

Changes afoot for Third Party Rights under Scottish Contracts



Peter Alderdice

peter.alderdice@shepwedd.com

Andrew Kinnes

andrew.kinnes@shepwedd.com

Antiquated rules of Scots contract law on the rights of third parties are to be swept away and replaced with a new flexible regime under proposed legislation introduced to the Scottish Parliament today.

The Contract (Third Party Rights) (Scotland) Bill implements widely supported recommendations contained in last year's Report on Third Party Rights by the Scottish Law Commission and, if passed by law-makers at Holyrood, will overhaul the current system of third-party rights with implications for the drafting of finance documentation and other legal agreements written under Scots law.

Banks and Financial Institutions and other businesses with operations in Scotland should keep a close eye on the passage of the Bill through parliament and plan ahead for necessary changes to their legal documentation – especially those provisions aimed at non-contracting parties, such as indemnities in favour of their employees and officers, and immunity provisions for delegates and agents.

Reform

Introduced under an expedited parliamentary procedure for non-contentious law reform, the Bill is intended to bring much needed modernisation to existing common law rules which derive from the centuries-old Roman law doctrine of "jus quaesitum tertio" (often translated as "right acquired by a third person").

The proposed legislation follows developments in a number of other jurisdictions which have updated their

laws on third-party rights in recent years to better enable parties to a contract to create enforceable rights for third parties.

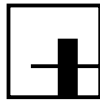
Shortcomings of the existing regime

Scots law has historically placed substantial limitations on the situations in which third parties can acquire rights under contracts to which they are not a party. The circumstances are, in fact, so restricted that enforceable third-party rights seldom arise under conventional Scottish contracts at present.

The most notable limitation is the "requirement of irrevocability" i.e. that a third-party right cannot be constituted in a contract unless the right has first been made irrevocable. This requirement has, in the words of the Scottish Law Commission, posed a "significant barrier" to the use of third-party rights under Scots law.

That a contract, or a clause within a contract, must be irrevocable goes against the general principle of freedom of contract – that contracting parties are free to agree to whatever they wish – and has resulted in a system which is insufficiently flexible to be of practical value in commercial transactions.

With no other modern system of law having an equivalent



requirement that a third-party right be irrevocable, this limitation is one which is to be abolished under the proposed legislation.

Out with the old...

The removal of the requirement of irrevocability will greatly increase the circumstances in which third-party rights can be created in Scottish contracts.

In most cases the parties to a contract are to be free to create third-party rights which are capable of being cancelled or modified and this will make the reformed system of third-party rights a much more useful tool in structuring the rights and responsibilities of contracting and non-contracting parties.

Something to think about

The role of third-party rights in Scottish contracts is something which has hitherto enjoyed little attention due to the limited circumstances in which they could arise. Should the Bill be passed by parliament, it will become much easier to create third-party rights – both intentionally and inadvertently – so a careful review of current terms and conditions and other existing precedents would be well advised to avoid conferring any unintentional rights on third parties after the new law comes into force.

In cases where there is no intention to create rights in favour of non-contracting parties, express provisions excluding the operation of third-party rights legislation – of the type commonly seen in English law agreements – may in the future become ubiquitous north of the border too.

As ever though, the devil is in the detail and those familiar with third-party rights legislation in other jurisdictions – such as the Contracts (Rights of Third Parties) Act 1999 in England and Wales – should be mindful that there are a number of crucial differences under the proposed new Scottish regime which will necessitate specific consideration.

In those cases where parties want to create third-party rights under their contract, the ability of the contracting parties to cancel or modify those rights without the consent of the relevant third parties will be a key concern – particularly as the Bill before the Scottish Parliament proposes that a statutory form of estoppel or personal bar will apply in certain cases.

Whilst the final text of the proposed legislation is still subject to amendment, there is a high degree of consensus in support of the Bill's approach and with the Bill passing through the Scottish Parliament under a fast-track process the changes to third-party rights in Scotland could be in place soon – and not before time too!

For more information on the impact of the Contract (Third Party Rights) (Scotland) Bill on legal documentation in Banking and Finance transactions and Financial Products and Services, please contact Peter Alderdice or Andrew Kinnes.