

## New regime for the contractual rights of Third Parties in Scotland



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Third party rights are conferred by contracting parties on a person who is not a party to the contract concerned.

Such rights have long been recognised as capable of being created in Scots Law in certain circumstances under the general or common law, known as *jus quaesitum tertio*.

The Scottish Law Commission announced proposals for the reform and updating of the current law on third party rights, in 2016. The Commission recommended the creation of an updated statutory regime for third party rights, to replace the common law rules. The outcome of the review is new legislation creating such a statutory regime: the Contract (Third Party Rights) (Scotland) Act 2017.

### Introduction

It has been a general principle of Scots law that there are circumstances in which a contract entered into directly between parties can contain rights that are enforceable by a third party who is not one of the parties to the contract. This concept is so well established under Scots law that it bears a Latin name – the *jus quaesitum tertio* (JQT). However, not only are the rules at common law for creation of such rights poorly understood, they have generally been regarded as inflexible and archaic, and long overdue for reform.

As part of its wider consideration of contract law in Scotland, the Scottish Law Commission undertook a review of this area of the law, in response to concerns that Scots law was falling behind international, and particularly European, reform in this area. Jurisdictions which historically did not recognise third party rights, such as England and Wales, have legislated to introduce them; and those jurisdictions which did recognise them, such as France, have updated and clarified their rules.

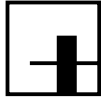
The outcome of this review is the Contract (Third Party Rights) (Scotland) Act 2017 which will come into force on 26 February 2018. The Act replaces and abolishes the existing common law JQT rules regarding the creation and enforcement of contractual rights in favour of persons other than the parties to the contract.

### Third Party Rights

Classic examples of where contracts have been used to create benefit for third parties are:

- life assurance, where benefits are payable to someone other than the policyholder;
- family holidays booked with a tour operator, where only one member of the family is a party to the contract;
- the rights of conditional beneficiaries under a company pension scheme, such as the spouse, on the pension scheme member's death; and
- the rights of a purchaser or tenant of a development in relation to a building contract between an employer and contractor.

One of many difficulties with the current law is the requirement that the third party right cannot exist unless the contract is not capable of being revoked by the contracting parties. Neither can the third party right itself be amended or rescinded, resulting in a rigidity that is unappealing to commercial parties. The Act seeks to address this and other issues by providing a clear statutory code for creation and protection of third party rights.



### A new statutory code

Although the Act abolishes the JQT for any contracts entered into after it comes into force, existing JQT rights will continue to be dealt with under the old rules.

For contracts entered into after the Act is in force, only statutory third party rights can be acquired. However, a contract entered into before these provisions come into effect can expressly provide that the Act's third party rights will apply, but in that case, any common law right to which a third party was entitled will not be enforceable.

### Creation of Third Party Rights

The Act entitles contracting parties to create a right in favour of a third party, which allows that third party to enforce or otherwise invoke a contractual undertaking contained in the contract. There are two requirements for creation of such rights:

- The contract must contain an undertaking that one or more of the parties to it will do (or not do) something for the benefit of an identified third party; and
- The contracting parties must intend that this right be enforceable by that third party.

There is no requirement that this intention be expressed, and it can also arise by implication. It will be prudent, therefore, where there is no intention to create such rights, expressly to exclude third party rights in the body of the contract. It is expected that standard wording excluding third party rights will start to appear in most contracts.

Although the third party must be identified, there is no requirement that they exist at the time of contracting. So third party rights can be created in favour of as yet unincorporated companies, or unborn children.

### Conditional Third Party Rights

The Act expressly provides that conditional third party rights can be created. This is in keeping with the common law position. No common law third party rights can be acquired in respect of contracts entered into on or after 26 February 2018, but conditional or contingent third party rights in contracts that pre-date that date, but which have not yet crystallised, for example a survivor's pension payable under an insurance contract, are also protected.

The original drafting of the Act could have had the effect that such contingent rights created before the commencement of the Act might not have been protected. But a timely amendment to the

Act, highlighted to government by Shepherd and Wedderburn, has ensured that existing conditional third party rights will now be safeguarded under the Act.

### Modification or Revocation of Third Party Rights

Under the common law rules, third party rights had to be irrevocable before coming into existence. The Act reverses this position, and modification or cancellation of the right by the contracting parties will be permitted at any time before the third party does, or refrains from doing, something in reliance on that right.

This position can be overridden if the third party knew that the contracting parties were entitled to modify or cancel the right, or if they have agreed to such modification or cancellation. However, the contract must specify that the parties are entitled to modify or cancel the third party right.

It should not be thought that this is necessarily always going to be an attractive option for contracting parties. In the construction industry, for example, where third party rights are granted in place of a collateral warranty involving a construction-related agreement, it is unlikely that the beneficiary of such third party rights would be prepared to accept an arrangement that entitles the parties to modify or revoke those rights. In such circumstances we would expect such agreements to contain an express restriction on the right of the parties to do so.

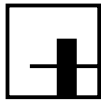
Accordingly, careful thought should be given when drafting contracts, and the issues should be discussed with the contracting parties, to ensure that provisions relating to third party rights are appropriate to the circumstances and do not run the risk of adversely affecting the commercial requirements of the parties.

### Enforcing rights against employees

In England, under the Contracts (Rights of Third Parties) Act 1999, a third party does not have the right to enforce a term of an employment contract against the employee. This prevents companies in the employer's group from enforcing clauses such as confidentiality provisions or restrictive covenants, which may cause problems if the original employing entity is wound up. The 2017 Act has no such restriction, and so employers in Scotland will be able to state that group companies may enforce clauses in an employment contract.

### Third party remedies

There is doubt about whether, under the current law, a third party has a right to claim damages. The Act removes this doubt by providing that a third party is entitled to any remedy to which a contracting party would be entitled under the contract.



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## Renunciation of third party rights

A person with a third party right has a right to renounce it, either expressly or implicitly, which will extinguish the right. This right cannot be excluded by the contracting parties.

Since there is no requirement on a third party to accept the right to be able to use it, this provision provides a clear method of rejecting it, if that is wanted. In those circumstances a clear and express renunciation, in writing, will ensure that the matter is beyond doubt.

## Prescription

The Act makes it clear that a third party right is an obligation arising from the contract for the purposes of the Prescription and Limitation (Scotland) Act 1973. A third party right will therefore normally prescribe after 5 years.

## Rights in the future

Once the Act comes into force, it will be a lot easier for third party rights to be created, with the removal of

the irrevocability requirement. While most such rights are likely to be set out expressly in the contract, it is possible that parties may inadvertently create rights, and so care is required. We are including default wording in Scottish contracts that will exclude third party rights from arising, unless expressly provided for. Such exclusions are common in contracts south of the border, where statutory third party rights have been available since the introduction of the Contracts (Rights of Third Parties) Act 1999. They are likely to become standard in Scottish contracts too.

The Property Standardisation Group has produced suitable wording for excluding third party rights in contracts:

“This [Agreement] does not create any rights in favour of third parties under the Contract (Third Party Rights) (Scotland) Act 2017 to enforce or otherwise invoke any provision of this [Agreement] [or otherwise].”

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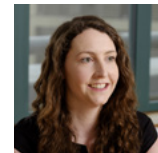
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