* 1997 SLT 905 (discussed at para 2.42 of the DP).
[36] *SME* Vol 15, para 837.

more convenient and efficient than requiring that one or more of the contracting parties sue alongside the third party. In the Discussion Paper we could see no need to elaborate on this point, which for Scots law seems self-evident. Consultees agreed, although the Senators of the College of Justice suggested that the Rules of Court should require a third party suing a contracting party to serve the summons also on the other contracting party or parties for their interest. We see some force in this observation, although we are not sure whether it needs to be a general rule for all such cases.

6.56 We accordingly recommend:

43. There is no need for the proposed statute to require a person bringing an action to enforce a third-party right against one or more of the contracting parties liable to perform to bring any other contracting party into that action. It should be considered, however, whether the Rules of Court ought to require the service of the summons on any such other contracting party for its interest.

(3) Double liability for contracting party bound to perform to the third party?

6.57 Section 5 of the 1999 Act provides that:

> "Where under section 1 a term of the contract is enforceable by a third party, and the promisee has recovered from the promisor a sum in respect of –
>
> (a) the third party's loss in respect of the term, or
>
> (b) the expense to the promisee of making good to the third party the default of the promisor,
>
> then, in any proceedings brought in reliance on that section by the third party, the court or arbitral tribunal shall reduce any award to the third party to such extent as it thinks appropriate to take account of the sum required by the promisor."

6.58 This unusual provision is not reflected in any of the comparator instruments or other measures analysed for the purposes of the present project. It reflects the continuing ability of the contracting party not due to perform to the third party (B) to sue the other contracting party (A) for the performance otherwise due to the third party, while protecting A from double liability in respect of the same obligation.

6.59 In the Discussion Paper we expressed the view that it is not clear that a provision like section 5 of the 1999 Act would serve any useful purpose in Scots law. Consultees agreed, with the Faculty of Advocates also expressing the view that if parties contracted about the possibility of double liability to the third party, that should govern the situation rather than any rule of law. As we have discussed above, it may be the law already that where B's breach of the contract with A disables the latter from performing to the third party, then the third party may have a claim against B. But we are making no recommendation that this possible rule be included in our proposed statute; and in any event it involves no double liability for A.

6.60 We accordingly recommend:

44. No equivalent to section 5 of the Contracts (Rights of Third Parties) Act 1999 should be included in our proposed statute.

Chapter 7 Arbitration

7.1 We did not consider the applicability of arbitration to third-party rights under contracts in our Discussion Paper. The subject came up initially when considering whether to include within our draft Bill provisions about enforcement of third-party rights other than in court proceedings. This led us to look carefully at section 8 of the Contracts (Rights of Third Parties) Act 1999, which makes detailed and somewhat complex provision on the subject of arbitration. We also received helpful advice on section 8 and its genesis from Professor Andrew Burrows who was the lead Law Commissioner for England & Wales in this matter at the relevant time.

7.2 Having formed the tentative view that we should recommend legislation similar to section 8 in its effect, we consulted the Scottish Arbitration Centre and a number of practising Scottish arbitrators, who were generally supportive of that view. So, for example, J Gordon Reid QC commented:

> Various commercial interests south of the Border seem to have thought TPR [*third-party rights*] in an arbitration context worthwhile. It seems obvious that Scotland should in general terms, follow suit or go one better if it can.
>
> There is precious little commercial arbitration in Scotland so any legislative assistance which removes a possible disadvantage (compared with litigation) is likely to be beneficial.[1]

Hew Dundas also remarked:

> For the commercial sector trading both north and south of the border (eg construction-related or property companies etc), there are clear merits in the laws of England and Scotland being closely aligned except where differences are necessary; the present circumstance is not, IMHO, one of the latter.

Section 8 of the 1999 Act

7.3 Section 8 of the 1999 Act is there despite an initial recommendation in the Law Commission Report that "a third party shall have no rights of enforceability … in respect of an arbitration agreement or a jurisdiction agreement".[2] This was because such agreements with provision covering third-party rights "must be seen as both conferring rights and imposing duties".[3] The duty involved for the third party would be having to submit to arbitration of disputes. Not only would this be inapt in the context of third-party rights, it would also be inappropriate for arbitration, the very essence of which is the consensual nature of the process between the parties.

7.4 We understand from Professor Burrows, however, that the Law Commission was not unhappy when commercial interests lobbied the UK Government to the effect that the

[1] On the use of arbitration in Scotland since the coming into force of the Arbitration (Scotland) Act 2010, see note 39 below.
[2] Law Com No 242, recommendation 52.
[3] Ibid, para 14.18. The conclusion also applied to jurisdiction clauses, with which we do not deal.

proposed legislation would not be as helpful as it could be unless it effectively ensured that the Arbitration Act 1996 applied even if a third party under the third-party-right Act was to be involved. Section 8, which was drafted in close collaboration between Professor Burrows and experienced arbitrators, was accordingly introduced at a late stage of what became the 1999 Act's Parliamentary progress. It was not controversial and passed unamended on to the statute book.[4]

7.5 Section 8(1) of the 1999 Act applies to a term which is enforceable by a third party and which "is subject to a term providing for the submission of disputes to arbitration". The section provides that in such case "the third party shall be treated for the purposes of [the Arbitration Act 1996] as a party to the arbitration agreement as regards disputes between himself and the promisor relating to the enforcement of the substantive term by the third party". Professor Burrows comments that "What s. 8(1) brings about is that the third party can not only take advantage of the provisions of the Arbitration Act 1996 to enforce his right to arbitrate but is also "bound" to arbitrate if he wishes to enforce his substantive right."[5] The approach is sometimes described as one of 'conditional benefit': the third party's substantive right in the contract apart from the right to arbitration is dependent upon arbitral enforcement where enforcement is necessary. Hence the quotation marks Professor Burrows places around the word "bound" in the passage above. Further, a court will, on application to that effect, stay any court action by which the third party seeks to enforce its substantive right. The effect of the stay is to suspend the action while an arbitration takes place; but it remains possible for the court to resume hearing the case if, for example, the arbitration fails to take place or the arbitrator rules that the matter is not within his or her jurisdiction.

7.6 Section 8(2) applies to a third-party right term which provides only for one or more descriptions of dispute between the third party and the promisor to be submitted to arbitration, making section 8(1) inapplicable. The third party who exercises the right to enforce the arbitration clause is to be treated as a party to the arbitration agreement in relation to the matter with respect to which the right is exercised, and to be treated as having been so immediately before the exercise of the right. Professor Burrows explains:

> Section 8(2) deals with the rarer situation where the third party is given a right to arbitrate under s. 1 of the 1999 Act but the "conditional benefit" approach underpinning section 8(1) is inapplicable. E.g., where the contracting parties give the third party a right to arbitrate a tort claim by the promisor against the third party. To avoid imposing a pure burden on the third party, s. 8(2) requires the third party to have chosen to exercise the right.[6]

Again, therefore, the third party is not bound to arbitrate in this situation. A crucial distinction between section 8(2) and section 8(1) is that the former applies only if the right is exercised by the third party; this does not apply to section 8(1).[7]

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[4] See further A Burrows, "The Contracts (Rights of Third Parties) Act 1999 and its implications for commercial contracts" [2000] LMCLQ 540, 551-552; C Ambrose, "When can a third party enforce an arbitration clause?" [2001] Journal of Business Law 415.

[5] Burrows, "The Contracts (Rights of Third Parties) Act 1999" (see note above), 552.

[6] Ibid, 552 note 29.

[7] A Burrows, *A Restatement of the English Law of Contract* (2016) summarises the overall position as follows in section 47(7): "A third party who has a [third party] right … to enforce a written arbitration agreement, or has a [third party] right to enforce a term that, by reason of a written arbitration agreement, is conditional on resolving any dispute by arbitration, is to be treated as a party to the contract for the purposes of the Arbitration Act 1996." The commentary on the section adds: "What that provision [s 8 of the 1999 Act] essentially seeks to ensure is that the rules in the Arbitration Act 1996 are applicable where a third party under the 1999 Act has either a right

7.7 A typical example for the application of section 8(2) is the building contract with related sub-contracts, where the main contract says that any dispute between employer and sub-contractor will be dealt with by way of arbitration, or there are back-to-back arbitration clauses in main contract and sub-contracts, suggesting that all disputes between the parties, whatever their nature, are to be determined by an arbitral process. Such disputes will typically involve a tort claim by the employer in respect of sub-contractor negligence of some kind, since the chain of contract and sub-contract will provide the pathway for other kinds of claim by the parties, e.g. the sub-contractor will generally have to claim payment from the main contractor under the sub-contract between them. The main point of the arbitration clause, then, will be to enable the sub-contractor to use it as a defence to stay any court action in tort by the employer.[8] If the main contract provides, in addition to the arbitration clause, a right for a sub-contractor to claim payment for performance directly from the employer (in addition to the right it will have against the main contractor under the sub-contract), then the question will be whether section 8(1) applies rather than section 8(2). If section 8(1) does apply, then the sub-contractor will have to proceed by way of arbitration; if the sub-section does not apply, then court action to obtain payment will be open to the sub-contractor.

7.8 The distinction between section 8(1) and (2) may be further explained in this way. For section 8(1) there must be both a third-party right to arbitrate and a third party benefit, the latter of which, however, the third party can enforce only through the former. For section 8(2), there is only the third party's right to arbitration. In the absence of any substantive benefit for the third party to enforce, the right to arbitration must here be essentially a defensive one, to be used primarily, if not exclusively, when the third party is sued by one of the contracting parties in a dispute that is covered by the arbitration clause. The third party is entitled by section 8(2) to plead the arbitration clause to stay the action against it. By this exercise of the right the third party is to be treated as having become immediately beforehand (i.e. fictitiously) a party to the arbitration clause for the purposes of the Arbitration Act 1996.[9]

7.9 Section 8 has been discussed in detail in two cases.[10] In *Nisshin Shipping Co Ltd v Cleaves & Co Ltd*,[11] the contracts were charterparties containing arbitration clauses. Each also provided for payment of commission to third party chartering brokers (C) who had negotiated the charterparties on behalf of N. C wanted to claim payment in arbitration proceedings with N. There were four other similar charterparties in which there was no arbitration clause, and in these C sought payment by way of court action. N sought to have all the proceedings go forward together in court.

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to enforce an arbitration agreement or a right to enforce a (substantive) term conditional on going to arbitration" (ibid, p 246).

[8] Or even, conceivably, an employer's claim against the sub-contractor as the holder of a third-party right under the sub-contract! See, for a claim of this kind coupled with an alternative in negligence, *Scott Lithgow Ltd v GEC Electrical Projects Ltd* 1989 SC 412.

[9] If the arbitration clause in *AES Ust-Kamenogorsk Hydropower Plant LLP v Ust-Kamenogorsk Hydropower Plant JSC* [2010] EWHC 772 (Comm), [2010] 1 CLC 519; [2011] EWCA Civ 647, [2012] 1 WLR 920; [2013] UKSC 35, [2013] 1 WLR 1889 was actually in favour of a third party (on which point we have much doubt), then it may well have been an example for the application of s 8(2).

[10] It is also briefly summarised in the case cited in the preceding footnote and in *Christina Mulchrone v Swiss Life (UK) plc* [2005] EWHC 1808 (Comm) para 14; but the latter case was decided on other issues.

[11] *Nisshin Shipping Co Ltd v Cleaves & Co Ltd* [2003] EWHC 2602 (Comm).

7.10 Colman J held first, that while the commission clauses contained no direct statement of a right to enforce for C, they did purport to confer a benefit on C and since there was nothing to show any contrary intention of the contracting parties C did have a right to enforce. He then went on to hold that the enforcement of these rights was subject to the arbitration agreements in the charterparties, even though these agreements made no express mention of the brokers (C). He used the Explanatory Notes to the 1999 Act to reach this result as an application of section 8(1), finding an assignment analogy given in the Notes helpful in getting there, and seeing the third party as standing in the shoes of the charterers to enforce a promise which they (the charterers) could also have enforced.

7.11 In *Fortress Value Recovery Fund LLP v Blue Skye Special Opportunities Fund LP*,[12] the claimants were creditors and shareholders of one of the limited partners under a Deed of Limited Partnership, while the defendants were other partners in the Deed who were granted various indemnities and liability exclusions under the Deed. The Deed also contained an arbitration clause in the following terms:

> "Any dispute, controversy or claim arising out of or in connection with this agreement or the formation, breach, termination of invalidity thereof, that the parties hereto are unable to resolve between themselves, shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce of Paris by three arbitrators appointed in accordance with the aforementioned rules."

7.12 The claimants' court action against the defendants was brought in tort on the basis of conspiracy, unlawful interference and dishonest assistance. The claim was that the defendants had set up a dishonest scheme to divert the assets of the partnership away from the other partners towards themselves and to enable them to extract fees and other value from the assets. On the basis of their third-party rights to immunities and exclusions of liability under the Deed, the defendants argued that the court proceedings should be stayed and referred to arbitration under the arbitration clause in the Deed. The case almost exactly matches the situation which the Law Commission thought made section 8(2) necessary in the first place, save that in addition to the arbitration clause the third parties also had the substantive benefit of indemnities and liability exclusions under the contract.

7.13 At first instance Blair J rejected the defendants' application. The dispute did not relate to a substantive term of the contract in terms of section 8(1). The indemnity and exclusion clauses provided defences rather than positive rights of action. This could not prevent others from suing them in any court in which jurisdiction could be established, where the defendants could then raise their indemnity and exclusion clauses as a defence.

7.14 This decision was upheld by the Court of Appeal, but on different grounds. Blair J's distinction was inconsistent with section 1(6) of the 1999 Act which expressly states that a third party availing itself of an exclusion is enforcing a term in the contract. For section 8(1) to apply it had to be clear that the third-party right was subject to the arbitration clause. "Very clear language" would be required to achieve this. The matter was one of construction of the contract. There were also countervailing considerations of general policy, such as that the contracting parties could become forced to arbitrate, and that arbitration proceedings under the Deed could become fragmented. Section 8(2) likewise did not apply. There had to be a contractual *right* to arbitrate *in the third party*, and general language in the arbitration

[12] *Fortress Value Recovery Fund LLP v Blue Skye Special Opportunities Fund LP* [2013] EWCA Civ 367, [2013] 1 WLR 3466, upholding [2012] EWHC 1486 (Comm) but on different grounds.

agreement such as "the parties hereto", referring to the Deed, did not do that. Express wording to the required effect could easily have been inserted, but had not been; and the proposed reading was inconsistent with other express words in the Deed.

7.15 In the *Fortress Value* case Toulson LJ (as he then was) gives the following useful exegesis of the distinction between section 8(1) and (2):

> Section 8(1) is aimed at the situation in which a contract contains a promise by the promisor, P, to confer a conditional benefit on a third party, T; that is, a substantive benefit, subject to a procedural condition that T may enforce it only by a particular process, i.e. arbitration. In such a case T is to be treated as a party to the arbitration agreement in relation to the enforcement of the benefit. If T attempted to enforce P's promise by bringing an action, it would be open to P to allow the action to proceed and to contest the claim on its merits, but P would have the right to invoke section 9 of the Arbitration Act 1996 with a view to obtaining a stay of the action.
>
> In short, P has the option of letting the action proceed or of enforcing the procedural condition that T should proceed by way of arbitration. This accords with the underlying rationale that it should be open to P to attach a procedural condition to the substantive right, but P need not insist on T adhering to the condition.
>
> Section 8(2) is aimed at the different situation in which a term of the contract gives a unilateral right to T to require that a dispute with P of an identified description should be submitted to arbitration. In that situation T is to be treated as a party to an arbitration agreement with P if and when T exercises the right.
>
> In summary, section 8(1) allows for P to give T an enforceable substantive right, subject to a procedural condition on which P may but need not insist. By contrast, section 8(2) allows for P to give T an enforceable procedural right, which T may but need not exercise (since the right is unilateral).[13]

7.16 In a valuable article on section 8 published in 2001 (i.e. before the *Nisshin* case), Clare Ambrose made a number of points which can now be taken as significant criticisms of the approach espoused by Colman J in that case. They may also be seen as supportive of the more cautious judicial approach evident in the *Fortress Value* case. In particular, she comments that "[i]t is far from clear that parties to a contract who confer a benefit on a third party should be *presumed* to intend that the third party should be bound by an arbitration or jurisdiction clause covering disputes arising under that contract".[14] Parties may have chosen a specialist type of arbitral tribunal that is unsuitable for disputes with the third party, or the wording of their clause may also be inappropriate for application to a third party (e.g. words that characterise the contracting parties but not any third party). Ambrose argues that "section 8(1) should be construed so that it can only be invoked by (or against) third parties if, on its true construction, disputes relating to a third party's enforcement of his rights under section 1 [*of the 1999 Act*] are agreed to be referred to arbitration".[15] This will also "reduce the uncertainty and undesirability of courts having to manipulate arbitration clauses which are not apt to cover third party terms".[16]

7.17 Clare Ambrose is also critical of section 8(2). She thinks that the sub-section leads to a distinction between the conferral of a "positive" benefit (such as a right to a payment), to

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[13] Ibid, at paras 42-45.
[14] C Ambrose, "When can a third party enforce an arbitration clause?" [2001] Journal of Business Law 415, 422.
[15] Ibid, 423.
[16] Ibid, 424.

which section 8(1) applies, and the "negative" benefit of an arbitration clause as a means of excluding court action if the third party so chooses, which is conferred by section 8(2). In part, this is because she thought it makes uncertain whether other "negative" benefits, such as those conferred by an exclusion clause, could be covered by section 8(1). That doubt may have been removed for the time being by the *Fortress Value* case, and one can also point to section 1(6) of the 1999 Act making it clear that in general such negative benefits as exclusion clauses are covered as substantive third-party rights under section 8(1). But in any event section 8(2) is "not a user-friendly provision" in Ambrose's view.[17] In particular, the fiction that the third party is to be treated as a party to the arbitration agreement 'immediately' before exercising the right to arbitrate is "awkward."[18]

Some further comparative evidence

7.18 Provisions very similar to section 8 of the 1999 Act have been included in the relatively recent Singapore, Cayman Islands and Hong Kong legislation on third-party rights,[19] suggesting that the section is seen as embodying a satisfactory approach to the issue in question. The development probably also reflects significant shifts of thought in the world of international commercial arbitration. While party consent manifested in an arbitration agreement is a prerequisite for arbitration, this "does not altogether exclude the possibility that an arbitration agreement … might also bind other parties".[20] There has been serious discussion of "arbitration without privity" even before the 1999 Act.[21] As Dr Andrea Marco Steingruber remarks in his study of the concept of consent in international arbitration, "[o]ften the traditional role and bilateral nature of arbitration cannot accommodate modern transactions which take place in areas such as construction contracts, banking and financial transactions, reinsurance contracts, and transactions involving multinational corporations and States operating through State agencies or other emanations of the State."[22] But he goes on to argue that, rather than abandoning consensual analysis, a new approach to consent is emerging to address multi-party and, indeed, multi-contract relations in international arbitration. This embraces the case of third-party beneficiaries of rights under a contract.[23]

7.19 After referring to the 1999 Act in England for the proposition that "[w]here the contract contains an arbitration agreement, the third party is bound by the agreement and constrained to follow the arbitral process", *Redfern and Hunter* notes the existence of a

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[17] Ibid, 430.
[18] Ibid, 430.
[19] See, for Singapore, s 9 of the Contracts (Rights of Third Parties) Act (Act 39 of 2001); for the Cayman Islands, s 11 of the Contracts (Rights of Third Parties) Law 2014; and, for HK, s 12 of the Contracts (Rights of Third Parties) Ordinance (c 623, 2015).
[20] N Blackaby and C Partasides QC, *Redfern and Hunter on International Arbitration* (6th edn, 2015), para 2.42. See also *Dallah Real Estate and Tourism Holding Company v The Ministry of Religious Affairs, Government of Pakistan* [2010] UKSC 46, [2011] 1 AC 763, per Lord Collins at paras 105-107.
[21] The phrase was apparently coined by Jan Paulsson: see his "Arbitration without Privity" (1995) 10 ICSID: Foreign Investment Law Journal 232.
[22] A M Steingruber, *Consent in International Arbitration* (2012), para 1.13.
[23] Ibid, paras 9.26-9.28 (illustrating what Dr Steingruber calls a rule of "automatic transfer" under a "principle of extension of consent to arbitration"). It also includes cases of agency, assignment, subrogation, a "group of companies" doctrine (which is, however, distinct from the case of third-party beneficiaries; see e.g. *Dow Chemical France v Isover St Gobain* (Interim Award), ICC Case No 4131, 23 September 1982), arbitral estoppel, multiple contracts and successive contracts. Arbitration without privity is also significant in investment and sports disputes arbitrations. See too the example of "string contracts", discussed in F Davidson, *Arbitration* (2nd edn, 2012), para 13.08.

similar principle in France and Italy,[24] and that "[t]he US courts have invoked the principle of estoppel to similar effect".[25] But speaking of the third party as 'bound' or 'constrained' is to state the matter with insufficient accuracy and precision. In a monograph published in 2010, Stavros L Brekoulakis gives a detailed comparative analysis of the subject, showing with reference to further US as well as Austrian Supreme Court cases in 2005 and 2009 respectively that:

> "[I]n most jurisdictions the necessary threshold for the third-party beneficiary to be entitled to rely on the arbitration clause is to establish that the parties purported to confer on the third party a substantive benefit right under the contract containing the arbitration agreement. Once this point is proved, the third-party beneficiary will automatically be *entitled to enforce* the arbitration clause contained in the relevant contract."[26]

7.20 Dr Brekoulakis goes to discuss the distinct point whether the party promising the substantive benefit may bring an arbitration claim against the third-party beneficiary or, putting the matter in another way, is the third-party beneficiary bound by the arbitration clause contained in the main contract? He comments:

> "The prevailing view is that the mere status of third-party beneficiary imposes no duty to arbitrate. This effectively means that if, but only if, the third-party beneficiary chooses to exercise the substantive benefit offered to it, it will be bound by the arbitration clause contained in the main contract. Accordingly, if a third-party beneficiary brings an action against the promisor before a national court seeking to enforce the substantive benefit, the court action must be stayed. But if the promisor commences arbitration proceedings against the third-party beneficiary requesting the tribunal to declare that the third party is not entitled to the substantive benefit, the third-party beneficiary may successfully challenge the tribunal's jurisdiction, on the ground that it is not bound by the arbitration clause in the main contract."[27]

7.21 This general position is achieved in various ways in the different jurisdictions. Dr Brekoulakis contrasts the 'benefit conditional on arbitral enforcement' and 'third-party right to arbitrate' approaches under the two provisions of the 1999 Act with French views under which either the third party has to give specific consent to the arbitration, regardless of what it is doing with the substantive benefit,[28] or the third party who takes the substantive benefit is bound by the arbitration clause by analogy with a transferee under a transferred contract.[29]

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[24] *Redfern and Hunter on International Arbitration*, para 2.53, citing *Banque populaire Loire et Lyonnaise v Société Sangar*, Cour de Cassation (1ère Ch. Civ.), 11 July 2006 (France) and e.g. *Assicurazioni Generali SpA v Tassinari*, Judgment No 2384, Corte di Cassazione, 18 March 1997; *L'Italia SpA v Milani*, Judgment No 3207, Corte di Cassazione, 1 April 1994 (Italy).

[25] *Redfern and Hunter on International Arbitration*, para 2.53, citing *Cargill International SA v M/T Pavel Dybenko* 991 F.2d 1012, 1019 (2nd Circuit 1993); *American Bureau of Shipping v Société Jet Flint SA* 170 F.3d 349, 353 (2nd Circuit 1999); *Avila Group Inc v Norma J of California* 426 F.Supp 537, 542 (DCNY 1977); *Astra Oil Co Inc v Rover Navigation Ltd* 344 F.3d 276, 279 note 2 (2nd Circuit 2003); *Birmingham Associates Ltd v Abbott Laboratories* 547 F.Supp.2d 295 (SDNY 2008), 2008 US Dist LEXIS 30321.

[26] S Brekoulakis, *Third Parties in International Commercial Arbitration* (2010), paras 2.143-2.163 (quotation at para 2.158, emphasis supplied), citing inter alia *Continental Cas Co v American National Insurance Co* 417 F 3d 727, 735 (7th Cir 2005); OGH, 30 March 2009, docket no 7 Ob 266/08 (Austria); *Kyung Sup Ahm v Rooney, Pace* 624 F Supp 368 (SDNY 1985) at 371-2.

[27] S Brekoulakis, *Third Parties in International Commercial Arbitration*, para 2.165. See also paras 2.179-2.180, for a re-statement of this position on which "there is safe consensus" (ibid, para 2.178).

[28] The basis for a decision of the Cour de Cassation in 1987, published in (1987) Rev Arb 139, and (1988) Rev Arb 559, with a note by J-L Goutal arguing that the third party can opt for arbitration without being thereby bound: see further A M Steingruber, *Consent in International Arbitration*, para 9.28.

[29] C Larroumet, "Promesse pour autrui, stipulation pour autrui et arbitrage" (2005) Rev Arb 906.

The latter approach is also preferred in Austria, it is said.[30] In the USA use is made of the principles of equitable estoppel so that the third party who relies on the substantive benefit is estopped from denying that it is bound by the arbitration clause also to be found in the contract.[31] We understand that in Germany a person wishing to enforce its third-party rights in a contract must respect the dispute resolution choice made by the parties to the contract.[32]

7.22 In further illustration of current international trends Hew Dundas has drawn our attention to a note about two recent Chilean cases in which the Supreme Court of Chile and the Santiago Court of Appeal have respectively decided that a third party to a contract could invoke an arbitration clause in the contract, in one case to claim its third-party right, in the other to have a court action against it referred to the arbitral tribunal.[33] David Bartos has supplied us with an English translation of a judgment by the Swiss First Civil Law Court, dated 19 April 2011, in which it was held that, where a third-party beneficiary under a contract had taken the initiative in joining other claimants in filing an arbitration request, it was not in the power of any other party to prevent him from doing so.[34] Simone Lamont-Black has suggested that under the DCFR a third-party right may be made conditional upon arbitral enforcement by the third party.[35]

Non-commercial contexts for arbitration

7.23 Our discussion to this point has focused primarily on commercial arbitration. But arbitration occurs in other settings. It is becoming increasingly important in the resolution of internal trusts disputes (which may of course be commercial in nature).[36] Rachael Kelsey of SKO Family Law Specialists in Edinburgh has drawn our attention to the use of arbitration clauses in various forms of agreement reached in family contexts such as pre-nuptial marriage contracts and settlements made upon the breakdown of personal relationships. She also referred us to the example of "pre-purchase agreements" between unmarried couples buying homes together, in which arbitral processes if the couple's relationship breaks down can be particularly useful. She explained:

> "There is another type of family law contract, however, which is fairly common and that is what tends to be called, colloquially, the "pre-purchase agreement." This is where a couple who are unmarried intend to buy heritable property together. Since 2007/08 most lenders now require a substantial deposit and often as not also require that title be taken in common where the lending is to be made on joint and several

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[30] S Brekoulakis, *Third Parties in International Commercial Arbitration*, para 2.168.

[31] See S Brekoulakis, *Third Parties in International Commercial Arbitration*, paras 2.169-2.175. He also discusses questions of applicable law at paras 2.177-2.178, arguing that tribunals may apply transnational substantive rules since "issues of third-party beneficiary do not touch on public policy or international public law. They are issues that sit comfortably with commercial law" (ibid, para 2.178).

[32] See R Bamforth and I Tymczyszyn (Olswang) and A van Fleet and M A Correro (Greenberg Traurig), "Joining non-signatories to an arbitration: recent developments" (2007) 2(8) *Arbitration* 9-13, 12.

[33] Barros Letelier & González, "Arbitration without privity?", Lexology, October 08 2015, accessible at http://www.lexology.com/library/detail.aspx?g=5cc72e7d-1e90-45f1-abe0-cdf74dc7bb0d. in the second case this was achieved by regarding the third party as having become a contracting party.

[34] A.X.___ v., B.X.___ *et al.* 4A_44/2011. The original of the decision is in French, and the text is available on the website of the Federal Tribunal of Switzerland, www.bger.ch.

[35] S Lamont-Black "Third-party rights and transport documents under the DCFR – potential for an appropriate and effective EU unification and an improvement for the UK?", in W Verheyen, F Smeele and M Hoeks (eds), *Common Core, PECL and DCFR: could they change shipping and transport law?* (2015) pp 129-52, 143-8 (also discussing jurisdiction clauses).

[36] See a special issue of *Trusts and Trustees* on the subject in 2012 (vol 18(4)); M Conaglen, "The enforceability of arbitration clauses in trusts" (2015) 74 Cambridge LJ 450-79. George Washington provided in his will for arbitration of any disputes arising from it: see N Le Poidevin QC, "Arbitration and trusts: can it be done?" (2012) 18(4) *Trusts and Trustees* 302 note 1 for more detail.

basis. At a practical level this means that many couples buying properties now get assistance from family members for the provision of the deposit and also find themselves having to take title in equal pro indiviso shares. We are told by conveyancers that lenders are often also unenthusiastic about there being second ranking securities. Good practice therefore requires that there is separate contractual provision as between the couple in advance of the purchase to deal with what is to happen in the event that the relationship breaks down, particularly in relation to repayment of the deposit from the third party. These contracts are particularly susceptible to an arbitration clause given that it is often uneconomic for parties to litigate and also because there is an issue with the current state of the law when it comes to a lack of flexibility around the options for couples where one of them wants to buy the other out. Clearly, one possibility is that in contracts such as this they could be multiparty with the family member also being a party to the contract but that again does make things more unwieldy and increase costs (which is a huge issue for couples who are starting out and, who, by definition, do not have a huge amount of money). It does occur to me that the TPR rights that are being proposed in terms of the draft bill are potentially useful and helpful in situations such as this and that they would, as presently drafted, be workable/functional and, indeed, enhance rather than detract from the usefulness or arbitration as a method of dispute resolution."[37]

In Scotland, this is to be set against the background of the institution in 2011 of the Family Law Arbitration Group Scotland (FLAGS) model for arbitration in family law matters.[38] There are 48 FLAGS-trained family arbitrators at the time of writing.

Scots arbitration law

7.24 In Scotland the governing statute on arbitration is now the Arbitration (Scotland) Act 2010.[39] Account must also be taken of the Scottish Arbitration Rules, to be found in Schedule 1 of the 2010 Act. Some of these rules are default, in that they can be modified or disapplied by parties' arbitration or other agreement; the remainder cannot be so disapplied or modified and are mandatory.[40] Amongst the "founding principles" stated in section 1 of the 2010 Act is the following: "parties should be free to agree how to resolve disputes subject only to such safeguards as are necessary in the public interest". Under the definitions section "dispute" includes— (a) any refusal to accept a claim, and (b) any other difference (whether contractual or not)"; while ""party" means a party to an arbitration".[41] The Explanatory Notes offer no comment on this, but it must be wider in scope than "parties to the arbitration agreement". This is because the 2010 Act elsewhere refers to the possibility of parties to the arbitration being persons claiming "through or under a party to the arbitration agreement".[42] The 2010 Act thus deliberately leaves open the possibility that persons not privy to the arbitration agreement might nonetheless become parties to the arbitration under the agreement. The example given in the Explanatory Notes is the third party who is an assignee of the contract which includes the arbitration agreement.

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[37] Text of email dated 05/01/2016.
[38] Further detail on the group is on its website: http://www.flagsarb.com/.
[39] As to the use of the Act so far (more extensive than might have been thought) see *The Scottish Arbitration Survey Report No 1 Covering the Period 1 July 2013 to 30 June 2014* (University of Aberdeen, The Law Society of Scotland and Burness Paull, June 2015).
[40] Arbitration (Scotland) Act 2010, ss 7-9.
[41] Arbitration (Scotland) Act 2010, s 2.
[42] Arbitration (Scotland) Act 2010, ss 10 and 11. See also (the default) Rule 1 of the Scottish Arbitration Rules: "An arbitration begins when a party to an arbitration agreement (or any person claiming through or under such a party) gives the other party notice submitting a dispute to arbitration in accordance with the agreement." For discussion of the equivalent phrase in s 82(2) of the Arbitration Act 1996 (England & Wales) see T Molloy QC and T Graham, "Arbitration of trust and estate disputes" (2012) 18(4) *Trusts and Trustees* 279, 282-6.

7.25 The law on whether an assignee can be bound by an arbitration agreement made by its cedent and another party is, however, less than wholly clear at present.[43] In their commentary on the 2010 Act, Dundas & Bartos say that an assignee can become a party to both contract and arbitration agreement, although where an assignee has not become a party to the arbitration agreement, "he may be a person claiming 'through or under' the assignor who is still party to the agreement".[44]

7.26 Dundas & Bartos also make the following statement, with which we have no difficulty in agreeing:

> The holder of a jus quaesitum tertio (right conferred by contract to a third party) by virtue of a contract which also contains an arbitration agreement governed by Scots law will not be bound by and therefore not be a party to the arbitration agreement, given the absence of a Scottish equivalent of s.8 of the Contracts (Rights of Third Parties) Act 1999.[45]

Although not stated in such terms, it can probably be taken as read that such a third party is also not a party "through or under" one of the parties to the arbitration agreement. This would anyway seem correct in principle: the third-party right of existing Scots law and in our proposals arises through or under the contract, not by virtue of the third party standing in the place or shoes of one or more of the contracting parties like an assignee.[46]

7.27 We would add the further point of principle that our proposed legislation on third-party rights is, like the 1999 Act, founded on the basis that contracting parties can only create rights (in a Hohfeldian sense of that word) for third parties.[47] To provide for a requirement that disputes about the third-party right be subject to arbitration, whether expressly or indirectly, is in general to impose inappropriately a duty on the third party.

7.28 For there to be an arbitration at all under the 2010 Act there must first be an "arbitration agreement", which is "an agreement to submit a present or future dispute to arbitration" (a dispute being defined as already noted as "any refusal to accept a claim" and "any other difference (whether contractual or not)".[48] It follows first from the reference to "present dispute" that there is no difficulty where contracting parties and a third party are already in dispute about a third party right said to arise from the contract. The disputants can agree amongst themselves to submit their dispute to arbitration if they so wish.

7.29 The issue with which we are concerned, however, 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. This will be either to make a claim to a substantive third-party right under the contract, or to make a claim which does not arise under the contract (for example, to property, damages for a delict, or the reversal of unjustified enrichment), or to resist a litigation claim against it by one

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[43] See Anderson, *Assignation*, paras 9.15-9.16; also F Davidson, *Arbitration* (2nd edn, 2012), paras 5.45-5.46 ('Transmission of rights and duties under arbitration agreements'). It is not, however, for the present project to seek to clarify this area of the law.
[44] Dundas and Bartos, *Arbitration (Scotland) Act*, S10.39.
[45] Dundas and Bartos, *Arbitration (Scotland) Act*, para S10.42.
[46] In this a clear distinction can be drawn with English law under the 1999 Act, at least as set out in the latter's Explanatory Notes, for which see above, para 7.10.
[47] For the Hohfeldian sense of 'rights' see paras 3.11-3.12 above.
[48] Arbitration (Scotland) Act 2010, s 4; the definition of 'dispute' is in s 2.

of the contracting parties on a matter not arising directly from the contract. Again, if the contracting parties are content that the matter, whatever it is, 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.

7.30 Also central to the policy of the 2010 Act is the exclusion of the courts' jurisdiction in cases for which the parties have entered an arbitration agreement. The critical section giving effect to this policy is section 10, which in pertinent part reads as follows (key words and phrases italicised for highlighting purposes):

> 10 **Suspension of legal proceedings**
>
> (1) The court *must, on an application by a party to legal proceedings concerning any matter under dispute, sist those proceedings* in so far as they concern that matter if—
>
> > (a) an *arbitration agreement provides that a dispute on the matter is to be resolved by arbitration* (immediately or after the exhaustion of other dispute resolution procedures),
> >
> > (b) the *applicant is a party to the arbitration agreement* (or is claiming through or under such a party),
> >
> > (c) notice of the application has been given to the other parties to the legal proceedings,
> >
> > (d) the *applicant has not*—
> >
> > > (i) *taken any step in the legal proceedings to answer any substantive claim against the applicant*, or
> > >
> > > (ii) *otherwise acted since bringing the legal proceedings in a manner indicating a desire to have the dispute resolved by the legal proceedings* rather than by arbitration, and
> >
> > (e) nothing has caused the court to be satisfied that the arbitration agreement concerned is void, inoperative or incapable of being performed.
>
> (2) Any provision in an arbitration agreement which prevents the bringing of the legal proceedings is void in relation to any proceedings which the court refuses to sist. …

7.31 'Sist' is the Scottish equivalent of the English 'stay' and has the same effect of suspending the court action to allow an arbitration to take place.[49] The court has no discretion but to grant the sist if the conditions in section 10 are met.[50] If, however, the

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[49] A sist may be sought by either pursuer or defender on grounds *other* than the existence of a relevant arbitration agreement (e.g. the availability of legal aid to one or other party). See further *SME*, Civil Procedure Reissue, paras 170-172.

[50] In our view it does not follow from this that, in the event, of one or more of the conditions in section 10 not being met, the court still has a discretion to grant a sist for arbitration (c.f. F Davidson, *Arbitration* (2nd edn, 2012), para 5.31). It is only necessary to ask specifically whether the court could grant such a sist were any one of conditions (a)-(e) not met to see that this cannot be possible. We discuss condition (d) in particular at para 7.42 below.

arbitration does not take place, or the tribunal decides in the exercise of its power to determine jurisdiction (which is mandatory under the Scottish Arbitration Rules) not to accept the claim, the court action may be resumed.[51] The tribunal may decide in this connection "what matters have been submitted to arbitration in accordance with the arbitration agreement".[52]

7.32 The key point in section 10 of the 2010 Act for third-party right cases, however, is that only a person who is a party to the arbitration agreement can invoke that agreement in pursuit of a sist for arbitration. In the problem which we wish to address – a contract providing for the resolution of future disputes by arbitration – a third party who was not party to the constitution of the contract cannot be a party to the arbitration agreement, or a person "claiming through or under a party to the arbitration agreement".[53] If third-party right cases are to be susceptible to arbitration, we need to establish a mechanism (or mechanisms) by which a third party can become a party to the arbitration agreement.

Policy conclusions

7.33 The right policy approach to bring Scots law into line with the position, not only in England & Wales and other Common law jurisdictions, but in modern arbitration law more generally, would seem to be to recognise that contracting parties may provide for disputes with third parties on whom they intend to confer an enforceable benefit (a third-party right) to be also subject to arbitration (and thereby, for the most part, exclude the courts), while not binding the third party to arbitration (because it has a right which it need not exercise, albeit the price of doing so will be loss of the substantive benefit). In order to make this effective in relation to the Arbitration (Scotland) Act 2010, however, the law must enable such third parties to become parties to the original arbitration agreement. Further, contracting parties may provide third parties with a right to have claims outside the contract submitted to arbitration. Such claims, whether *by* or *against* the third party, must arise other than under the contract creating the third-party right. That might happen by way of independent delictual, unjustified enrichment, or property claims, or even under collateral contracts. Again, for the third party to be able to exercise this right to arbitration, it must be possible for it to become a party to the arbitration agreement under the 2010 Act. Again, however, the third party cannot be under any duty to become party to the arbitration agreement.

7.34 Enabling third-party right disputes to be submitted to arbitration in this fashion does not seem to be inconsistent with the policy of the Arbitration (Scotland) Act 2010. The problem which the 2010 Act does not resolve at present is how the third party can enforce or invoke an arbitration agreement between the contracting parties, save by being made by the contracting parties and with its consent party to that arbitration agreement or by making a separate arbitration agreement with one or more of the contracting parties. That will not be possible if at the time enforcement is sought the contracting parties are unwilling to accommodate the third party, whatever their intention may have been at the time of their agreement as disclosed by interpretation thereof.

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[51] For the arbitrator's mandatory power to determine the tribunal's jurisdiction, see Scottish Arbitration Rules, rules 19-21 and 23.
[52] Scottish Arbitration Rules, rule 19(c).
[53] Arbitration (Scotland) Act 2010, ss 10 and 11.

The scheme of our draft Bill

7.35 The correct way in which to implement the policy with regard to third parties and arbitration would seem to be to follow the divisions found in section 8 of the 1999 Act so that a third party can become a party to an arbitration agreement under the 2010 Act in order (i) to enforce a substantive third-party right to some performance from one or more of the original contracting parties, or (ii) to enforce or invoke a right to arbitration against contracting parties in a dispute which does not arise directly from any other provision in the contract itself. We deal with each of these in turn before going on to show that in neither case is there any question of the third party coming under a *duty* to arbitrate directly enforceable by the contracting parties.

(i) Third party enforcing substantive third-party right by arbitration

7.36 A person with a substantive third-party right under a contract becomes a party to an arbitration agreement also found (separately) in the contract if that agreement provides that a dispute about the undertaking constituting that substantive right *must* be submitted to arbitration in accordance with the arbitration agreement. In other words, the substantive benefit is wholly conditional, or dependent, upon arbitral enforcement. Our draft Bill describes the arbitration agreement as providing "for a dispute on the matter … to be resolved by arbitration".[54] If the third party submits the dispute to arbitration, it will then be for the arbitrator to decide first whether or not the arbitration agreement is intended to give the third party a right to arbitration.[55] If so, the claim to the substantive benefit to the third party is dependent upon arbitral rather than judicial enforcement. If the arbitrator decides that the third-party dispute is not covered by the arbitration agreement, the third party is of course free to sue instead in court.

7.37 The third party who raises a court action first rather than submitting to arbitration in respect of a dispute relating to its substantive right may be met with an application by the defender contracting party or parties for a sist for arbitration (since under the contract such a dispute *must* be submitted to arbitration).[56] We think that in these circumstances the mere fact that the third party has raised a court action should not be seen as an automatic renunciation of either its substantive right or the right to submit disputes about that right to arbitration. The third party may well have raised the action on taking the view (whether with or without professional advice) that even a generally expressed arbitration agreement between the contracting parties did not extend to disputes about its substantive right. If, having obtained a sist for arbitration, the defenders' first procedural step in the subsequent arbitration was to argue that the third-party right had been renounced by the raising of the sisted court action, they could hardly be seen as acting in good faith in the arbitration.

7.38 Whether, however, there may nonetheless be circumstances in which the defenders could successfully respond to a third-party *action*, not with an application for a sist, but with a

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[54] See s 9(2)(b) of the draft Bill. It will be noted that the same formula is also used in s 9(3) where (as explained in paras 7.39-7.41 below) the arbitration agreement can only provide the third party with the *option* of submitting a dispute to arbitration for resolution, but cannot compel it to do so. Although in both types of case the arbitration agreement will provide for disputes to be resolved by arbitration, they will, in practice, do so by means of different language – such resolution is mandatory for the s 9(2) type but optional for the s 9(3) type.

[55] See the mandatory Rule 19 of the Scottish Arbitration Rules and also the further discussion of interpretation at paras 7.44-7.47 below.

[56] The defender(s) will lose their right to a sist for arbitration by taking "any step in the legal proceedings to answer any substantive claim" of the third party (Arbitration (Scotland) Act 2010, s 10(1)(d)(i)).

counter-claim that the third party had now renounced its substantive rights by trying to enforce them in the wrong manner, is, we think, best left to the court in which the question arises. But we think it not at all likely that such an argument would be successful unless the arbitration agreement very clearly covered disputes about the third party's right, and yet a court action had been raised. It may, though, prevent the making of un-meritorious strategic arguments and save courts and arbitrators from waste of time and other resources if it is provided explicitly that the third party's right to arbitration is not lost merely by raising an action first. If, however, the third party refuses outright to submit to the arbitration even after a sist, then it will probably lose its substantive right anyway, because that right is conditional upon arbitral enforcement.

(ii) Third-party right to arbitration only

7.39 A third party may also become a party to an arbitration agreement intended to operate in its favour even although it has no other third-party right under the contract in question (in other words, the third-party right is purely procedural); but only by actually invoking it. This will typically occur by way of the third party seeking a sist for arbitration in a litigation raised against it by one or more of the contracting parties (as in the *Fortress Value* case discussed above). But it may also be a way for a third party to make a claim against one or more of the contracting parties, or in relation to the matters at stake in the dispute. The claims, whether by or against the third party, will be in respect of a property right or arising from delict or unjustified enrichment or some other entitlement outside the contract containing the arbitration agreement.

7.40 An example of this latter possibility may be provided by the "pre-purchase agreements" already mentioned, under which cohabiting couples who have purchased a house together, but with the financial assistance of a relative who takes title to it jointly with them to secure his or her interest, agree to arbitration in the event of their separation.[57] The agreement between the couple may provide for the arbitration to involve the relative as a party thereto, but not spell out what is to happen to the relative's property rights and or how the funding provided by that person is to be repaid. The relative's third-party right to participate in the arbitration will accordingly be to have a determination of the legal effects of the property right and the claim for repayment of its funding in the circumstances of the dispute.

7.41 In such circumstances, however, the third party becomes a party to the arbitration agreement only if that party so chooses. It may equally choose to litigate the dispute, and we do not think there is anything the contracting parties can do about that. There is no basis for a sist for arbitration against a person who is not party to the arbitration agreement.

7.42 But is the third party's choice of raising an action in such circumstances also a renunciation of its entitlement to submit the dispute to arbitration? We think that it should be made clear in the draft Bill that the mere raising of an action should not be treated as renunciation of the right to submit to arbitration.[58] In this connection it should be noted that section 10(1)(d)(ii) of the 2010 Act provides in effect that a person who raises an action may still seek a sist of that action *unless* it has "otherwise acted since bringing the legal

[57] See para 7.23 above.
[58] The party litigant ineligible for legal aid and without professional advice (such as might be found in a family law case) needs to be remembered here, amongst other points: see further para 7.47 below.

proceedings in a manner indicating a desire to have the dispute resolved by the legal proceedings rather than by arbitration". This makes it clear that a pursuer may have the possibility of arbitration brought to its attention and opt to go down that route instead. The sist will leave open the possibility of a return to court in the event that the arbitrator determines the dispute not to be within the scope of the arbitration agreement. It is consistent with the 2010 Act, therefore, to provide that only if combined with other relevant facts and circumstances (in particular, persistence with the action even after the other party has indicated readiness to submit the dispute to arbitration under the clause in question) should the third party's raising an action be held to amount to a renunciation of its right to arbitration.

(iii) No duty on third party to arbitrate

7.43 In neither of the two cases covered by the draft section is the third party under any duty to arbitrate. In the first case, arbitral enforcement is a condition of the substantive right, and the third party thus has a choice between submitting to arbitration and not doing so. While in a sense this ties the third party to arbitration, this is simply to obtain a benefit which otherwise it would not have at all. The contracting parties can of course waive the condition of arbitral enforcement of a third party's substantive right, and allow a court action over the dispute instead. In the second case, similarly, the third party only becomes a party to the arbitration agreement by choosing to invoke it, whether by seeking a sist of the defender's action against it, or by submitting a claim of its own in an arbitration under the agreement. But in this case the third party can renounce the right to have any claims against it referred to arbitration, or raise an action of its own about a matter in dispute with one or more of the contracting parties. There is no question of any compulsion on the third party to arbitrate in this second case, no matter how mandatory the wording of the arbitration agreement may appear to be on the matter.

(iv) Drafting and interpreting the arbitration agreement

7.44 We think that our draft Bill meets the criticisms of the 1999 Act's section 8(1) made by Clare Ambrose.[59] The contracting parties are left free not to include the third party or disputes over the third party's right in their arbitration agreement if they so wish, while an arbitrator or a court may be persuaded that as a matter of interpretation a seemingly general arbitration clause which, however, makes no direct mention of the substantive third-party right does not apply to disputes about that right. Drafted as it is, our draft Bill allows what she thinks would be the desirable outcomes of a narrow approach to the scope of the 1999 Act:

> The parties may ensure that third-party rights are treated as "subject to" an arbitration clause by drawing the arbitration clause widely, for example: "all disputes arising under this contract shall be arbitrated at London". Parties could avoid uncertainty by making express provision in their arbitration agreement for third party disputes, such as: "all disputes arising under this contract shall be arbitrated, including any disputes as to the sub-contractor's rights under this contract". The parties could also make provision in the substantive terms of their contract to make clear that certain third parties' rights are subject to arbitration.[60]

[59] See paras 7.16-7.17 above.
[60] C Ambrose, "When can a third party enforce an arbitration clause?" [2001] Journal of Business Law 415, 423.

7.45 But such clarity may not always be achieved by the contract drafter. In this context Lord Hoffmann has made some important observations on the better approach to interpretation of general arbitration clauses:

> "In my opinion the construction of an arbitration clause starts from the assumption that the parties, as rational businessmen, are likely to have intended any dispute arising out of the relationship into which they have entered or purported to enter to be decided by the same tribunal. The clause should be construed in accordance with this presumption unless the language makes it clear that certain questions were intended to be excluded from the arbitrator's jurisdiction. As Longmore LJ remarked … 'if any businessman did want to exclude disputes about the validity of a contract, it would be comparatively easy to say so.'"[61]

Dundas & Bartos elaborate what may be seen as the converse case:

> "Where, however, the arbitration agreement covers only a limited scope of disputes arising out of a main contract and leaves other disputes for litigation or other forms of dispute resolution the assumption in [*Fiona Trust and Holding Corp v Privalov* [2007] 4 All ER 951] will not apply and standard principles of contractual interpretation will apply."[62]

7.46 Lord Hoffmann's "assumption/presumption" runs somewhat against Clare Ambrose's previously cited argument against presumptions in the interpretation of arbitration clauses that they are applicable to third-party right disputes under the contract.[63] But we think her concern is about general arbitration clauses which are, however, more or less on their face in some way inapt to disputes involving a third party and its rights under a contract between others (as, perhaps, in the *Fortress Value* case).[64] In that situation, Lord Hoffmann's "assumption/presumption" might be more readily overcome, with the effect that the third-party dispute could be found not to be covered by the arbitration agreement, whether by a court considering the matter or an arbitrator determining its own jurisdiction. Finally, it is also important to remember that these matters of interpretation of the arbitration agreement are essentially for the arbitral tribunal under the Scottish Arbitration Rules. A court which is asked to sist an action for arbitration should not be seeking to take a definitive view on questions which are for the tribunal to decide

7.47 But in general treating an arbitration agreement which appears to be designed to cover disputes arising from the contract in general as also reaching third parties with rights under that contract seems more consistent with ordinary commercial understandings. It is probably also the better assumption to make in the pre-purchase agreement case. In both settings, it would be highly undesirable to have separate proceedings giving rise to the possibility of two (or more) incompatible decisions about the subject-matter of the dispute. This factor also provides another reason for not treating the third party's raising of an action as by itself a renunciation of its right to arbitrate; the door through which all disputes can be

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[61] *Fiona Trust and Holding Corp v Privalov* [2007] 4 All ER 951 (HL) para 13; Dundas and Bartos, *Arbitration (Scotland) Act*, paras S4.07-S4.09.

[62] Dundas and Bartos, *Arbitration (Scotland) Act*, S4.09, citing *Guidance Investments Ltd v Guidance Investments Hotel Co BSC (Closed)* [2013] EWHC 3413 (Comm)

[63] See para 7.16 above.

[64] See paras 7.11-7.15 above.

brought under the shelter of the arbitral tribunal should remain open unless the third party takes clear steps to close it.[65]

(v) Avoiding fictions

7.48 Finally, we have taken particular note of Clare Ambrose's forceful criticism of section 8(2) of the 1999 Act in preparing our draft Bill. We wish to avoid awkward fictions. Our overall policy is to recognise third-party rights in contracts, including third-party rights to arbitration of disputes, where such rights are intended by the contracting parties. Section 9(2)(b) of our draft Bill makes a third party a party to an arbitration agreement where the contracting parties so intend and the third party actually takes a first procedural step to exercise the right thus intended.[66] While at first sight it may look a little strange for a right to come into effect at the very moment the right-holder starts to act under it, it is not so very different from the standard case where the right becomes effective merely by the creditor for whom the contract provides coming into existence.[67]

7.49 Further, it is not any part of our thinking on third-party rights in general to draw distinctions between 'positive' and 'negative' benefits in this area; both are covered within our concept of third-party rights.[68] A right to compel another person to submit to arbitration while not being bound to do so oneself is perfectly compatible with our Bill's conception of a third-party right. In principle, therefore, we can see nothing in our draft Bill to prevent contracting parties creating a third-party right (but not duty) to arbitration of disputes arising between them and the third party while not also including any more substantive third-party right.

Difficulties with Article 6(1) ECHR?

7.50 In consultation David Bartos, advocate, raised with us a possible difficulty with the overall approach just outlined. He pointed out the potential significance of article 6(1) of the European Convention on Human Rights in the present context:

> In the determination of his civil rights and obligations … everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgment shall be pronounced publicly.

Several decisions of the European Court of Human Rights have made clear that arbitration proceedings are affected by article 6(1).[69] Their gist is that the rights to a public hearing and judgment, to an impartial tribunal, and also one established by law, can be waived but only with the free and unequivocal consent of the parties to the dispute.[70] So far as non-statutory arbitration is concerned, this will usually be through the consent manifested by an arbitration agreement. A third party who is required to arbitrate in order to resolve disputes about its

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[65] See para 7.31 above.
[66] This could include submitting to an arbitration after raising, then sisting, an action on the disputed matter.
[67] See paras 4.9-4.10 above.
[68] See paras 3.6-3.14 and 4.25-4.28 above.
[69] There are useful discussions of Art 6(1) ECHR in the context of trust arbitrations in T Molloy and T Graham, "Arbitration of trust and estate disputes", (2012) 18(4) *Trusts and Trustees* 279, 289-9; Trust Law Committee, "Arbitration of trust disputes" (2012) 18(4) *Trusts and Trustees* 296, 301-5.
[70] See e.g. *Deweer v Belgium* (A/35) (6903/75) [1979-80] 2 EHRR 439; *Suovaniemi v Finland* (31737/96), 23 February 1999, unreported. See further Dundas and Bartos, *Arbitration (Scotland) Act*, paras S1.20-S1.22; note also F Davidson, *Arbitration* (2nd edn, 2012), paras 1.14-1.17.

substantive rights under the contract cannot be said to give a waiver of its article 6(1) ECHR rights by its free and unequivocal consent to that manner of proceeding.[71]

7.51 In the European Court of Human Rights case of *Suda v Czech Republic*, the applicant was a minority shareholder of a public company, C.[72] In November 2003 the general meeting of the company took a majority decision (although the applicant voted against it) by which C. would be closed down without liquidation and its assets taken over, under contract, by the main shareholder, E (another company). The redemption value of the shares held by the minority shareholders, including the applicant, and the means by which it could be disputed, were determined by the contract concluded by C and E to transfer the assets). A clause in the contract provided that any re-examination of the redemption value would be a matter for arbitration and not ordinary court proceedings. This right to re-examination appeared in the contract in order to fulfil the requirements of article 220p paragraph 2 of the Czech Commercial Code, which obliged "the principal shareholder to give the other shareholders an appropriate financial settlement…The contract for taking over the assets must inform the minority shareholders of their right to payment as well as their right to re-examine the amount in a period of 2 months counted from the day the asset transfer was registered." The vote at the general meeting had two parallel outcomes: a contract between C and E was formed and article 220p was triggered. Mr Suda's right to have the price re-examined arose from the application of the national Commercial Code, not the contract to transfer the assets which did not intend to confer a benefit on Mr Suda. He was therefore not a third party right-holder in the sense under discussion in this chapter generally. Court proceedings brought by the applicant to have the redemption value re-examined and invalidated were, however, unsuccessful due to the arbitration clause.

7.52 The European Court of Human Rights held that article 6(1) ECHR was violated. The court's reasoning is summarised thus in the information note published on its website:[73]

> The present case concerned neither voluntary arbitration nor compulsory arbitration required by law, but an agreement to submit to arbitration made by third parties, namely, the company of which the applicant was a minority shareholder and the main shareholder of that company. The Court had to examine the compatibility with the requirements of Article 6 § 1 of a given situation that obliged the applicant to have recourse to arbitration under a clause that he had not himself contracted. The applicant had instituted proceedings in the ordinary courts, which had found that the clause in question had been validly contracted and had declared the proceedings terminated without ruling on the merits of the case. The only option open to the applicant had therefore been to submit the case to the arbitrators named in the clause in question and wait for them to rule on whether they had jurisdiction to hear the case. Had he done so, however, he would have run the risk that the arbitrators, who were on the list of a private company and were guided by the rules governing that company, which he had not chosen, would rule not only on their jurisdiction but also, in the event that they accepted jurisdiction, on the merits of the case.

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[71] See further Dundas and Bartos, *Arbitration (Scotland) Act*, para S4.10: "An arbitration agreement governed by Scots law which confers a *jus quaesitum tertio* (right conferred to a third party) will not bind the third party to arbitration, not least because its mere existence will not amount to a waiver by the third party of its right under art 6(1) of the ECHR …".

[72] *Suda v Czech Republic* (1643/06), 28 October 2010. The judgment in the case is available only in French and Romanian. The following summary draws on the English information note available on the ECtHR website at http://hudoc.echr.coe.int/eng?i=002-764. The European Court of Human Rights has subsequently followed and applied *Suda*: see *Chadzitaskos and Franta v Czech Republic* (7398/07, 31244/07, 11993/08 and 3957/09), 27 September 2012.

[73] See http://hudoc.echr.coe.int/eng?i=002-764.

> Accordingly, the arbitrators imposed on the applicant would have indirectly determined the scope of jurisdiction of the ordinary courts because, if they had made an arbitration award on the merits of the case, any application by the applicant to the court would have been limited to procedural matters. It was only if the arbitrators had considered that the arbitration clause in question could not confer jurisdiction on them that the ordinary court could have ruled on the merits of the case. It was clear that the arbitration procedure would not in the present case fulfil two of the fundamental requirements of Article 6 § 1, namely, a) a lawful tribunal – because the arbitration clause gave decision-making power to arbitrators on the list of a limited liability company that was not an arbitration tribunal established by law – and b) a public hearing – because the arbitration procedure would not have been public and the applicant had not in any way waived his right to a public hearing. Lastly, national regulations concerning companies, governing relations between shareholders, were absolutely necessary to any activity subject to a market regime. These sometimes gave rise to an obligation on minority shareholders to sell their shares to the majority shareholder. The Court found that minority shareholders should be afforded appropriate means of defence in order to prevent an imbalance resulting in arbitrary and unjust deprivation of one person's property in favour of another. Requiring the applicant to submit his pecuniary claim to arbitration bodies that did not meet the fundamental guarantees of Article 6 § 1, without his having waived those guarantees, amounted to a violation of his right to a court.

7.53 The decision in *Suda* is clearly coloured by the court's perception that the power of majority over minority shareholders had been abused. But it looks nonetheless like a strong assertion that arbitration agreements can only escape the requirements of article 6(1) ECHR by virtue of the prior consent of the parties to the arbitration. While a third party may of course enter arbitration proceedings voluntarily in order to enforce some substantive third-party right under a contract made by others, or to defend a claim against it to which an arbitration clause in a contract between others is relevant, it cannot be required to do so. If section 8 of the 1999 Act and section 9 of our draft Bill do compel a third party to undertake arbitral rather than judicial proceedings, then after *Suda* they would seem to fall foul of article 6(1). This would make section 8 of the 1999 Act potentially subject to a judicial declaration of incompatibility in England & Wales, while section 9 of our draft Bill would lie beyond the legislative competence of the Scottish Parliament.[74]

7.54 We have, however, come to the view that there is no question of our draft Bill (or the 1999 Act) compelling any party to undertake arbitral proceedings contrary to Article 6(1) ECHR. We set out our reasons for this conclusion in the following paragraphs.

7.55 The growing international recognition of "arbitration without privity" and paradigm shifts in the understanding of what arbitral consent means, discussed above, are also more positive indicators of the general commercial acceptability of third-party right-holders being subject at least to some extent to arbitration clauses in the contracts from which these rights spring. In these developments the expression of arbitration as a *pre-condition* for enforcing a benefit in some way in dispute is not seen as a means of binding or constraining the third party's freedom of choice. As Colman J said in the *Nisshin* case, others have created the possibility of a benefit which would not otherwise exist for that third party, and which that third party remains free to reject or renounce.[75] The third party might become better off with the benefit, but is no worse off merely through not taking it up.

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[74] See s 29(2)(d) of the Scotland Act 1998.
[75] *Nisshin Shipping Co Ltd v Cleaves & Co Ltd* [2003] EWHC 2602 (Comm), paras 52-53.

7.56 There is also an important distinction between the situation revealed in the *Suda* case and what may be termed the ordinary case of third-party rights under a contract with an arbitration clause — i.e. that covered by section 8(1) of the 1999 Act and section 9(2)(a) of our draft Bill — where there is a substantive third party benefit which can only be enforced through an arbitral process. In general with the latter, the substantive right is to a benefit, whether positive, as with a payment of money, or negative, as with the conferral of some immunity from a potential liability. *Suda* in contrast is not about a third-party right or benefit of such a kind, but rather involves a situation in which a person held shares which in the circumstances he was compelled to sell and had to submit to whatever detrimental decision about the value of those shares was made by arbitrators entirely appointed by others. That outcome was heavily influenced by a particular provision of Czech company law which had been repealed even before the European Court pronounced judgment.[76] There is surely a considerable difference between the *Suda* situation and making a party choose whether or not to pursue a dispute about a contractually provided benefit through a genuinely commercial arbitration process established under the contract.

7.57 Nor, more obviously, is it objectionable under article 6(1) ECHR for contracting parties to provide a third party with a *right* to have disputes with them arbitrated, as in section 8(2) of the 1999 Act and section 9(2)(b) of our draft Bill. The aim of both sub-sections is to deal with the case where the third-party right clause takes the form of an undertaking for the submission of disputes between the third party and one or more of the contracting parties to arbitration, i.e. the third-party right is specifically a right *for the third party* to submit disputes to arbitration. The third party cannot be bound to arbitrate (imposition of a duty); but if it chooses to invoke the arbitration clause in response to an action against it by a contracting party, then the third party by voluntary action becomes party to an arbitration agreement between itself and the contracting party or parties. In terms of article 6(1) ECHR, therefore, section 9(2)(b) of the draft Bill appears to be entirely acceptable, as also section 8(2) of the 1999 Act.

7.58 Thus, overall, the effect of section 9 of our draft Bill is that a third party who takes a voluntary step into the arbitration process, either acting on its own initiative or in responding to a dispute being raised against it, thereby waives the rights to a judicial hearing that meets the full requirements of article 6(1) ECHR.

7.59 Finally, we note that standard works on the English law of contract and arbitration do not see the article 6(1) point as a difficulty for section 8 of the 1999 Act, even although they note the general applicability of article 6(1) ECHR to arbitration proceedings.[77] Some anxiety about potential problems arising from article 6(1) was expressed by the Law Commission for England & Wales in its 1996 Report.[78] But clearly the enactment of section 8 of the 1999 Act in the shadow of the earlier enactment of the Human Rights Act 1998 (even although that

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[76] See *Suda v Czech Republic* (cited at note 71 to para 7.51 above), para 15, and the response of the Czech Government to the *Suda case* dated 16 September 2011, accessible at http://caselaw.echr.globe24h.com/0/0/czech-republic/2012/03/08/case-of-suda-against-the-czech-republic-109755-1643-06.shtml.

[77] Amongst contract books see e.g. *Chitty on Contracts* (32nd edn, 2015) paras 18.100, 32.015 (texts unchanged since 31st edn of 2012); *Treitel The Law of Contract* (13th edn, 2011) para 14.098; for arbitration books see *Russell on Arbitration* (24th edn, 2015) paras 1.039-1.041, 3.027, 7.034; Lord Mustill and S Boyd, *Commercial Arbitration: 2001 Companion Volume to the Second Edition* (2001), 76-9 and chapter 8. The second edition was published in 1989, before both the Human Rights Act 1998 and the Contracts (Rights of Third Parties) Act 1999. A third edition of *Mustill & Boyd* was, however, anticipated at the time of writing (May 2016).

[78] Law Com No 242 para 14.18 note 26.

would not come into force until 2 October 2000) meant that any doubts on this score had been overcome.

Conclusions

7.60 We would accordingly recommend:

45. It should be provided that a third party becomes a party to an arbitration agreement between other parties for the purposes of the Arbitration (Scotland) Act 2010 if (i) a contract contains an undertaking in favour of that third party, disputes about which must be submitted to arbitration under an arbitration agreement in the contract; or (ii) a contract contains an arbitration agreement providing that one or more descriptions of dispute between one or more of the contracting parties and a third party other than those covered by (i) above may be submitted to arbitration, and the third party invokes that agreement.

(Draft Bill, section 9)

46. In cases of the kind provided for in recommendation 45, the third party is not to be regarded as having renounced its right to invoke an arbitration agreement merely by first raising a court action in relation to the matter under dispute.

(Draft Bill, section 10(2))

Chapter 8 List of Recommendations

1. (a) The legislation should be a comprehensive statutory statement of the law on third-party rights in contracts, replacing the relevant common law; but it should not do more than that. The statutory rules should in general be subject to any express provisions in the contract, and may be varied or disapplied if parties wish.

   (b) From commencement, no new *jus quaesitum tertio* may be created, though existing ones will continue to be effective, and the legislation will not apply (unless parties so agree) to undertakings in favour of a third party which were created before commencement**.**

   (Paragraph 1.45; Draft Bill, *passim*; sections 12 and 13)

2. The legislation should apply generally to contracts involving third-party rights, with no express exclusions (in particular, for employment contracts). This would, however, leave existing specific third-party rights regimes (such as that governing the carriage of goods by sea) intact.

   (Paragraph 1.62)

3. The principal persons involved in a contract containing a third-party right should be described as the 'contracting parties' and the 'third party'.

   (Paragraph 3.5; Draft Bill, section 1)

4. The statutory replacement for *jus quaesitum tertio* should be termed 'third-party right'.

   (Paragraph 3.14; Draft Bill, section 1)

5. The provisions in a contract which are intended to comprise the third party's rights thereunder should be referred to as the 'undertaking'.

   (Paragraph 3.21; Draft Bill, section 1(1)(a))

6. The third party should be entitled to enforce or otherwise invoke the right comprised in the undertaking.

   (Paragraph 3.24; Draft Bill, section 1(2))

7. The third party must be identified or identifiable from a description in the contract.

   (Paragraph 4.8; Draft Bill, section 1(3))

8. It should continue to be the case that a right in favour of a third party who is not in existence at the time that the right is set up is valid and enforceable by any such third party on subsequently coming into existence.

   (Paragraph 4.10; Draft Bill, section 1(4)(a))

9. When a third-party right is drawn in favour of a class, a person who was in existence at the time the relevant contract is formed, but was not at that time a member of the intended class, may become entitled to benefit from and to enforce the third-party right upon joining the class if the contracting parties so intend**.**

(Paragraph 4.12; Draft Bill, section 1(4)(b))

10. The current law, including the rules on contractual interpretation, should continue to be used to determine the identity of any third party with a right under a contract, but no legislative provision to this effect is needed.

(Paragraph 4.15)

11. The intention of the contracting parties as determined from their contract that a person who is not a party to the contract should be legally entitled to enforce or otherwise invoke the undertaking in its favour should continue to be the basis for the existence of a third-party right.

(Paragraph 4.16; Draft Bill, section 1(1)(b))

12. There should be legislative provision to the effect that neither delivery, intimation or communication of the undertaking to the third party is necessary for the constitution of a third-party right. This is, however, without prejudice to the application of any other legal rules imposing requirements for the creation of an enforceable obligation.

(Paragraph 4.18; Draft Bill, section 2(4)(b) and (7))

13. The current rule in Scots law, that the intention of contracting parties to create a right by their contract for an identified or identifiable third party can be express or implied, should remain. No special rules are needed on when an intention to create a third-party right is to be implied.

(Paragraph 4.24; Draft Bill, section 2(3))

14. It should be expressly provided that (i) an exclusion or limitation of the third party's liability to one or more of the contracting parties, or to a fourth party; (ii) agreements that a third party should not be liable at all; and (iii) agreements that a third party is to be indemnified against any liability, can constitute a third-party right.

(Paragraph 4.28; Draft Bill, section 2(5) and (6))

15. There should be no requirement of acceptance by the third party for the constitution of a third-party right.

(Paragraph 4.29)

16. There is no need in the present exercise to deal with competing claims between the third party and the contracting parties, and these should be left as matters for the interpretation of the contract and/or the application of other relevant rules of law such as donation.

(Paragraph 4.34)

17. It is unnecessary to enact a rule that a third-party right may be validly constituted other than in formal writing.

(Paragraph 4.37)

18. There should be express but general provision that a third party's right may be future or conditional in nature.

(Paragraph 4.39; Draft Bill, section 2(2))

19. Any requirement that a third-party right cannot be constituted in a contract unless the right has first been made irrevocable by the contracting parties should be abolished. Instead, it should be made clear that a third-party right may be constituted even although it is subject to cancellation or modification, whether by the contracting parties or through other circumstances, and that contracting parties may cancel or modify a third-party right unless prevented by some other provision in the proposed statute.

(Paragraph 5.5; Draft Bill, sections 2(4)(a) and 3(1))

20. Where a contract sets up a third-party right, the fulfilment of conditions for the third party's entitlement to enforce the right will prevent any subsequent modification or cancellation by the contracting parties in respect of that third-party entitlement.

(Paragraph 5.14; Draft Bill, section 4(1))

21. Where a contract sets up a third-party right, the contract may expressly reserve to the contracting parties a power to cancel or modify the undertaking with retroactive effect notwithstanding the fulfilment of any conditions for the third party's entitlement to enforce the right or the rendering of performance under the right. The power must, however, be consistent with the constitution of a third-party right.

(Paragraph 5.20; Draft Bill, section 4(2))

22. Where a contract provides for an unconditional third-party right, the contracting parties will have no entitlement to modify or cancel the right if the undertaking conferring the right has been notified to the third party by the contracting parties. This rule is subject to the freedom of the contracting parties to provide otherwise in the contract or the notification.

(Paragraph 5.27; Draft Bill, section 5)

23. There should be no provision to the effect that any registration of the contract containing the undertaking in favour of the third party has the effect of making that party's right uncancellable or unmodifiable.

(Paragraph 5.31)

24. An express statement in the relevant contract that a third-party right conferred by the contract is uncancellable and/or unmodifiable should be given effect.

(Paragraph 5.36; Draft Bill, section 3(2))

25. There is no need to provide for the enforceability of a post-contract promise to the third party by the contracting parties that a third-party right conferred by the contract is uncancellable or unmodifiable.

(Paragraph 5.38)

26. A third-party right becomes uncancellable or unmodifiable where, to the knowledge, or with the acquiescence, of the contracting parties, (i) the third party acts (or refrains from acting) in reliance on knowledge of its right, and (ii) the third party's position is thereby affected to a material extent, and (iii) subsequent cancellation or modification of that right by the contracting parties would adversely affect the third party to a material extent. In so far as the rules of personal bar or waiver might otherwise be available in such a situation they are to be expressly disapplied.

(Paragraph 5.46; Draft Bill, section 6))

27. In addition, such third party reliance as is reasonably foreseeable by the contracting parties (although they had no actual knowledge of it at the time it happened) should also have the effect of making the third-party right uncancellable or unmodifiable.

(Paragraph 5.47; Draft Bill, section 6(1)(d)(ii))

28. The contracting parties may provide in their contract that third-party reliance in terms of recommendations 26 and 27 will not have the effect of making the third party right uncancellable or unmodifiable. But to be effective such an exclusion must be brought sufficiently to the notice of the third party before any act of reliance by that party.

(Paragraph 5.51; Draft Bill, section 6(3))

29. No provision is needed about the effects of assignation in relation to making a third-party right uncancellable or unmodifiable. Where appropriate the proposed rules on third party reliance may provide routes to solutions in problem cases.

(Paragraph 5.63)

30. There should be no provision to the effect that any purported acceptance of the right by the third party has the effect of making the right uncancellable or unmodifiable.

(Paragraph 5.65)

31. There should be no legislative provision on whether the third party's death prior to any cancellation or variation of the contract containing its right has the automatic effect of making the right uncancellable or unmodifiable so that it becomes enforceable by the deceased's executors.

(Paragraph 5.68)

32. In relation to making a third-party right uncancellable or unmodifiable, there should be no provision about the effect of the third party declaring a trust over its right.

(Paragraph 5.70)

33. The statute should provide that a third party may renounce or reject the right conferred upon it by the contracting parties, with the effect that the right then falls.

(Paragraph 6.8; Draft Bill, section 10)

34. Such renunciation of a third-party right may be express or implied from the third party's conduct, although the mere passivity of the third party will be insufficient.

(Paragraph 6.8; Draft Bill, section 10)

35. No further provision is needed to protect contracting parties against unfairness to them resulting from the third party's renunciation of its right, or to say that the third party's power to renounce cannot be excluded by the contracting parties.

(Paragraph 6.8)

36. The statute should provide that the third party has at its disposal all the remedies for breach of its right to which a contracting party would be entitled were the undertaking in favour of such a party. But the contracting parties should be left free to define the remedies with which a third party may enforce its right.

(Paragraph 6.15; Draft Bill, section 7)

37. The statute should include a general rule to the effect that the party bound to perform under the right in favour of the third party may assert against the third party all defences which the party bound to perform could assert against the other party to the contract, so long as these defences are also relevant to the third party's right under the same contract. This rule may be varied or excluded in the contract.

(Paragraph 6.30; Draft Bill, section 8)

38. No equivalent to section 3(4) of the Contracts (Rights of Third Parties) Act 1999 need be included in the proposed statute.

(Paragraph 6.37)

39. It should be made clear that the short negative prescription of the Prescription and Limitation (Scotland) Act 1973 applies to third-party rights arising from a contract.

(Paragraph 6.40; Draft Bill, section 11)

40. There should be no express rule to the effect that the third party has a remedy against the initially defaulting party where one contracting party defaults on a contractual obligation with the result that another contracting party is unable to offer due performance of a third-party right.

(Paragraph 6.45)

41. No express provision is needed to allow contracting parties to exclude or limit a liability to third parties that would otherwise arise.

(Paragraph 6.49)

42. No equivalent to section 4(1) of the Contracts (Rights of Third Parties) Act 1999 should be included in our proposed statute.

(Paragraph 6.54)

43. There is no need for the proposed statute to require a person bringing an action to enforce a third-party right against one or more of the contracting parties liable to perform to bring any other contracting party into that action. It should be considered, however, whether the Rules of Court ought to require the service of the summons on any such other contracting party for its interest.

(Paragraph 6.56)

44. No equivalent to section 5 of the Contracts (Rights of Third Parties) Act 1999 should be included in our proposed statute.

(Paragraph 6.60)

45. It should be provided that a third party becomes a party to an arbitration agreement between other parties for the purposes of the Arbitration (Scotland) Act 2010 if (i) a contract contains an undertaking in favour of that third party, disputes about which must be submitted to arbitration under an arbitration agreement in the contract; or (ii) a contract contains an arbitration agreement providing that one or more descriptions of dispute between one or more of the contracting parties and a third party other than those covered by (i) above may be submitted to arbitration, and the third party invokes that agreement.

(Paragraph 7.60; Draft Bill, section 9)

46. In cases of the kind provided for in recommendation 45, the third party is not to be regarded as having renounced its right to invoke an arbitration agreement merely by first raising a court action in relation to the matter under dispute.

(Paragraph 7.60; Draft Bill, section 10(2))

APPENDIX A

DRAFT BILL

Contract (Third Party Rights) (Scotland) Bill

[DRAFT]

An Act of the Scottish Parliament to make provision about the enforcement of contractual terms by third parties.

INTRODUCTORY NOTE

At common law, the parties to a contract can create an enforceable right in favour of a third party, known as a *jus quaesitum tertio* (or JQT). However, the current law is not well defined. In addition, the requirement that the right must be irrevocable means that it is insufficiently flexible to be of practical value. The Contract (Third Party Rights) (Scotland) Bill ("the Bill") seeks to reform that rule of contract law, replacing it with a statutory version.

1 Creation of a third-party right

(1) A person who is not a party to a contract acquires a third-party right under it where—

(a) the contract contains an undertaking that one or more of the contracting parties will do, or not do, something for the person's benefit, and

(b) at the relevant time it was the intention of the contracting parties that the person should be legally entitled to enforce or otherwise invoke the undertaking.

(2) The third-party right is the right to enforce or otherwise invoke the undertaking.

(3) The person who is to acquire a third-party right under a contract must be identifiable from the contract by being either named or described in it.

(4) A third-party right may be acquired by a person despite the fact that at the relevant time the person—

(a) was not in existence, or

(b) did not fall within the description of persons (if any) whom the contracting parties intended should benefit from, and be legally entitled to enforce or otherwise invoke, the undertaking.

(5) In subsections (1)(b) and (4), "the relevant time" means—

(a) the time when the contract was constituted, or

(b) if the undertaking was added to the contract by a modification of its terms, the time when the modification was made.

NOTE

This section sets out the essentials necessary for the creation of a statutory third-party right. The terminology used in this section, and elsewhere in the Bill, (i.e. "third-party right", third party", "contracting party", "undertaking") is in accordance with recommendations 3 to 5.

Subsection (1) states that the contracting parties may create a right in favour of a person who is not a party to the contract. It sets out two requirements: first, the contract must contain an undertaking that one or more of the contracting parties will do or not do something for that person's benefit. (This requirement is further discussed in section 2(5) and (6).) Additionally, in implementation of recommendation 11, they must intend that the person is to be able to enforce or otherwise invoke the undertaking. (This guards against accidental or incidental benefits qualifying as third-party rights.) Subsection (5) specifies the time at which the contracting parties' intention is to be measured.

Subsection (2), in implementation of recommendation 6, defines the third-party right as the right of the third party to enforce or otherwise invoke the undertaking in the contract. Generally, the third party will wish to enforce the right but there will be cases where it is more appropriate to talk about the right being invoked, especially where it consists of an immunity from liability.

Subsection (3) sets out a further requirement for the creation of a third-party right, namely that the intended beneficiary must be identifiable from the contract either by name, or alternatively by way of description (e.g. "the subsidiaries of [a named company]", or "the spouse or civil partner of a member of the [named] pension scheme"). This implements recommendation 7. By subsection (4), the right may come into existence at a future date if, at the time the undertaking is entered into, the person who is named or (more typically) who answers a particular description has either not yet come into existence or does not yet fall within that description. This is in implementation of, respectively, recommendations 8 and 9.

Subsections (3) and (4) may well be the most important in practice, where contracting parties wish to confer a third-party right on a person who cannot yet be individually identified. For instance, a company may want a contract with an IT supplier to confer third party benefits on other companies in the same group, including ones which may become part of the group in the future; or contracting parties may wish to provide rights for as yet unknown sub-contractors to be employed during the course of the main contract. By these subsections, it is open to the contracting parties to describe the class of persons who are to have a third-party right.

Section 1 is to be read in conjunction with the general Scots law rules of contract (as foreshadowed in recommendation 1(a)). For example, it is competent, save in specified situations, to make an oral contract; hence there is no requirement that the undertaking be written. Equally, since – as a general principle – the existence of a right is dependent on there being a right-holder, no right arises until (in the case of a person identified in the contract by name) such a person comes into existence or (in the case of a person identified by description) there is a person answering the relevant description.

2 Creation: further provision

(1) This section makes provision elaborating on section 1.

(2) The undertaking referred to in section 1(1)(a) may be one which depends on something happening or not happening (whether or not it is certain that that thing will or will not happen).

(3) The intention of the contracting parties referred to in section 1(1)(b) may be express or implied.

(4) A person may acquire a third-party right to enforce or otherwise invoke an undertaking despite the fact that—

(a) the undertaking may be cancelled or modified,

(b) there has been no delivery, intimation or communication of the undertaking to the person.

(5) The reference in section 1(1)(a) to an undertaking to do something includes an undertaking to indemnify a person.

(6) The reference in section 1(1)(a) to an undertaking not to do something includes an undertaking—

(a) not to hold a person liable in a matter,

(b) not to enforce, or not to enforce in full, a person's liability in a matter.

(7) This Act is without prejudice to any other enactment, or rule of law, that imposes requirements which must be fulfilled if an enforceable obligation is to be created.

NOTE

This section gives further detail about the creation of a third-party right.

Subsection (2), which implements recommendation 18, provides that the undertaking can be dependent on something happening or not happening; this applies whether the thing is certain either to happen or not. In this way, the third-party right may be future (i.e. it is dependent on the occurrence of an event which is certain to happen) or conditional. In the latter case, the general law of conditions applies; thus the condition may be suspensive, that is the existence of the right is suspended pending the occurrence of an event which may or may not happen, or resolutive, when the right comes into existence but will be brought to an end on the occurrence of an event which may or may not occur.

An example of a suspensive condition is given by the case of *Love v Amalgamated Society of Lithographic Printers of Great Britain and Ireland* 1912 SC 1078 (discussed in the Report, e.g. at paras 2.29-2.32). Mr Love's employer operated a benefit scheme for dependants of sick employees, and there was a mechanism for changes to be made to the scheme. Mrs Love's eventual entitlement to benefits was thus dependent on her husband falling sick (which is classified as the fulfilment of a suspensive condition, as her right is suspended until the condition is met). For an example of a resolutive condition, the case of *Kelly v Cornhill Insurance Company Ltd* 1964 SC (HL) 46 (whose facts are set out in paragraph 2.33 of the Report) serves as a good illustration. The son's right under his father's insurance policy had come into existence once his father granted permission but could have been brought to an end at any time by the permission being withdrawn.

Subsection (3) provides that there is no requirement that the contracting parties' intention to create a third-party right be express. It can also arise by implication, if the contract is interpreted as having that meaning; this implements recommendation 13. The usual rules for interpreting contracts apply to this exercise.

Subsection (4)(a) implements recommendation 19. Under the common law of *jus quaesitum tertio*, as set out almost a century ago in *Carmichael v Carmichael's Executrix* 1920 SC (HL) 195, the right must be irrevocable before it can come into existence; a central plank of the Bill is to reverse that position. This subsection does so, by making it clear that the existence of a third-party right is not reliant on it being uncancellable or unmodifiable.

Subsection (4)(b) removes any doubt which might exist under the current law on *jus quaesitum tertio* as to whether the creation of a third-party right is dependent on the undertaking having been delivered, intimated or otherwise communicated to the third party. Delivery, intimation or communication will be strong indicators of the contracting parties' intention to create a right in a person's favour, but they are not a necessary step. The subsection is to be read with subsection (7), which signals that any special rules on the creation of obligations must be followed. For example,

where the Requirements of Writing (Scotland) Act 1995 applies then the Bill is subject to that Act. Subsections (4)(b) and (7) implement recommendation 12.

Subsections (5) and (6) provide that an undertaking to indemnify a person, or to limit or exclude a person's liability, may be treated as a third-party right. This implements recommendation 14. In certain fields, such as in sectors of the oil industry, it is common to have agreements to hold third parties harmless, and these subsections remove any doubt that such agreements would fall within the Bill's scope.

3 Contracting parties' freedom to alter third party's entitlement

(1) An undertaking contained in a contract which has given rise to a third-party right may be cancelled or modified by the contracting parties.

(2) Nothing in this Act precludes a contract from providing that an undertaking, which is contained in the contract and in relation to which a third-party right has arisen, will not be cancelled or modified by the contracting parties.

(3) Subsection (1) is subject to sections 4 to 6.

NOTE

Subsection (1) builds on the freedom enjoyed by contracting parties under section 2(4)(a), which removes the current common law bar on creating a third-party right unless it is irrevocable. Subsection (1), in partial implementation of recommendation 19, creates an express freedom for contracting parties to modify or cancel an existing third-party right unless (by subsection (3)) any of the exceptions in sections 4 to 6 applies.

Subsection (2), in implementation of recommendation 24, provides that contracting parties remain free to declare that a third-party right cannot be modified or cancelled. Such a declaration can be conditional. In some situations, a third party may require a declaration of irrevocability before it is prepared to enter into obligations of its own; this section clearly allows for such action to be taken.

4 Third party's entitlement not subject to retroactive change

(1) No account is to be taken of the cancellation or modification of an undertaking contained in a contract where and in so far as the undertaking is being enforced or otherwise invoked—

(a) by virtue of a person's third-party right to do so, and

(b) in consequence of something happening or not happening prior to the undertaking being cancelled or (as the case may be) the modification being made.

(2) Subsection (1) does not apply in relation to a cancellation or modification if the contract provided that it may be made with retroactive effect.

NOTE

This section, and sections 5 and 6, are exceptions to the general rule in section 3(1), which allows the contracting parties to modify or cancel a third-party right.

Subsection (1), which implements recommendation 20, contains a rule as to when a third-party right can, and cannot, be modified or cancelled after it has been created. Its effect is that a right may not be modified or cancelled once any conditions to which its enforcement was subject have been fulfilled. (As an example, see the discussion of *Love* in the note to section 2(2) above.) If, however, the contract provides that the undertaking may be modified or cancelled with retroactive effect then that provision overrides the general rule (in implementation of recommendation 21).

5 Effect of giving third party notice of undertaking

(1) Subsection (2) applies (subject to subsections (3) and (4)) where—

(a) a person who has a third-party right arising from an undertaking contained in a contract is given notice of the undertaking by a contracting party, and

(b) the undertaking is subsequently cancelled or modified.

(2) No account is to be taken of the cancellation or (as the case may be) modification of the undertaking when it is being enforced or otherwise invoked by virtue of the third-party right.

(3) Subsection (2) does not apply if—

(a) the undertaking is one which depends on something happening or not happening, and

(b) it remained uncertain whether that thing would happen or not at the time when the notice mentioned in subsection (1)(a) was given.

(4) Subsection (2) does not apply in relation to the cancellation or modification of the undertaking if—

(a) at the time when the notice mentioned in subsection (1)(a) was given, the person given the notice was told by the contracting party that the undertaking may be cancelled or (as the case may be) that the modification may be made, or

(b) the person who has the third-party right has given assent to the cancellation or (as the case may be) modification of the undertaking.

NOTE

This section implements recommendation 22. It provides that – subject to specific exceptions mentioned in the following paragraph – no account is to be taken of the modification or cancellation of an undertaking once the undertaking has been notified to the third party by a contracting party. The Bill does not define what amounts to notification, but it is to be assessed objectively.

The exceptions are in subsections (3) and (4). The first provides that, at the point of notification, the undertaking remained conditional. The second applies either where the third party was told by the contracting party, at notification, that the cancellation or modification may be made, or where the third party agreed to the modification or cancellation.

6 Undertaking in favour of third party cannot be affected by modification or cancellation of contract after it has been relied on

(1) Subsection (2) applies (subject to subsections (3) and (4)) where—

(a) a person has a third-party right to enforce or otherwise invoke an undertaking contained in a contract,

(b) the person has done something, or refrained from doing something, in reliance on the undertaking,

(c) doing or (as the case may be) refraining from doing the thing has affected the person's position to a material extent,

(d) either—

(i) the contracting parties acquiesced in the person doing or (as the case may be) refraining from doing the thing, or

(ii) the person's doing or (as the case may be) refraining from doing the thing in reliance on the undertaking could reasonably have been foreseen by the contracting parties, and

(e) subsequent to the person doing or (as the case may be) refraining from doing the thing mentioned in paragraph (b), the undertaking has been cancelled or modified.

(2) Where the person is enforcing or otherwise invoking the undertaking by virtue of having the third-party right, no account is to be taken of the cancellation or modification of the undertaking if the person's position would be adversely affected to a material extent were the undertaking treated as having been cancelled or (as the case may be) modified.

(3) Subsection (2) does not apply in relation to the cancellation or modification of the undertaking if—

(a) the contract provides—

(i) that the contracting parties are entitled to cancel or (as the case may be) modify the undertaking, and

(ii) that their entitlement to do so will not be affected by the person doing, or refraining from doing, something in reliance on the undertaking, and

(b) the person knew or ought to have known about that provision of the contract before the person did, or refrained from doing, the thing mentioned in subsection (1)(b).

(4) Subsection (2) does not apply in relation to the cancellation or modification of the undertaking if the person has given assent to it.

(5) In legal proceedings, a person seeking to enforce or otherwise invoke an undertaking by virtue of having a third-party right to do so may not plead that a contracting party—

(a) is personally barred from cancelling or modifying the undertaking, or

(b) has waived any right to cancel or modify the undertaking.

NOTE

This section implements recommendations 26 to 28. Subsection (2) provides that a third-party right becomes irrevocable (i.e. no modification or cancellation will be effective) where the five events in subsection (1) have occurred. The steps are:

- a person has a third-party right;
- the person either does something, or refrains from doing something, in reliance on the right;
- as a result, the person suffers a material adverse effect;
- the contracting parties either acquiesced in the person's action (or inaction) or it was reasonably foreseeable that the person would act (or not act) in that way; and
- subsequently the right is modified or cancelled.

This scheme is closely modelled on that in section 1(3) and (4) of the Requirements of Writing (Scotland) Act 1995, which is sometimes known as the doctrine of statutory *rei interventus*, or 'detrimental reliance'.

The effect of subsection (2) is overridden (by subsections (3) and (4)) in two situations: first, where the third party knew or ought to have known that the contracting parties were entitled, under their contract, to modify or cancel the undertaking despite the third party relying on it to its prejudice and, secondly, where the third party has agreed to the modification or cancellation of the undertaking.

Subsection (5) provides that the section replaces any claim which a person would otherwise have had at common law. The intention is to provide a clear statutory framework in place of the rules governing personal bar and waiver.

7 Remedies available to third party

(1) This section applies where a person has a third-party right to enforce or otherwise invoke an undertaking contained in a contract.

(2) The person has available, as a remedy for breach of the undertaking, any remedy for breach which a contracting party would be entitled to were the undertaking one in favour of the contracting party.

(3) Subsection (2) is subject to any contrary provision made in the contract.

NOTE

Section 7, which implements recommendation 36, specifies what remedies a third party has in the event of its right being breached (which would include anticipatory breach). At common law, a third party has a wide range of remedies, including the ability to sue for payment and to seek specific implement. Under the current law there is a long-standing doubt as to whether a third party has a right to claim damages. This section is included in order to remove such doubt by providing, in subsection (2), that a third party is entitled to any remedy to which a contracting party would be entitled under the contract were the undertaking in favour of that party (instead of the third party).

Subsection (3) allows the contracting parties to make contrary provision in their contract. They may exclude, restrict, or even extend the available remedies, if they wish.

8 Defences available against third party

(1) This section applies where a person has a third-party right to enforce or otherwise invoke an undertaking contained in a contract.

(2) A contracting party has available, as a defence against a claim by the person that the undertaking has been breached, any defence which is both—

(a) a defence that a contracting party would have against any other contracting party, and

(b) relevant to the undertaking.

(3) Subsection (2) is subject to any contrary provision made in the contract.

NOTE

Section 8, which implements recommendation 37, deals with defences which may be raised against a claim by the third party in respect of its right. This would arise typically where the third party claims that the right has been breached. The provision supplements the direct defences against the third party (e.g. the latter's duress or misrepresentation, as explained in paragraphs 6.31-6.37 of the Report).

The section makes clear that the contracting party is entitled to assert any defence to which a contracting party would be entitled against any other contracting party, provided that the defence is also relevant to the undertaking in the third party's favour. That proviso is added in order to deal satisfactorily with situations in which the contract is (for example) frustrated or involves illegality which, however, does not affect the third-party right as such.

Subsection (3) provides that contrary provision as to defences may be made in the contract. This will allow parties to tailor the applicable regime to their own circumstances; an example is given in paragraph 6.27 of the Report.

9 Arbitration

(1) In relation to a dispute to which subsection (2) or (3) applies, the person who has the third-party right mentioned in subsection (2) or (as the case may be) (3) is to be regarded as a party to the arbitration agreement mentioned in that subsection.

(2) This subsection applies to a dispute if—

(a) the dispute concerns an undertaking being enforced or otherwise invoked by virtue of a person's third-party right to do so, and

(b) an arbitration agreement provides for a dispute on the matter under dispute to be resolved by arbitration.

(3) This subsection applies to a dispute if—

(a) subsection (2) does not apply to the dispute,

(b) an arbitration agreement provides for a dispute on the matter under dispute to be resolved by arbitration,

(c) a person who is not a party to the agreement has a third-party right to enforce or otherwise invoke the agreement in relation to the matter under dispute, and

(d) the person who has the third-party right has—

(i) submitted the dispute to arbitration, or

(ii) sought a sist of legal proceedings concerning the matter under dispute on the basis that an arbitration agreement provides for a dispute on the matter to be resolved by arbitration.

(4) A person who is not a party to an arbitration agreement is to be regarded as having submitted a dispute to arbitration under the agreement if the person—

(a) has a third-party right to enforce or otherwise invoke the agreement in relation to the matter under dispute, and

(b) has done whatever a party to the agreement would need to do in order to submit the dispute to arbitration.

(5) In this section and section 10(2)—

"arbitration agreement" has the meaning given by section 4 of the Arbitration (Scotland) Act 2010, and

"dispute" is to be construed in accordance with section 2(1) of that Act.

NOTE

Section 9 implements recommendation 45. It provides a mechanism by which any arbitration agreement between the contracting parties can operate in respect of third-party rights. (The provision has been inspired by the equivalent one in England and Wales, in section 8 of the Contracts (Rights of Third Parties) Act 1999, and the court decisions on it, few though they are. One detailed manifestation of this is in the language in subsections (2)(b) and (3)(b), which echoes that of section 8(1)(a) and (2)(a) of the 1999 Act. The formula of an arbitration agreement providing for a dispute to be resolved by arbitration is a useful one, as it covers a range of wording which may be used in any particular agreement: e.g. where the dispute *must* or *may* or *can* be submitted to arbitration. As will be clear from the notes below, disputes covered by subsection (2) *must* be submitted to arbitration if the third party wishes to resolve the dispute, whereas those falling within subsection (3) *may* be so submitted.)

Arbitration is governed in Scotland by the Arbitration (Scotland) Act 2010. Section 9 aims to create the conditions necessary so that that Act can apply where appropriate. In doing so, two fundamental features of an arbitration must be borne in mind: first, that only parties to the arbitration agreement can participate in the arbitration (though there are limited exceptions to this) and, secondly, that no party can be compelled to submit to arbitration unless it has signed a valid arbitration agreement. The first of these bars the third party (who is, by definition, not a signatory to the arbitration agreement) from participating; section 9(1)(a) overcomes this by deeming such a person to be a party to the arbitration agreement in specified circumstances (as discussed below). The second feature – the requirement for consent – is discussed in chapter 7 of the Report and lies underneath the terms of section 9.

For section 9 to apply at all there must be an arbitration agreement in the contracting parties' contract providing for the submission of disputes to arbitration. The circumstances in which a third party may have an interest in that arbitration agreement are set out in subsections (2) and (3). There are only two of them, and they are mutually exclusive. The circumstances can best be described in terms of the type of dispute which may arise.

Subsection (2) covers disputes about a substantive third-party right. This will be the typical situation. For example, the third party may have the right to be indemnified by a contracting party against specific types of claim for which the third party is found liable. If a dispute arises in connection with that indemnity (and provided that the main contract requires contractual disputes, including disputes about the undertaking in the third party's favour, to be submitted to arbitration) then the third party must submit the dispute to arbitration if it wishes to pursue it. That is because, in this type of situation, performance of the right is only enforceable by arbitration. Alternatively, if a contracting party raises a court action against the third party in respect of such a dispute, the latter may seek a sist of the legal proceedings. The basis of the third party's ability either to submit to arbitration or to seek a sist is found in subsection (1), by which the third party is to be regarded, in relation to that dispute, to be a party to the arbitration agreement.

Subsection (3), by contrast, comprises the relatively rare type of dispute which is not about a third-party right arising from an undertaking in the contract but rather about a free-standing right. The contracting parties may have provided in their contract that disputes about certain such free-standing rights may be resolved by arbitration. By way of example, a construction contract which envisages the appointment of sub-contractors (i.e. third parties) may specify that certain non-contractual claims involving a third party, such as those arising under delict, can be submitted to arbitration. (It may be that, in addition, the sub-contractors are given substantive third-party rights under the contract, in which case any disputes about such rights will fall under subsection (2).) In this situation, a delictual dispute involving the third-party will fall under subsection (3), which gives the third party 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.

Subsections (4) and (5) are interpretation provisions. The former is to be read with subsection (3)(d)(i), and the latter serves to tie section 9 in with the scheme and language of the Arbitration (Scotland) Act 2010.

10 Renunciation of third-party right

(1) A third-party right is extinguished if, and to the extent that, the person who has the right renounces it (expressly or by implication).

(2) A person is not to be regarded as having renounced a third-party right to enforce or otherwise invoke an arbitration agreement by bringing legal proceedings in relation to a dispute which the agreement provides for the resolution of by arbitration.

NOTE

Subsection (1), which implements recommendations 33 and 34, allows a person with a third-party right to renounce it. This may be done either expressly or implicitly. The effect of such renunciation is that the right is extinguished. The power to renounce cannot be excluded by the contracting parties, since otherwise they would be able to force a person to accept a benefit which they may not want.

One reason for including this provision is that there is no requirement on a third party to accept the right in order to be able to use it. It is therefore important to have a clear method of rejecting the right if that is desired. This may be done at any time, thus providing the third party with something akin to the freedom of contract enjoyed by the contracting parties. It also offers a practical solution for a third party who, subjectively, considers that the right is onerous. (If, viewed objectively, the contracting parties impose a burden or a duty on a third party then they have not succeeded in creating a third-party right at all, and so there is nothing for the third party to renounce.)

Subsection (2), which relates to arbitration, implements recommendation 46. As mentioned in the note to section 9, a third party who is regarded, by section 9(1), as a party to an arbitration agreement may take advantage of that status either by submitting a dispute to arbitration or by seeking a sist of court proceedings which have been taken against that party in respect of the dispute. If, however, the third party chooses to raise a court action instead, it is not to be taken to have renounced its right to submit the same dispute to arbitration merely because it chose to raise court proceedings. (Of course, a contracting party will be entitled to seek a sist under section 10 of the Arbitration (Scotland) Act 2010 in respect of those proceedings if it wishes to do so.)

11 Prescription

(1) An undertaking contained in a contract which is capable of being enforced or otherwise invoked by virtue of a third-party right is an obligation arising from the contract for the purposes of the Prescription and Limitation (Scotland) Act 1973.

(2) In subsection (1), "third-party right" means a right which has arisen by virtue of either—

(a) section 1, or

(b) the rule of law mentioned in section 12.

NOTE

Section 11, which implements recommendation 39, removes any doubt that there may be as to whether a third-party right is an obligation arising from the contract for the purposes of the Prescription and Limitation (Scotland) Act 1973. It makes clear that the right normally prescribes after the short negative prescriptive period of 5 years; the same applies to a JQT under the common law.

12 Abolition of common-law rule: *jus quaesitum tertio*

(1) The rule of law by which a person who is not a party to a contract may acquire a right to enforce or otherwise invoke the contract's terms ceases to have effect.

(2) Subsection (1) does not affect any right acquired before that subsection comes into force.

NOTE

Section 12, in conjunction with section 13 and in implementation of recommendation 1(b), provides for the orderly transition between the current common law of *jus quaesitum tertio* and the statutory third-party rights regime set out earlier in the Bill. It provides that, on commencement, existing JQTs will continue in force but it will not be competent to create new ones; instead, third-party rights as defined in section 1(2) may be created.

13 Application

Nothing in sections 1 to 10 applies in relation to an undertaking constituted before the day on which section 1 comes into force.

NOTE

By section 13 the Bill only applies to a third-party right created on or after the day on which section 1 is brought into force (which will be done by regulations made under section 14). Such a right may either be contained in a contract entered into on or after that day, or in a pre-existing contract to which it is added by the contracting parties on or after that day.

14 Commencement

(1) This section and sections 13 and 15 come into force on the day after Royal Assent.

(2) The other provisions of this Act come into force on such day as the Scottish Ministers may by regulations appoint.

15 Short title

The short title of this Act is the Contract (Third Party Rights) (Scotland) Act 2016.

APPENDIX B

THIRD-PARTY RIGHTS IN PRIVATE LAW

In this Appendix we set out the relevant material contained in the DCFR, PICC, CESL, and 1999 Act, but without any intervening commentary.

Draft Common Frame of Reference (DCFR)

II. – 9:301: *Basic rules*

(1) The parties to a contract may, by the contract, confer a *right or other benefit* on a third party. The third party need not be in existence or identified at the time the contract is concluded.

(2) The nature and content of the third party's right or benefit are determined by the contract and are subject to any conditions or other limitations under the contract.

(3) The benefit conferred may take the form of an exclusion or limitation of the third party's liability to one of the contracting parties.

II. – 9:302: *Rights, remedies and defences*

Where one of the contracting parties is bound to render a performance to the third party under the contract, then, in the absence of provision to the contrary in the contract:

> (a) the third party has the same rights to performance and remedies for non-performance as if the contracting party was bound to render the performance under a binding unilateral undertaking in favour of the third party; and
>
> (b) the contracting party may assert against the third party all defences which the contracting party could assert against the other party to the contract.

II. – 9:303: *Rejection or revocation of benefit*

(1) The third party may reject the right or benefit by notice to either of the contracting parties, if that is done without undue delay after being notified of the right or benefit and before it has been expressly or impliedly accepted. On such rejection, the right or benefit is treated as never having accrued to the third party.

(2) The contracting parties may remove or modify the contractual term conferring the right or benefit if this is done before either of them has given the third party notice that the right or benefit has been conferred. The contract determines whether and by whom and in what circumstances the right or benefit can be revoked or modified after that time.

(3) Even if the right or benefit conferred is by virtue of the contract revocable or subject to modification, the right to revoke or modify is lost if the parties have, or the party having the right to revoke or modify has, led the third party to believe that it is not revocable or subject to modification and if the third party has reasonably acted in reliance on it.

UNIDROIT Principles of International Commercial Contracts (PICC)

ARTICLE 5.2.1

(Contracts in favour of third parties)

(1) The parties (the "promisor" and the "promisee") may confer by express or implied agreement a *right* on a third party (the "beneficiary").

(2) The existence and content of the beneficiary's right against the promisor are determined by the agreement of the parties and are subject to any conditions or other limitations under the agreement.

ARTICLE 5.2.2

(Third party identifiable)

The beneficiary must be identifiable with adequate certainty by the contract but need not be in existence at the time the contract is made.

ARTICLE 5.2.3

(Exclusion and limitation clauses)

The conferment of rights in the beneficiary includes the right to invoke a clause in the contract which excludes or limits the liability of the beneficiary.

ARTICLE 5.2.4

(Defences)

The promisor may assert against the beneficiary all defences which the promisor could assert against the promisee.

ARTICLE 5.2.5

(*Revocation)*

The parties may modify or revoke the rights conferred by the contract on the beneficiary until the beneficiary has accepted them or reasonably acted in reliance on them.

ARTICLE 5.2.6

(Renunciation)

The beneficiary may renounce a right conferred on it.

Proposed Common European Sales Law (CESL)

Article 78

Contract terms in favour of third parties

1. The contracting parties may, by the contract, confer a *right* on a third party. The third party need not be in existence or identified at the time the contract is concluded but needs to be identifiable.

2. The nature and content of the third party's right are determined by the contract. The right may take the form of an exclusion or limitation of the third party's liability to one of the contracting parties.

3. When one of the contracting parties is bound to render a performance to the third party under the contract, then:

> (a) the third party has the same rights to performance and remedies for non-performance as if the contracting party was bound to render the performance under a contract with the third party; and
>
> (b) the contracting party who is bound may assert against the third party all defences which the contracting party could assert against the other party to the contract.

4. The third party may reject a right conferred upon them by notice to either of the contracting parties, if that is done before it has been expressly or impliedly accepted. On such rejection, the right is treated as never having accrued to the third party.

5. The contracting parties may remove or modify the contract term conferring the right if this is done before either of them has given the third party notice that the right has been conferred.

Contracts (Rights of Third Parties) Act 1999 (c.31), as amended

1.— Right of third party to enforce contractual term.

(1) Subject to the provisions of this Act, a person who is not a party to a contract (a "third party") may in his own right enforce a term of the contract if—

(a) the contract expressly provides that he may, or

(b) subject to subsection (2), the term purports to confer a benefit on him.

(2) Subsection (1)(b) does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party.

(3) The third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description but need not be in existence when the contract is entered into.

(4) This section does not confer a right on a third party to enforce a term of a contract otherwise than subject to and in accordance with any other relevant terms of the contract.

(5) For the purpose of exercising his right to enforce a term of the contract, there shall be available to the third party any remedy that would have been available to him in an action for breach of contract if he had been a party to the contract (and the rules relating to damages, injunctions, specific performance and other relief shall apply accordingly).

(6) Where a term of a contract excludes or limits liability in relation to any matter references in this Act to the third party enforcing the term shall be construed as references to his availing himself of the exclusion or limitation.

(7) In this Act, in relation to a term of a contract which is enforceable by a third party—

"the promisor" means the party to the contract against whom the term is enforceable by the third party, and

"the promisee" means the party to the contract by whom the term is enforceable against the promisor.

2.— Variation and rescission of contract.

(1) Subject to the provisions of this section, where a third party has a right under section 1 to enforce a term of the contract, the parties to the contract may not, by agreement, rescind the contract, or vary it in such a way as to extinguish or alter his entitlement under that right, without his consent if—

(a) the third party has communicated his assent to the term to the promisor,

(b) the promisor is aware that the third party has relied on the term, or

(c) the promisor can reasonably be expected to have foreseen that the third party would rely on the term and the third party has in fact relied on it.

(2) The assent referred to in subsection (1)(a)—

(a) may be by words or conduct, and

(b) if sent to the promisor by post or other means, shall not be regarded as communicated to the promisor until received by him.

(3) Subsection (1) is subject to any express term of the contract under which—

(a) the parties to the contract may by agreement rescind or vary the contract without the consent of the third party, or

(b) the consent of the third party is required in circumstances specified in the contract instead of those set out in subsection (1)(a) to (c).

(4) Where the consent of a third party is required under subsection (1) or (3), the court or arbitral tribunal may, on the application of the parties to the contract, dispense with his consent if satisfied—

(a) that his consent cannot be obtained because his whereabouts cannot reasonably be ascertained, or

(b) that he is mentally incapable of giving his consent.

(5) The court or arbitral tribunal may, on the application of the parties to a contract, dispense with any consent that may be required under subsection (1)(c) if satisfied that it cannot reasonably be ascertained whether or not the third party has in fact relied on the term.

(6) If the court or arbitral tribunal dispenses with a third party's consent, it may impose such conditions as it thinks fit, including a condition requiring the payment of compensation to the third party.

(7) The jurisdiction conferred on the court by subsections (4) to (6) is exercisable by both the High Court and a county court.

3.— Defences etc. available to promisor.

(1) Subsections (2) to (5) apply where, in reliance on section 1, proceedings for the enforcement of a term of a contract are brought by a third party.

(2) The promisor shall have available to him by way of defence or set-off any matter that—

(a) arises from or in connection with the contract and is relevant to the term, and

(b) would have been available to him by way of defence or set-off if the proceedings had been brought by the promisee.

(3) The promisor shall also have available to him by way of defence or set-off any matter if—

(a) an express term of the contract provides for it to be available to him in proceedings brought by the third party, and

(b) it would have been available to him by way of defence or set-off if the proceedings had been brought by the promisee.

(4) The promisor shall also have available to him—

(a) by way of defence or set-off any matter, and

(b) by way of counterclaim any matter not arising from the contract,

that would have been available to him by way of defence or set-off or, as the case may be, by way of counterclaim against the third party if the third party had been a party to the contract.

(5) Subsections (2) and (4) are subject to any express term of the contract as to the matters that are not to be available to the promisor by way of defence, set-off or counterclaim.

(6) Where in any proceedings brought against him a third party seeks in reliance on section 1 to enforce a term of a contract (including, in particular, a term purporting to exclude or limit liability), he may not do so if he could not have done so (whether by reason of any particular circumstances relating to him or otherwise) had he been a party to the contract.

4. — Enforcement of contract by promisee.

Section 1 does not affect any right of the promisee to enforce any term of the contract.

5. — Protection of promisor from double liability.

Where under section 1 a term of a contract is enforceable by a third party, and the promisee has recovered from the promisor a sum in respect of—

(a) the third party's loss in respect of the term, or

(b) the expense to the promisee of making good to the third party the default of the promisor,

then, in any proceedings brought in reliance on that section by the third party, the court or arbitral tribunal shall reduce any award to the third party to such extent as it thinks appropriate to take account of the sum recovered by the promisee.

6.— Exceptions.

(1) Section 1 confers no rights on a third party in the case of a contract on a bill of exchange, promissory note or other negotiable instrument.

(2) Section 1 confers no rights on a third party in the case of any contract binding on a company and its members under section 33 of the Companies Act 2006 (effect of company's constitution).

(2A) Section 1 confers no rights on a third party in the case of any incorporation document of a limited liability partnership or any agreement (express or implied) between the members of a limited liability partnership, or between a limited liability partnership and its members, that determines the mutual rights and duties of the members and their rights and duties in relation to the limited liability partnership.

(3) Section 1 confers no right on a third party to enforce—

(a) any term of a contract of employment against an employee,

(b) any term of a worker's contract against a worker (including a home worker), or

(c) any term of a relevant contract against an agency worker.

(4) In subsection (3)—

(a) *"contract of employment", "employee", "worker's contract", and "worker"* have the meaning given by section 54 of the National Minimum Wage Act 1998,

(b) *"home worker"* has the meaning given by section 35(2) of that Act,

(c) *"agency worker"* has the same meaning as in section 34(1) of that Act, and

(d) *"relevant contract"* means a contract entered into, in a case where section 34 of that Act applies, by the agency worker as respects work falling within subsection (1)(a) of that section.

(5) Section 1 confers no rights on a third party in the case of—

(a) a contract for the carriage of goods by sea, or

(b) a contract for the carriage of goods by rail or road, or for the carriage of cargo by air, which is subject to the rules of the appropriate international transport convention,

except that a third party may in reliance on that section avail himself of an exclusion or limitation of liability in such a contract.

(6) In subsection (5) *"contract for the carriage of goods by sea"* means a contract of carriage—

(a) contained in or evidenced by a bill of lading, sea waybill or a corresponding electronic transaction, or

(b) under or for the purposes of which there is given an undertaking which is contained in a ship's delivery order or a corresponding electronic transaction.

(7) For the purposes of subsection (6)—

(a) *"bill of lading", "sea waybill" and "ship's delivery order"* have the same meaning as in the Carriage of Goods by Sea Act 1992, and

(b) a corresponding electronic transaction is a transaction within section 1(5) of that Act which corresponds to the issue, indorsement, delivery or transfer of a bill of lading, sea waybill or ship's delivery order.

(8) In subsection (5) *"the appropriate international transport convention"* means—

(a) in relation to a contract for the carriage of goods by rail, the Convention which has the force of law in the United Kingdom under regulation 3 of the Railways (Convention on International Carriage by Rail) Regulations 2005,

(b) in relation to a contract for the carriage of goods by road, the Convention which has the force of law in the United Kingdom under section 1 of the Carriage of Goods by Road Act 1965, and

(c) in relation to a contract for the carriage of cargo by air—

(i) the Convention which has the force of law in the United Kingdom under section 1 of the Carriage by Air Act 1961, or

(ii) the Convention which has the force of law under section 1 of the Carriage by Air (Supplementary Provisions) Act 1962, or

(iii) either of the amended Conventions set out in Part B of Schedule 2 or 3 to the Carriage by Air Acts (Application of Provisions) Order 1967.

7.— Supplementary provisions relating to third party.

(1) Section 1 does not affect any right or remedy of a third party that exists or is available apart from this Act.

(2) Section 2(2) of the Unfair Contract Terms Act 1977 (restriction on exclusion etc. of liability for negligence) shall not apply where the negligence consists of the breach of an obligation arising from a term of a contract and the person seeking to enforce it is a third party acting in reliance on section 1.

(3) In sections 5 and 8 of the Limitation Act 1980 the references to an action founded on a simple contract and an action upon a specialty shall respectively include references to an action brought in reliance on section 1 relating to a simple contract and an action brought in reliance on that section relating to a specialty.

(4) A third party shall not, by virtue of section 1(5) or 3(4) or (6), be treated as a party to the contract for the purposes of any other Act (or any instrument made under any other Act).

8.— Arbitration provisions.

(1) Where—

(a) a right under section 1 to enforce a term ("the substantive term") is subject to a term providing for the submission of disputes to arbitration ("the arbitration agreement"), and

(b) the arbitration agreement is an agreement in writing for the purposes of Part I of the Arbitration Act 1996,

the third party shall be treated for the purposes of that Act as a party to the arbitration agreement as regards disputes between himself and the promisor relating to the enforcement of the substantive term by the third party.

(2) Where—

(a) a third party has a right under section 1 to enforce a term providing for one or more descriptions of dispute between the third party and the promisor to be submitted to arbitration ("the arbitration agreement"),

(b) the arbitration agreement is an agreement in writing for the purposes of Part I of the Arbitration Act 1996, and

(c) the third party does not fall to be treated under subsection (1) as a party to the arbitration agreement,

the third party shall, if he exercises the right, be treated for the purposes of that Act as a party to the arbitration agreement in relation to the matter with respect to which the right is exercised, and be treated as having been so immediately before the exercise of the right.

9.— Northern Ireland.

(1) In its application to Northern Ireland, this Act has effect with the modifications specified in subsections (2) and (3).

[...]

(3) In section 7, for subsection (3) there is substituted—

> "(3) In Articles 4(a) and 15 of the Limitation (Northern Ireland) Order 1989, the references to an action founded on a simple contract and an action upon an instrument under seal shall respectively include references to an action brought in reliance on section 1 relating to a simple contract and an action brought in reliance on that section relating to a contract under seal.".

(4) In the Law Reform (Husband and Wife) (Northern Ireland) Act 1964, the following provisions are hereby repealed—

> (a) section 5, and
>
> (b) in section 6, in subsection (1)(a), the words "in the case of section 4" and "and in the case of section 5 the contracting party" and in subsection (3), the words "or section 5".

10.— Short title, commencement and extent.

(1) This Act may be cited as the Contracts (Rights of Third Parties) Act 1999.

(2) This Act comes into force on the day on which it is passed but, subject to subsection (3), does not apply in relation to a contract entered into before the end of the period of six months beginning with that day.

(3) The restriction in subsection (2) does not apply in relation to a contract which—

> (a) is entered into on or after the day on which this Act is passed, and
>
> (b) expressly provides for the application of this Act.

(4) This Act extends as follows—

> (a) section 9 extends to Northern Ireland only;
>
> (b) the remaining provisions extend to England and Wales and Northern Ireland only.

APPENDIX C

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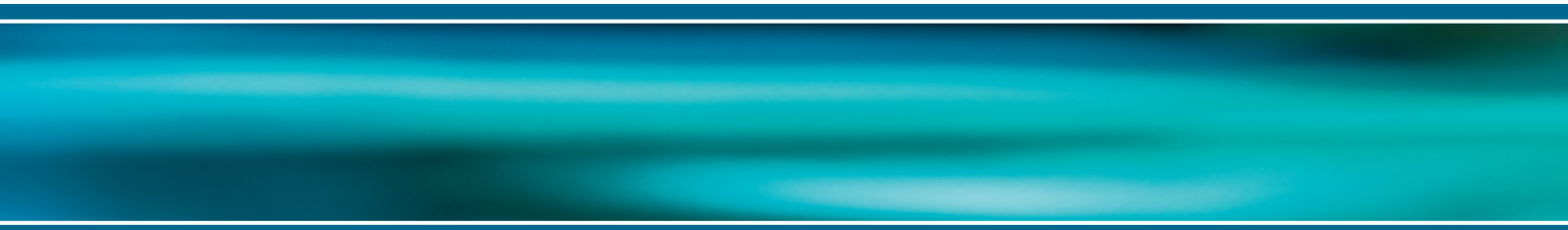

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