Business and Regulatory Impact Assessment

Title of Proposal

Draft Contract (Scotland) Bill ("**the Bill**")

Purpose and intended effect

Background

Contract law impacts on day to day economic life in relation to all types of transactions and for businesses and individuals alike. It is therefore important economically and socially that the contract law regime in Scotland is fit for 21st century conditions. As remarked by a Scottish judge with special reference to contract law's business context:

> "The object of our law of contract is to facilitate the transactions of commercial men, and not to create obstacles in the way of solving practical problems arising out of the circumstances confronting them, or to expose them to unnecessary pitfalls."[1]

That there may be issues with the present law in this regard was identified in 2008 in a report by the Business Experts and Law Forum[2]. This highlighted a lack of comprehensibility and accessibility in Scots law as a major factor for businesses in opting for English law in the drafting of their contracts.

Contract law has four main jobs:

- enabling parties (individuals or other legally recognised persons), to make arrangements with other such parties that will be obligatory in law between them (formation of contract);
- determining what the substance of the parties' contractual obligations is where that is disputed between them (interpretation);
- providing means by which the obligations in the contract can be enforced by a party should another party not carry out its side of the bargain (remedies for breach of contract);
- regulating the general freedom of contract, by providing rules on when obligations apparently undertaken by the parties are not treated as binding them, or obligations are imposed upon them (contractual penalties).

[1] *R & J Dempster Ltd v Motherwell Bridge and Engineering Ltd* 1964 SC 308, 332 (Lord Guthrie).

[2] The Business Experts and Law Forum (BELF) was established by the Cabinet Secretary for Justice to enable and encourage businesses to choose Scotland as the seat of their business and legal activities. Their membership comprised individuals from the following organisations: the Scottish Government, the Royal Bank of Scotland Group, the Law Society of Scotland, the Committee of Scottish Clearing Banks, the Institute of Chartered Accountants Scotland, Norwich Union, Glasgow Caledonian University, CBI, Shepherd and Wedderburn LLP, the Dean of the Faculty of Advocates, and a legal adviser to the Civil Courts Review. See their Report at: http://www.gov.scot/Publications/2008/10/30105800/0.

The Report on Review of Contract Law: Formation, Interpretation, Remedies for Breach, and Penalty Clauses (Scot Law Com No 252), published by the Scottish Law Commission ("SLC") on 29 March 2018, covers each of these aspects of the law of contract. It represents four separate areas within an overall contract law review project.[3] They are discussed in the Report in the following order:

- formation of contract;
- interpretation of contract;
- remedies for breach of contract, and
- penalty clauses.

A separate Discussion Paper ("DP") was published in relation to each of these four areas (formation in March 2012, interpretation in February 2011, remedies in July 2017 and penalty clauses in November 2016). Each DP suggested either restatement and reform of the law (formation and remedies) or reform of the law only (interpretation and penalties). The suggestions were made on the basis of a comparison of these four aspects of Scots contract law with various international comparators, in particular the Draft Common Frame of Reference: Principles, Definitions and Model Rules of European Private Law ("DCFR").[4] The aim of the exercise was to carry out a health check of the Scots law of contract against these international comparators, in order to determine whether the law in this area required modernisation and simplification. Consultees welcomed the exercise, not least because it might lead to greater use of Scots law to govern contracts. For example, the Law Society of Scotland in their response to a consultation on a draft of Part 1 of the Bill commented that:

> "we [also] support the objective of ensuring that Scottish contract law keeps pace with the DCFR. Irrespective of Scotland's position within the EU, it is clearly desirable to have a law of contract which measures up to international comparators. Among other documents, such as the Unidroit PICC, the DCFR is a useful part of that process."

Following this exercise and consultation in relation to the various suggestions for reform and restatement, the following recommendations were made in the Report:

- providing a statutory restatement of the law of formation of contract suitable for modern conditions (for example, in relation to electronic communications), with reform of the law in particular by abolition of the postal acceptance rule;

- allowing the law of interpretation of contract to develop further under the framework now established by the courts in the Supreme Court judgments in *Arnold v Britton*[5] and *Wood v Capita Investments*[6] (both of which cases were decided following publication of the SLC's Discussion Paper on interpretation);

- reforming three aspects of the law of remedies (i.e. mutuality, restitution after rescission for material breach, and contributory negligence as a factor restricting

[3] Two further areas of work within the project related to Third Party Rights and Execution in Counterpart. These have already led to legislation: the Contract (Third Party Rights) (Scotland) Act 2017 (which came into force on 26 February 2018) and the Legal Writings (Counterparts and Delivery) (Scotland) Act 2015 (which came into force on 1 July 2015 and introduced signing in counterpart into Scots law).

[4] The DCFR was prepared and published in 2009 by an academic group from the European Commission as part of an effort to promote more consistent and coherent legislation across the EU in contract law. It provides a contemporary statement of contract law based on comparative research from across the European Union.

[5] [2015] UKSC AC 1619.

[6] [2017] UKSC 24, [2017] 2 WLR 1095.

damages for breach of contract); but not proceeding with a statutory restatement of and reform of certain other aspects of the law of remedies for breach of contract;

- in respect of the law of penalty clauses, allowing the Supreme Court judgment in *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Limited v Beavis*[7] to bed in rather than embarking on further legislative reform.

The Contract (Scotland) Bill ("the Bill") restates and reforms aspects of the law of formation of contract (Part 1) and reforms the three aspects of the law of remedies for breach of contract already mentioned (Part 2). Part 3 contains general provisions which apply to both Parts 1 and 2, including a provision which makes it clear that the Bill is without prejudice to any enactment or rule of law which: (i) regulates any question which relates to the formation of a contract, mutuality of contract or remedies for breach of contract; (ii) requires writing for the formation of a contract; (iii) prescribes a form for a contract; (iv) regulates any question which relates to the essential validity of a contract, and (v) provides protection against unfair contract terms or for a particular category of contracting person.

A - Formation of contract

This section outlines the background to the recommendations in relation to reform and restatement of the law of formation of contract.

Part 1 of the draft Bill

The policy behind this part of the Bill has been developed in light of responses to the 2012 DP on Formation of Contract and our own further work on the subject (including a consultation on a draft of what is now Part 1 of the Bill carried out in autumn 2017).

Part 1 comprises a comprehensive statement of the law on formation of contract, including a number of specific reforms. This is driven in particular by improving the law's accessibility to all types of users, within and without the legal profession. Bringing all (or at least as much as possible) of the law into one place will simplify its use. Commenting on the SLC consultation on the draft Bill in 2017, Gillian Craig of MacRoberts observed: "The reform and codification of the law of contracts has been long overdue."[8] Pinsent Masons commented in their response to the 2012 DP that:

> "We consider that it would be useful to have a statutory statement of the law of formation of contract in Scotland as the existing law of contract has been strained to work with modern practice."

Clear statements of general principles will also assist in solving such recurrent problems as the "battle of the forms" where each party purports to contract on its own standard terms only. Further, in a number of areas the law of formation is uncertain because there is no direct Scottish authority in point (for example, the impact of a party's insolvency during a formation process). A comprehensive statutory scheme ensures that such questions have authoritative answers.

[7] [2015] UKSC 67, [2016] AC 1172.
[8] Gillian Craig (MacRoberts), "Contracting into the 21st Century – Contract (Formations) (Scotland) Bill", 12th October 2017, at https://goo.gl/UZKa44.

One of the most significant reforms in Part 1 is the provision which would abolish the postal acceptance rule (first established in the early 19th century). Under the rule, a contract entered into through letter or telegram can be held to be concluded when acceptance of the offer is posted. This is inconsistent with the general principle that communications take effect only when they reach their addressee, and with the expectations of business people and consumers, who do not anticipate being bound in contract without their knowledge. The rule causes uncertainty, confusion and difficulties with the law of contractual formation, and in legal practice is commonly excluded by express provision. Its removal was unanimously supported by consultees. Part 1 also sets out a rule for electronic communications based on the general principle of "reaching", removing uncertainty and bringing the law into line with 21st century conditions.

Law firm blogs commenting on Part 1 of the Bill during the 2017 consultation were supportive of these reforms. CMS's Law Now blog noted:

> "The Bill aims to provide clarification and align law of formation of contract with modern common practice, moving away from archaic rules and implementing provisions to reflect today's wide range of modern communication methods."[9]

CMS also commented that the postal acceptance rule was "out dated".[10] Gillian Craig of MacRoberts observed that:

> "The 21st century is a new-age digital era which requires updated and relevant protections to reflect today's electronic communications."[11]

Shepherd and Wedderburn remarked:

> "Having been imported into Scots law from England when Charles Dickens was just a lad, this 19th-century rule belongs to a bygone age where the postal system was the primary means of communication between parties transacting at a distance. In the digital age, there is clearly no longer a justification for retaining special protection for acceptances sent by post."[12]

B - Interpretation

A Report on this subject was published by the SLC in 1997,[13] but was not implemented, partly because it appeared that significant developments in judicial thinking on the subject took place in England and Wales the same year. These developments were led by Lord Hoffmann in the House of Lords and so were of influence in Scotland. They involved the court in an arguably wider use of "context" to interpret legal documents.[14] The SLC returned to the subject in 2011 as a result of the uncertainty which the Scottish courts in particular seemed to feel in dealing with the Hoffmann approach. Our 2011 DP suggested reform to allow the court to take account of the parties' common intention, relevant surrounding circumstances, and the nature and purpose of the agreement.

[9] CMS, "Contract Formation: So Long, Postal Acceptance?", 27.09.2017, at https://goo.gl/mTVDzy.
[10] CMS, "Contract Formation: So Long, Postal Acceptance?", 27.09.2017, at https://goo.gl/mTVDzy.
[11] Gillian Craig (MacRoberts), "Contracting into the 21st Century – Contract (Formations) (Scotland) Bill", 12th October 2017, at https://goo.gl/UZKa44.
[12] Shepherd & Wedderburn, "Goodbye 'Postal Acceptance Rule', Hello 'Out-of-Office Message' Rule?", 05 Sep 2017, at https://goo.gl/5evhjK.
[13] Report on Interpretation in Private Law (Scot Law Com No 160, 1997).
[14] *Investors Compensation Scheme v West Bromwich Building Society* [1997] UKHL 28, [1998] 1 WLR 896.

However the law appears to have become more settled since the appearance of the 2011 DP. The Report therefore concluded that now is not an appropriate time to recommend legislative reform of the law of contractual interpretation and that the law should instead be left to develop in the courts.

C - Remedies for Breach of Contract

As noted above, although there was some significant support for the idea of a statutory statement of the law of remedies (for example, from the Senators of the College of Justice), given it met with much more opposition than the proposal for a formation restatement, we concluded that now was not the time to proceed with this proposal. Similarly, and for the same reason, we are not recommending reform of the law of damages for breach of contract to deal with problems of non-patrimonial loss, "transferred loss", or the contract-breaker's gains from its breach.

Part 2 of the Bill

Part 2 of the Bill contains provisions which reform the law of remedies in three distinct areas, (a) mutuality, (b) restitution after rescission (termination for breach) and (c) contributory negligence. The policy behind this part of the Bill has been developed in light of responses to the 2017 DP on Remedies for Breach of Contract.

Mutuality

This Part of the Bill clarifies an existing difficulty in relation to the principle of mutuality (that where both parties have rights and duties under the contract, these rights and duties are interdependent or reciprocal and the enforceability of one party's rights is conditional upon the same party performing its own duties). The difficulty is the consequential rule that a party which has not performed or is not willing to perform its obligations cannot compel the other to perform. Two recent but contrasting Inner House decisions[15] suggest significant difficulties in understanding the scope of this rule. Part 2 of the Bill therefore contains provisions which clarify that party A, who is in breach of a contract with party B, is nevertheless entitled to exercise any right or to pursue any remedy arising out of party B's breach. This is provided that either (i) B is not lawfully withholding its performance in response to A's breach, or (ii) that B's alleged breach occurred before B terminated the contract for A's breach.

Rescission

Part 2 of the Bill also contains provisions which clarify the law in relation to mutual return or restoration of performances previously rendered under a contract by the parties (restitution) as a consequence of rescission (termination) of the contract for breach. There is currently no certainty as to what the law is in this area. "Rescission" is a remedy for breach which a party can invoke without the assistance of a court to bring a contract to an end. The party simply declares itself no longer bound under the contract, so that it may lawfully refuse to carry out any further obligations under the contract. The Bill therefore makes it clear that where parties have rendered performances under a contract but not received counter-performances reciprocally due under the contract before it is terminated by one for the other's breach, there should be restitution of the unreciprocated performances. The Bill goes on to make detailed

[15] *Forster v Ferguson & Forster, Macfie & Alexander* 2010 SLT 867 and *McNeill v Aberdeen City Council (No 2)* 2014 SC 335.

provision for the restitution of particular kinds of performances such as payment of money and transfer of goods.

Contributory negligence

Finally, Part 2 also contains provisions which clarify the law in relation to contributory negligence and breach of contract. Contributory negligence, which is carelessness on the part of the pursuer in an action for damages or a disregard for the pursuer's own interests which has contributed to the loss sustained as a result of the defender's conduct, has long been available as a defence in delictual claims for damages, leading to reduction of the amount to be awarded to the pursuer. But its availability as a defence to claims for damages based on breach of contract has been an open question for some time. The Bill introduces a form of contributory negligence as a defence for all claims of damages for breach of contract.

The Bill amends section 5 of the Law Reform (Contributory Negligence) Act 1945 to make the definition of "fault", subject to a new provision which has the effect of extending the definition to include "breach of contract". Therefore the defence will arise under section 1(1) of the 1945 Act where the pursuer in a claim of damages for breach of contract suffers loss partly through its own fault (which may or may not be a breach of contract or other legal wrong), and partly through the breach of contract by the other party. The damages recoverable in respect of the breach will be reduced to the extent the court considers just and equitable having regard to the pursuer's share in the responsibility for the loss.

Party autonomy

The principle of freedom of contact allows contracting parties the power to make their own rules about when obligations come into existence between them, and about their enforcement and also about remedies for breach of those obligations. Sections 1 and 16 of the Bill recognise this principle by providing that (with the exception of the section abolishing the postal acceptance rule and various other more general Bill sections, such as interpretation and commencement provisions) the Bill provisions in both Parts 1 and 2 are default in nature rather than prescriptive or mandatory. Therefore the rules apply when the parties themselves have not otherwise provided (in other words, where parties have not contracted out of them).

D - Penalty clauses

This area of law was previously considered by the SLC and a Report published in 1999.[16] The recommendations made in the 1999 Report were not implemented, however, after the Scottish Government conducted a public consultation about it in 2010. Instead the Government invited the SLC to reconsider the matter as part of the review of contract law in light of the DCFR.

Under Scots and English law between the end of the nineteenth century and 2015, a distinction was made between clauses which genuinely pre-estimated the damages payable on a breach of contract, and clauses which did not. The former were referred to as liquidated damages and were enforceable, while the latter were referred to as penalty clauses and were unenforceable.

[16] Report on Penalties Clauses (Scot Law Com No 171, 1999).

In 2015 the cases of *Cavendish Square Holdings BV v Makdessi and ParkingEye Ltd v Beavis*[17] came before the UK Supreme Court and were heard together. The decision in these cases marked a significant development. While the Court resisted calls for abolition of the penalties rule, it made radical adjustments to the law in England and Wales and (it is generally accepted) in Scotland also. The new approach is that while as a matter of public policy the law sets its face against the imposition of a punishment of one contracting party (debtor) by another (creditor) by way of a penalty clause, it is no longer a general pre-condition of a clause's enforceability that it be a pre-estimate of the financial loss which the creditor will suffer as a result of the conduct for which the penalty is incurred. While such a clause remains generally enforceable, the question is whether the clause offers protection for a legitimate interest of the creditor that is not extravagant, exorbitant or unconscionable.

The 2016 DP examined these cases and the criticism that the decisions had attracted from both commercial law practitioners and academic lawyers. It suggested three options: (i) leaving the courts to develop the law further, with further reform then to be considered if perceived to be necessary; (ii) abolition of the penalties rule, or (iii) replacement of the present law with a new scheme for the regulation of penalty clauses (set out in some detail). In response, a clear majority of consultees favoured leaving the courts to develop the law further. We therefore concluded in our Report that we should not recommend legislative reform of the rule ahead of seeing how the law develops after the *Cavendish/ParkingEye* cases. There is insufficient evidence that the decision is creating major difficulties in legal practice, while the judicially reformulated rule is still capable of striking down clauses seen as excessively penal in their effects. The Supreme Court has pointed the law in what seems to be the right general direction, while leaving it still open for further judicial refinement in the future.

Objectives

The objective of the SLC's contract project was to ensure that the four aspects of contract law referred to in the section above were as clear, certain and up-to-date as possible. If parties negotiating a contract are being advised by lawyers, this enables the advice to be given with a reasonable degree of confidence; and this will also hold good where contracting parties in dispute about the contract's meaning seek professional advice on the matter. However, many contracts are made, carried through, and become the subject of disputes between parties who have no professional assistance. For such parties it is even more important that the language of the law be clear so that, further, it is relatively readily understood by lawyer and non-lawyer alike.

The Scots law of contract has largely developed by judicial decision and juristic writing. The disadvantages of this are that a small legal system like Scotland may not produce sufficient case law to enable the law to keep moving with the times, while the law's accessibility to those without legal training or knowledge of its sources is limited. There are also problems of gaps (or incompleteness) in the common law and of differences of view between jurists as to what the law is. The first problem arises where there are no, or only very few, judicial decisions on a particular issue. The second may arise from the same difficulty; but it can also arise from a plethora of decisions which cannot readily be reconciled with each other. The result can be varying analyses of the law by both judges and jurists, with no way for the user of the law to determine which view is to be preferred.

[17] [2015] UKSC 67

> "Law which can only be tentatively identified after a trawl through extensive authorities must be condemned as not fit for purpose."[18]

Therefore the aim in recommending both the statutory statement of the law of formation and the reforms in relation to formation and remedies for breach in the Report has been to produce rules that are as clear and certain as they can be made in a form that is accessible to lawyer and layperson alike, that is, in statute. We have sought to remove rules that are no longer justified in contemporary conditions (for example, the abolition of the postal acceptance rule) and to supply ones providing answers to questions thrown up by these same conditions (such as when electronic communications take legal effect). We have also looked to produce clear answers on matters where differences of view have persisted over time with no resolution in sight (such as fundamental change of circumstances during a contract formation process). Finally the Bill seeks to fill gaps, or remedy incompleteness, where such difficulties seem to cause real problems for legal practitioners and others using the law.

The objective of the Bill is therefore also to increase legal certainty and clarity in relation to the law of formation of contract and in relation to the reform of the three areas of the law of remedies for breach of contract referred to above (and also congruent with what persons who may lack legal advice would reasonably expect the law to be). In relation to the abolition of the postal acceptance rule and the statement of a rule on electronic communications, a further objective is the modernisation of the law.

The economic impact of the Bill is unlikely to be adverse and will, in some respects, be positive (see Benefits section below). A particularly positive aspect will be the removal of uncertainty in the law which could otherwise only be resolved by judicial decision obtained at the expense of litigating parties.

Formation

The most significant recommendations in the Report concern formation of contract. A clear majority of consultees who responded to the Formation DP favoured a statutory statement of the law of formation and abolition of the postal acceptance rule, both of which are provided for in Part 1 of the Bill.

A comprehensive statutory statement of the law on formation of contract will enable any party wishing to do so to know what steps Scots law requires for a contract to exist, and will be a visible demonstration of the system's commitment to up-to-date business and consumer-friendly rules in contract law. One desirable effect of that might be the encouragement of parties otherwise unconnected to the system to contract under Scots law. It is understood that Scottish central government and local authorities always contract under Scots law but can have difficulty (and so resultant costs in terms of delay) in demonstrating what Scots law is when negotiating contracts with non-Scottish parties. A comprehensive statutory statement on formation goes some way towards resolving that particular difficulty. Further, a large part of the statutory restatement of the law on formation will be to the same effect as the present law, meaning again that little if any change to current practice is needed.

The view noted above, that adverse economic effects are unlikely, is based firstly on the belief that our reform proposals in relation to such matters as the postal acceptance rule will simply bring the law into line with existing business practice, in which the rule is commonly excluded by parties. But it will remain possible for those who wish a contract

[18] N Andrews, *Contract Rules: Decoding English Law* (2016), p vii.

to be concluded upon posting an acceptance (such as on-line traders), so to provide in their terms of business (as indeed they do at present).[19] The provisions in the Bill, like the present law, are 'default rules' which leave it open to parties who wish to do so to set out their own rules as to how a contract is to be formed between them. Therefore if a party perceived a particular rule or set of rules to have adverse effects upon its interests in particular circumstances, that party could devise an alternative scheme to which the law would give effect provided that any other parties involved had submitted to the scheme and it did not fall foul of any other legislation (for example, the law on unfair terms, which can be applied to non-contractual notices). This might help to overcome the possible adverse effect of discouraging parties from deciding to contract under Scots law.

Remedies for breach of contract

Further significant recommendations in the Report relate to individual reforms of three areas of the law of breach of contract. Part 2 of the Bill contains provisions on (a) aspects of mutuality of contract (b) restitution after termination and (c) contributory negligence.

Mutuality

As noted above, there is a clear need to clarify the law on when a party (A) in breach of contract may nonetheless make a claim of breach against the other party to the contract (B). In responding to our proposal for reform of the law in this area in our 2017 DP, the Faculty of Advocates commented:

> "We consider that simply because Party A is in breach of contract does not mean that it is not entitled to treat any part of the contract as remaining in full force and effect. If the contrary was the case, this would result in a great deal of unnecessary practical complication."

The Law Society of Scotland commented that a breach scenario can arise for a wide range of reasons and that party A in the above scenario should not be considered to have forfeited the right to pursue remedies arising out of party B's breach and occurring before termination in respect of A's breach.

Part 2 of the Bill therefore provides that party A, who is in breach of a contract with party B, is nevertheless entitled to exercise any right or to pursue any remedy arising out of party B's breach (i) where B's alleged breach occurs before B terminates the contract for A's breach; or (ii) unless B is lawfully withholding performance in respect of A's breach. The effect or objective of such a reform is to clarify and simplify this area of law and avoid the confusion arising from conflicting decisions of the courts on the matter.

Restitution after rescission

This too is an area of law on which there are inconsistent judicial decisions and differences of view amongst jurists and practitioners. The 2017 DP considered it clear in principle that where parties have rendered performances under a contract but not received the reciprocal counter-performances, and the contract is then rescinded

[19] For example, Amazon uses the following clause on its website: "When you place an order to purchase a product from Amazon.co.uk, we will send you an email confirming receipt of your order and confirming the details of your order. Your order represents an offer to us to purchase a product which is accepted by us when we send email confirmation to you that we've dispatched that product to you (the 'Dispatch Confirmation E-mail'). That acceptance will be complete at the time we send the Dispatch Confirmation E-mail to you."

(terminated) for breach, there should be restitution of the performances in question. There was near unanimous agreement to this proposition from consultees. The DP also asked whether, if consultees agreed, the system of rules set out on this matter in the DCFR provided a satisfactory clarification of the right approach to the issue, and there was majority agreement to this also, albeit some thought that the DCFR drafting could be improved upon.

Part 2 of the Bill therefore provides that after rescission for breach of contract where parties have rendered conforming performances under a contract but not received the reciprocal counter-performances, there should be reciprocal restitution of the uncompleted performances. It also contains provision for: (i) the repayment of money; (ii) the return of a benefit which is not a payment of money; (iii) the repayment of the value of a benefit which is not money and not returnable; (iv) how such a benefit is to be valued; and (v) the payment of compensation for any reduction in the value of the benefit between the time of receipt and the time of return.

Contributory negligence

The 2017 DP noted that it has been held that the Law Reform (Contributory Negligence) Act 1945 applies as a defence to some but not all claims for breach of contract. On this approach, the contract-breaker's breach must itself be negligent. The Report further notes an argument that the 1945 Act actually does not apply at all in breach of contract cases, and the cases saying that it does are wrongly decided. If the first view of the present law is correct, its dependence on the nature of the breach before the other party's contribution to its own loss can be taken into account leads to strange anomalies. The contract-breaker must argue that its breach constituted negligence while the other party must claim that it did not. If the second view is correct, there is potential unfairness in that a party's contribution to its own loss cannot be taken into account in assessing the contract-breaker's damages liability.

The 2017 DP therefore suggested three different options to consultees: (i) leaving the courts to develop the present law in light of cases; (ii) introducing contributory negligence as a defence in purely contractual claims (but only where the debtor failed in a duty of reasonable skill of care); or (iii) introducing contributory negligence as a defence for all contractual claims. The DP proposed proceeding with the third option and a majority of consultees agreed. For example, Morton Fraser commented that:

> "We agree that contributory negligence should be introduced as a defence to all contractual claims".

Section 22 of the Bill therefore amends the 1945 Act to extend the availability of contributory negligence as a defence, to all claims for breach of contract. The objective is to enable courts to take account of blameworthy steps actually taken by a party which can be shown to have contributed to the loss it actually suffered alongside breach by the other party, whether the first party's actions (or omissions) occurred before or after the breach.

Rationale for Government intervention

Left to itself, the common law in relation to formation of contract and the three areas of the law of remedies for breach of contract which the Bill reforms, can only be changed by a decision of an appropriate court and only if suitable cases arise.

The alternative is to introduce a modern, clear statute, which deals with all of the issues referred to above in a way not possible in any single court case. This is what the Bill does.

A majority of respondents to the Scottish Law Commission's DPs on Formation of Contract (March 2012) and Remedies for Breach of Contract (July 2017) also supported a comprehensive statutory restatement of the law in relation to formation of contract, the abolition of the postal acceptance rule and reform in the areas of (a) mutuality, (b) restitution after termination, and (c) contributory negligence. They were in favour of such a restatement and these particular reforms largely to increase legal certainty and clarity and to simplify and modernise these areas of law.

Consultation

Within Government

The contract law project is part of the Scottish Law Commission's Eighth, Ninth and Tenth Programmes of Law Reform which was approved by the Scottish Ministers.

Copies of the SLC's DPs on Formation of Contract, Interpretation, Remedies for Breach of Contract and Penalty Clauses were sent to the Civil Law Reform Unit of the Scottish Government Justice Directorate.

The SLC team met with members of the Civil Law Reform Unit of the Scottish Government at the outset to discuss the project and the Unit has regularly been kept informed about progress.

Public Consultation

As noted above, the DPs on Formation, Interpretation, Remedies and Penalty Clauses were published in March 2012, February 2011, July 2017 and November 2016 respectively. They were all also circulated to individuals and organisations identified by the SLC as having a potential interest in the topic and they were published on the Commission's website. The DPs were therefore freely available to the general public online and after 2012 their publication was also announced via Twitter.

(A) The Formation DP sought views of stakeholders on 51 questions. The consultation was open for 12 weeks and attracted responses from 19 consultees, including members of the public, an MBA student, University academics, the Senators of the College of Justice, the Faculty of Advocates, law firms and other representatives of the legal profession.

A further consultation, on a working draft of what is now Part 1 (with the general provisions from Part 3) of the Bill, took place from 1 September to 3 November 2017. The draft Bill, a covering minute and draft Explanatory Notes were posted on the SLC's website (and an announcement was made about the consultation on Twitter). Responses were received from the Law Society of Scotland, the Faculty of Advocates, CMS Cameron McKenna Nabarro Olswang LLP and Lorna Richardson (Commercial Law Lecturer at Edinburgh University). All responses were carefully considered in making the final policy decisions about the Bill.

(B) The Interpretation DP sought views of stakeholders on 17 questions. The consultation was open for 12 weeks and attracted responses from 16 consultees, including the Senators of the College of Justice, the Faculty of Advocates, the Law Society, University academics, solicitors, law firms, other representatives of the legal profession and the Royal Bank of Scotland.

(C) The Penalty Clauses DP sought the views of stakeholders on 32 questions. The consultation was open for 12 weeks and attracted responses from 14 consultees, including University academics, the Senators of the College of Justice, the Faculty of Advocates, solicitors, a barrister, law firms, other representatives of the legal profession, CCW Business Lawyers Ltd, the Competition and Markets Authority and the British Parking Association.

(D) The Remedies for Breach DP sought views of stakeholders on 79 questions. The consultation was open for 12 weeks and attracted responses from 11 consultees, including the Senators of the College of Justice, the Faculty of Advocates, the Law Society, University academics, law firms and other representatives of the legal profession.

Business

The SLC has also worked extensively at the outset of the contract project with an expert Business Advisory Group. Discussion with the Advisory Group helped define the scope of the project, and ongoing engagement with members of the Group throughout the course of the project has helped to refine policy. The Group included individuals from the following businesses and organisations:

- Scott Wilson Construction Ltd
- Federation of Small Businesses in Scotland
- In-House Legal Counsel, RES Ltd
- Wood Group Engineering (North Sea) Ltd
- Glasgow Chamber of Commerce
- Head of Legal and Democratic Services, Renfrewshire Council
- Confederation of British Industry
- Horizon Co-Invest Ltd
- Scottish Procurement Directorate, Scottish Government
- Head of Procurement, Scottish Borders Council
- Edinburgh Research and Innovation Ltd
- Commercial Counsel, William Grant & Sons Ltd

The SLC's project team made frequent presentations about their work in progress, particularly within "continuing professional development" programmes. While the audiences were made up mainly of practising lawyers, there were also representatives of business present at these occasions. All such presentations offered excellent opportunities for discussion with business interests.

Options

Option 1 – Do nothing

In terms of Option 1, the Bill would not be introduced and the current common law position in relation to formation of contract (including the outdated postal acceptance rule) and in relation to mutuality, restitution after rescission, and contributory negligence would remain. The opportunity would be lost to address the uncertainties and lack of clarity stemming from the current law and the benefits discussed below would not be realised.

Option 2 – Introduce the Bill

In terms of Option 2, the recommendations outlined in the Report in relation to formation of contract (Part 2) and remedies for breach of contract (Part 4 chapter 10) and implemented through the Bill would be introduced. If implemented, the changes to the law listed under "Objective" above would be brought about resulting in increased clarity, certainty, simplification and modernisation of the law.

The SLC therefore recommends Option 2.

Sectors and groups affected

The Bill is general in its application and not confined to any particular sector or group. As any member of the public may wish to enter into a contract, the draft Bill is capable of impacting upon anyone in Scotland. We anticipate, however, that the Bill's effects would most greatly be felt by the legal profession and businesses. Legal practitioners' work is currently adversely affected by the complexity and a lack of clarity of the law in relation to formation of contract, and remedies for breach of contract (mutuality, restitution after rescission, and contributory negligence) which the draft Bill seeks to reform. Similarly clarifying and simplifying the law in these areas will help to encourage businesses to opt to use Scots law in the drafting of their contracts. The provisions on mutuality and restitution after rescission should also facilitate the quicker settlement of contract disputes between businesses exercising the "self-help" remedies of withholding performance or terminating the contract in response to breach by a party.[20]

We have concluded that the Bill will not impact upon any person by virtue of their particular religion, belief, age, sexual orientation, gender, race or ethnicity.

Benefits

Option 1 - Do nothing

Option 1 would not produce any benefits, given that the present uncertainties and lack of clarity stemming from the current state of the law of formation of contract and remedies for breach of contract (mutuality, restitution after rescission, and contributory negligence) would continue. Further, the law in relation to the postal acceptance rule would remain in place, although outdated and out of step with contemporary conditions, and there would be no clear rule on the effectiveness of electronic communications in contract negotiations.

[20] The remedies mentioned are "self-help" in that their exercise does not require any prior judicial order.

Option 2 - Introduce the Bill

The Bill if introduced and implemented would bring the following benefits:

Increased certainty and clarity

The Bill provisions would clarify and simplify the law both in relation to formation of contract and remedies for breach of contract.

The resultant increased clarity and simplification as a result of the statutory statement of the law of formation, abolition of the postal acceptance rule and the reforms of the remedies for breach of contract would reduce the number of disputes and consequential litigation.

Accessibility of the law

The Bill would make the law more accessible to lawyer and layperson alike. It would enable professional advisers such as solicitors and advocates to advise their clients more clearly on the law in these areas and it would also assist those parties who make contracts without professional assistance. As noted above, for such parties it is even more important that the law be clear so that, further, it is relatively readily understood by lawyer and non-lawyer alike.

Part 1 of the Bill, which includes a statutory statement of the law on formation of contract, will enable any party wishing to enter a contract to know what steps Scots law requires for a contract to exist. This will be a visible demonstration of the system's commitment to up-to-date business and consumer-friendly rules in contract law. As noted above, one desirable effect of that might be the encouragement of parties otherwise unconnected to the system to contract under Scots law. Again as previously noted, we have also been told that Scottish central government and local authorities always contract under Scots law but can have difficulty (and so resultant costs in terms of delay) in demonstrating what Scots law is when negotiating contracts with non-Scottish parties. A comprehensive statutory statement might go some way towards resolving that particular difficulty.

Modernisation and simplification of the law

As stated above, abolition of the postal acceptance rule will have the benefit of modernising and simplifying an area of law which currently causes uncertainty, confusion and difficulties with the law of contractual formation. It will simplify the law as it will bring it into line with existing business practice, while a “pitfall” for businesses unaware of the rule will cease to exist. The rule is considered to be a particular obstacle to the smooth conduct of trade in an electronic age, so reform will help to modernise the law in this respect. There was unanimity amongst consultees that there was no need to retain the postal acceptance exception in modern conditions, for the reasons set out in the 2012 DP.

Potential Savings

The Bill’s contributory negligence provision would result in a saving both in terms of court time and preparation time for litigation in contributory negligence cases (and consequently a saving in terms of instructing costs both in relation to solicitors and advocates). This is because a contract-breaker would no longer have to establish its own breach was negligent in order to raise the question of the other party’s contributory

negligence (as it is assumed is required under the present law). Further, the provision itself might also promote the settlement of disputes between parties in this area.[21]

Costs

Option 1

As Option 1 is to do nothing, there would be no additional costs or savings associated with this option. Given the need for change outlined by the chosen Option 2 however, the lack of additional costs imposed by Option 1 would not add any positive value.

Option 2

The increased clarity, certainty and modernisation of the law which the implementation of Option 2 would bring would reduce costs. As noted above, the Bill would make the law more accessible to lawyer and layperson alike, which would have the effect of reducing the costs of contracting parties both at the contract formation stage and in any potential litigation.

Training costs

An initial training cost and familiarisation cost, principally for solicitors but perhaps also for other professionals in the relevant fields, would be likely. The costs would be small, and would be incurred only on first implementation.

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

It is possible that initial training would also be provided to the judiciary. We understand that the average daily cost (as opposed to cost per head) of providing training to the judiciary by the Judicial Institute at its premises is £913.66.

[21] See P Cane, *Atiyah's Accidents, Compensation and the Law* (8th edn, 2013) p 269. Empirical work on how judges in the UK use contributory negligence to decide cases is being conducted by James Goudkamp and Donal Nolan of Oxford University: see J Goudkamp and D Nolan, "Contributory Negligence in the Twenty-First Century: An Empirical Study of First Instance Decisions" (2016) 79 Modern Law Review 575 (stating at p 578: "[R]eliable information about judicial decisions on the doctrine of contributory negligence should facilitate the settlement of disputes by giving litigants and their advisers a clearer picture of the likely outcome of possible litigation"); J Goudkamp and D Nolan, "Contributory Negligence in the Court of Appeal: An Empirical Study" (2017) 37 Legal Studies 437; J Goudkamp and D Nolan, "Contributory Negligence and Professional Negligence: An Empirical Perspective", in K Barker and R Grantham (eds), *Apportionment in Private Law*, forthcoming.

Scottish Firms Impact Test

No Scottish Firms Impact Test was carried out. The aim of the Bill is principally to provide certainty and clarification in the law. Such certainty and clarification was highlighted by stakeholders as an area in need of reform and we anticipate that the Bill would be beneficial to relevant professionals and individuals alike.

It is anticipated that the Bill will bring benefits to all parties who wish to enter into contractual arrangements – both members of the public and business – as opposed to one particular sector, market or industry. The legal sector and businesses, we anticipate, would enjoy the greatest immediate benefit from the passage of the Bill, but this is not to the exclusion of any other sector. Further, it is not anticipated that the proposals will have any significant cost implications for any markets or industries. On the contrary, the Bill has the potential to reduce costs per transaction.

Competition Assessment

It is not anticipated that the Bill would have an impact on competition within Scotland. The recommendations reflected in the Bill do not create a competitive advantage for any particular sector or individual; they simply offer benefits for professionals and individuals alike.

- As discussed above, the legal sector, other relevant professionals and businesses would be positively affected by the Bill. We do not anticipate an impact upon any other particular market or product.

- The Bill would not result in any restrictions on competition in the legal services market or in other relevant professional markets. The number and range of suppliers would not be affected, nor would the ability of suppliers to compete be limited. We do not consider that the proposal would reduce incentive to compete vigorously.

The Bill does not introduce any new business forms.

Legal Aid Impact Test

Whilst it is possible that issues arising from the Bill might be such as to require advice and assistance in terms of the legal aid scheme, the parties whom we expect to use the Bill will not in the majority of cases be eligible for legal aid.

Additionally, nothing in the proposals will trigger an eligibility for legal aid, and the proposals are not anticipated to have any impact on the legal aid fund. The Access to Justice team at the Scottish Legal Aid Board is content that the Bill would not adversely affect either the legal aid scheme or the legal aid fund.

Enforcement, sanctions and monitoring

The Bill does not require public enforcement and imposes no sanctions. As previously noted, the Bill clarifies, increases the certainty of and modernises the law in relation to formation of contract and three discrete aspects of the law of remedies for breach of contract. Further, the Bill provisions are default only and parties are therefore free to contract otherwise than as provided for. Ultimately, any disputes concerning the

provisions of the Bill would be resolved by litigation or other dispute resolution process between the affected parties.

Implementation and delivery plan

If passed by the Scottish Parliament, sections 15, 23 and 25 of the Bill will come into force on the day after Royal Assent and the other provisions will come into force on the day or days appointed by the Scottish Ministers by regulations.

Post-implementation review

In accordance with section 3(1) of the Law Commissions Act 1965, the Scottish Law Commission has a duty to "keep under review" the laws with which it is concerned, and will endeavour to stay informed of the Bill's reception by the legal profession and wider business community. We anticipate that a review of the legislation by the Scottish Ministers would be appropriate 10 years from the date on which it is brought into effect. It is hoped that in light of the support from consultees for the proposals, the operation of the reformed law will be uncontroversial.

Summary and recommendation

Dismiss Option 1

This option would preserve the status quo and introduce no new legislation. It would not produce the benefits offered by Option 2 with the result that the law which is no longer up to date with practice (for example, the postal acceptance rule), uncertainties and lack of clarity stemming from the current common law position would continue.

Recommend Option 2

Option 2 is being recommended as it would bring increased clarity and certainty and modernisation of the law for the reasons outlined above.

- **Summary costs and benefits table**

Option	Total benefit per annum: - economic, environmental, social	Total cost per annum: - economic, environmental, social - policy and administrative
1	£0 Option 1 would not produce any benefits, given that the result would be that the uncertainties and lack of clarity stemming from the current common law of formation of contract and (a) mutuality and retention, (b) restitution after termination, and (c) contributory negligence would continue.	£0 There would be no direct cost in choosing Option 1 as Option 1 represents the status quo.

2	Option 2 would bring (i) increased certainty and clarity and (ii) modernisation and simplification of the law. The Bill would save the parties time as they would not need to work around the current common law. Therefore commercial transactions would be able to be conducted more efficiently.	The increased clarity and certainty which Option 2 would result in *savings from reducing the need to resort to court action*. An additional initial training cost (£450 approximate[22]) and familiarisation cost would be likely, principally for solicitors but perhaps also for other professionals in the relevant fields. The costs would be small and would be incurred only on first implementation.

Declaration and publication

I have read the Business and Regulatory Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed:

Lord Pentland, Chairman, Scottish Law Commission

20 March 2018

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