RESPONSE FOR THE FACULTY OF ADVOCATES

ON

CONTRACT (THIRD PARTY RIGHTS) (SCOTLAND) BILL

Introduction

1. The Faculty is grateful for the opportunity to comment upon the Contract (Third Party Rights) (Scotland) Bill (the "**Bill**") contained in the Appendix to the Scottish Law Commission, *Report on Third Party Rights* (SLC Report, No 245, 2016). In broad terms, the Faculty enthusiastically supported the proposals contained in the Commission's *Discussion Paper on Third Party Rights in Contract* (SLC DP, No 157, 2014). The Faculty considers that codifying and clarifying the common law of *ius quaesitum tertio* in modern language will be an important improvement for Scots contract law. We seek to offer in what follows substantive and drafting comments on each substantive section of the draft Bill.

Sections 1 & 2

2. The Faculty observe that the core concept in the Bill is that of the "undertaking": s 1(1)(a) and (b). It is not otherwise defined. We do not see that lack of a definition as per se necessarily problematic but we do observe that it gives rise to a number of uncertainties. The obvious uncertainty is that of the requirements of writing. The Requirements of Writing (Scotland) Act 1995, s 1(2)(a) sets out those juridical acts for which writing (or electronic writing in terms of s 9B) is a constitutive formal requirement. One of these is the "gratuitous unilateral obligation, except an obligation undertaken in the course of business". The use of the verb "undertaken" appears to have a slightly different shade of meaning in s 1(2)(a)(ii) than it does in s 1 of the Bill. There may be something to be said for using the word "stipulation" used in Art II.-9:301 DCFR instead. This would be consistent with the terms of s 10 which, in somewhat convoluted

language, states that "an undertaking contained in a contract" is an "obligation arising from the contract" for the purposes of the 1973 Act.

3. There is the fundamental question of whether the third party's right is to enforce the terms of the contract or only the "undertaking". Section 1(2) appears to permit only enforcement of the undertaking not the particular terms of the contract. That has important implications for the construction of, for instance, section 7 (for which see below). It is not immediately clear to us whether an "undertaking" in terms of sections 1 and 2 of the Bill requires to be in writing where the benefit conferred upon the third party is conferred gratuitously by one of the contracting parties.

4. We observed at the outset that we considered that the Bill is intended to codify and clarify the Scots law of third party rights. We refer to the opening paragraph of the Explanatory Notes which state that the Bill "seeks to reform that rule of contract law, replacing it with a statutory version". We would observe, however, that the terms of s 2(7), on an extended interpretation, leave the entire law of *ius quaesitum tertio* in force in so far as not inconsistent with the Bill.

5. There appear to be a plethora of synonyms for the third party's right: the section headings to s 3 and s 4, for instance, refer to the third party "entitlement". "Entitlement" is then again used in s 6(3)(ii) to refer to the contracting parties. It is thought that there is no reason not to use the word "right" consistently. Finally the relationship of section 1 with section 9 (arbitration) should be clarified. We have given our views on that matter in paragraph 10 below.

Section 4

6. In section 4(1), we observe that the words "No account is to be taken of the cancellation or modification…" (emphasis added) may lead to some confusion because they contemplate a situation where a cancellation or modification might be said to "exist" albeit that no account is to be taken of it. We observe that a similar result could be achieved, without the potentially confusing "existence" of an ineffective cancellation or modification, by the following wording:-

> *"Any purported cancellation or modification of an undertaking contained in a contract shall be void and of no effect where and in so far as the undertaking is being enforced or otherwise invoked - …"*

Section 7: Remedies

7. We observe that s 7(2) appears to confer a remedy in favour of the third party only in a case of breach. But the secondary remedies for breach presuppose a primary remedy to perform. We merely observe that it is curious that the primary remedy for performance is contained within the definition of s 1(2) rather than in section 6. We observe too that the formulation of s 7(2) proceeds on the analysis that a third party is not thereby a party to the contract, but is rather someone whose position is to be equated to a contracting party for defined purposes.

Section 8: Defences

8. Section 8(1) proceeds on the basis that all the third party may enforce is an "undertaking" rather than a term of the contract. Section 8(2) refers to the third party's "claim", but that claim is again formulated in terms of a breach of the undertaking. There is presumably no difficulty with the basic idea that the party liable to perform in favour of the third party should be entitled to raise relevant defences against the third party who demands performance in terms of s 1(2).

9. We did not immediately understand the terms of s 8(2)(b): given the "claim" in s 8(2)(a) arises only on breach of the undertaking, if a defence to that claim exists under s 8(1)(a) it is not at all clear what s 8(1)(b) adds. For our part we see much in the simplicity of the general principle expressed in Art 5.2.4 PICC: "the promissor may assert against the beneficiary all defences which the promissor could assert against the promisee". There seems no reason to doubt that this formulation could be adopted for s 8 by altering the preferred vocabulary of the Bill for the various participants.

Section 9: Arbitration

10. Section 1 of the Bill deals with substantive "third party rights" created by an undertaking in a contract and not procedural rights such as those created by an arbitration agreement. If the latter were intended to be included as covered by section 1, (and "contract" in section 1 intended to include "arbitration agreement"), there would be no need for section 9(2)(b) and 9(3)(b), or indeed section 9 at all. In addition it is not apparent under section 1(1)(a) that an undertaking in an arbitration agreement to resolve a dispute with a third party by arbitration rather than the courts will be "for the [third person's] benefit". Whether the third party derives "benefit" will depend on the terms of the arbitration agreement (e.g. who is to be the arbitrator or how he is to be chosen, any conditions as to the arbitration process etc.) While arbitration agreements are a species of contract at common law, for the reasons stated above it is doubtful that an argument

that "contract" in section 1 includes an arbitration agreement would succeed. However for the avoidance of doubt section 1 should provide that a contract under section 1 does not include an arbitration agreement under section 4 of the Arbitration (Scotland) Act 2010 – for which special provision is made under section 9.

11. Section 9(2) of the Bill is intended to apply to the situation where the third party C *is* the holder of a substantive third-party right under section 1. In contrast, section 9(3) of the Bill is intended to be apply to the situation where the third party C is *not* the holder of a substantive third-party right. Merely being mentioned in an arbitration agreement does not and cannot give a person a "third-party right" under section 1. Therefore it follows that the third party C who is empowered to invoke the arbitration agreement under section 9(3) is *not* the holder of a "third-party right to enforce or otherwise invoke the agreement in relation to the subject-matter under dispute". It follows that it should not be a requirement for section 9(3) to apply for C to have a substantive "third party right" under section 1. In short, any procedural ability to arbitrate that C acquires is as a *consequence of* section 9(3) and the holding of a section 1 substantive right should *not be a pre-requisite* for section 9(3) to apply. All of this has the following consequences in the drafting:

    - In section 9(3)(c) and (d) the words from "has a third-party right" to "has the third party right" should be omitted so that (c) reads:

        "(c) a person who is not a party to the agreement has –
        (i) submitted the dispute to arbitration, or
        (ii) sought a sist of legal proceedings concerning the matter under dispute . . .to be resolved by arbitration. "

        and (d) should be omitted.

    - in section 9(4) part (a) should be omitted (there is no third-party right to enforce)
    - in section 9(1) the words "or (as the case may be)(3)" should be replaced by "or mentioned in subsection (3)" (there is no third-party right)

12. Turning to the explanatory notes to s 9 we would query whether the statement that "no party can be compelled to submit to arbitration unless it has signed a valid arbitration agreement" is correct. The 2010 Act, s 4, implements Option II of Art 7 of the Model Law, which does not

require signature, whatever the New York Convention consequences of that may be. The explanatory notes are not therefore consistent with the 2010 Act. It is possible for a third party to take a substantive third party right without signing anything. It is difficult to see why, if the arbitration clause is so drawn as to subject disputes in relation to the substantive third party right to arbitration, it is necessary for the third party to sign anything in order to obtain the right (or be subject to the obligation) to arbitrate.

Section 10: Renunciation

13. There is the slow-burning question of whether the "renunciation" is unilateral or bilateral. Given that the right is conferred, exceptionally, without the third party's consent, there is much to be said for the view that renunciation may be unilateral and that the effect of renunciation should be retrospective (cf DCFR Art II.-9:303). It might be thought too that some provision should be made for the method by which renunciation is to take place if it occurs expressly, e.g., by communication to the party who would otherwise be bound to perform to the third party. There is also the question of the extent to which the right to renounce may be lost if the third party has conducted itself in such a way as to give rise to reliance on the part of the debtor, who has acted to his detriment, that the performance will be required. Ordinarily it might be thought that the common law of personal bar would still apply. But the express references to personal bar in other areas of the Bill support an alternative interpretation.

Section 11: Prescription

14. The only observations which the Faculty would offer in relation to this provision relate to the drafting. If an "undertaking" by one of the parties is to be considered for prescription purposes to be an "obligation" arising from the contract for the purposes of the 1973 Act, it might be thought that contractual vocabulary (obligation or stipulation) would be better than "undertaking".

25.10.2016