



Scottish Law Commission  
*promoting law reform*

| (DISCUSSION PAPER No 157)

Review of Contract Law

Discussion Paper on  
Third Party Rights in Contract

discussion  
paper



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# Discussion Paper on Third Party Rights in Contract

March 2014

DISCUSSION PAPER No 157

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**The Commission would be grateful if comments on this Discussion Paper were submitted by Friday 20 June 2014.**

**Please ensure that, prior to submitting your comments, you read notes 1-2 on the facing page.** Respondents who wish to address only some of the questions and proposals in the Discussion Paper may do so. All non-electronic correspondence should be addressed to:

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<sup>1</sup> Amended by the Scotland Act 1998 (Consequential Modifications) (No 2) Order 1999 (SI 1999/1820).

# Contents

	<i>Paragraph</i>	<i>Page</i>
<b>Abbreviations</b>		vii
<b>Chapter 1 Introduction</b>		
Background	1.1	10
The DCFR	1.2	10
Previous SLC Reports as starting points	1.12	13
Comparative material	1.15	14
Structure of the Discussion Paper	1.22	17
General options for reform	1.24	18
Advisory Group	1.25	18
Impact assessment	1.26	18
Legislative competence	1.30	19
<b>Chapter 2 Third Party Rights in Scots Law</b>		
Origins	2.1	20
Principles of voluntary obligations	2.4	21
<i>Conditional obligations</i>	2.6	21
<i>Delivery or equivalent of obligations in writing</i>	2.11	23
<i>Privity of contract and third party rights</i>	2.13	23
Rights, not duties	2.23	26
<i>Immunities as rights?</i>	2.24	26
Identification of the third party	2.26	27
<i>Third party as person fulfilling specified conditions</i>	2.27	27
<i>Third party not in existence when the contract is formed</i>	2.29	28
<i>Other instances of third parties with passive capacity only</i>	2.33	29
<i>Must the third party always be expressly identified in, or identifiable from, the contract?</i>	2.35	30
Contracting parties' intention to create third party rights	2.38	31
No requirement of third party acceptance	2.50	35
Formalities	2.53	36
The requirement of irrevocability	2.57	38
<i>Revocation of a third party right: conditionality</i>	2.70	42
Third party's rejection or refusal of the right or benefit	2.79	45
Position of the contracting parties	2.80	45
Assignability of the third party's right	2.81	46
Effect of invalidity, unenforceability or frustration of the contract on the third party	2.82	46
Third party remedies and exclusion clauses	2.84	47
Prescription	2.86	47

# Contents (cont'd)

	<i>Paragraph</i>	<i>Page</i>
<b>Chapter 3 Third Party Rights in Practice</b>		
Introduction	3.1	49
Company groups	3.4	50
(1) <i>Transferred loss in construction contracts</i>	3.11	52
(2) <i>Indemnities</i>	3.15	54
(3) <i>Restrictive covenants across a company group</i>	3.19	55
Construction projects and collateral warranties	3.20	56
Other uses of third party rights legislation	3.29	59
<i>Insurance</i>	3.30	59
<i>Settlement agreements</i>	3.33	61
<i>Outsourcing financial services</i>	3.35	61
<i>Community of interest cases</i>	3.37	61
<b>Chapter 4 Concepts and Terminology</b>		
Rights and benefits	4.2	66
The parties	4.7	68
Conditional obligations	4.19	72
<b>Chapter 5 Identification and Intention</b>		
Identification of the third party	5.3	74
<i>Third party identified in, or identified from, the contract</i>	5.3	75
<i>Third party not in existence</i>	5.9	76
<i>Third party in existence but not a member of the class in question</i>	5.11	77
Intention of contracting parties to confer a right	5.16	79
Should a third party right taking the form of an exclusion of liability be competent in Scots law?	5.22	81
<b>Chapter 6 Irrevocability</b>		
Abolition of irrevocability as a requirement of constitution	6.6	86
When should a third party right crystallise?	6.7	86
(1) <i>The effect of express contract terms and other statements by the contracting parties</i>	6.7	86
(2) <i>When there is no contractual provision on cancellation or alteration</i>	6.12	88
Assignment and irrevocability	6.32	94
Two kinds of case?	6.39	96

# Contents (cont'd)

	<i>Paragraph</i>	<i>Page</i>
<b>Chapter 7 Renunciation or Rejection, Remedies and Defences</b>		
Renunciation or rejection of its right by the third party	7.2	98
Remedies available to third party	7.9	100
<i>Rectification</i>	7.14	102
Defences	7.15	103
<i>“Set-off”</i>	7.20	105
<i>Prescription</i>	7.26	106
<i>Liability of one contracting party if the other defaults on the contract</i>	7.27	107
<i>Contracting out of liabilities to third parties</i>	7.28	107
Other points arising from the 1999 Act	7.31	108
<i>Third party can enforce a term of the contract only</i>	7.32	108
<i>Concurrency between the third party and the contracting parties</i>	7.34	109
<i>Double liability for contracting party bound to perform to the third party?</i>	7.36	109
<b>Chapter 8 Relationship with Specific Rules</b>		
Introduction	8.1	111
Current law	8.3	111
A provisional view	8.5	113
Options for reform: a constraint	8.7	113
<b>Chapter 9 Overview of Suggestions for Reform</b>		115
<b>Chapter 10 List of Questions and Proposals</b>		120
<b>Appendix A</b>		128
<b>Appendix B</b>		138

# Abbreviations

1999 Act,

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

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)

CESL,

Proposal for a Regulation on a Common European Sales Law, COM(2011) 635 final, available at:

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0635:FIN:en:PDF>

CISG,

The United Nations Convention on Contracts for the International Sale of Goods (1980), available at:

<http://www.uncitral.org/pdf/english/texts/sales/cisg/V1056997-CISG-e-book.pdf>

DCFR,

C von Bar and E Clive (eds), *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR)* (2010)

Gloag, *Contract*,

W M Gloag, *The Law of Contract: A Treatise on the Principles of Contract in the Law of Scotland* (2<sup>nd</sup> edn, 1929)

Gloag & Henderson,

Lord Eassie and H L MacQueen (eds), *Gloag and Henderson The Law of Scotland* (13<sup>th</sup> edn, 2012)

Hogg, *Obligations*,

M Hogg, *Obligations* (2<sup>nd</sup> edn, 2006)

Huntley and Dedouli, "Third Party Rights",

J A K Huntley and A K Dedouli, "Third Party Rights, Promises and the Classification of Obligations" 2004 JR 303

LC No 242, 1996,

Law Commission of England & Wales, Report on Privity of Contract: Contracts for the Benefit of Third Parties (LC No 242, 1996)

Macgregor, *Report on the Draft Common Frame of Reference*,

L Macgregor, *Report on the Draft Common Frame of Reference: a Report Prepared for the Scottish Government* (March 2009)

MacQueen, "Third Party Rights in Contract",

H L MacQueen, "Third Party Rights in Contract: A Case Study on Codifying and not Codifying" in L Chen and C H (Remco) van Rhee (eds), *Towards a Chinese Civil Code: Comparative and Historical Perspectives* (2012)

MacQueen, "Third Party Rights in Contract: *Jus Quaesitum Tertio*",

H L MacQueen, "Third Party Rights in Contract: *Jus Quaesitum Tertio*" in K G C Reid and R Zimmermann, *A History of Private Law in Scotland, Volume II: Obligations* (2000)

MacQueen and Thomson, *Contract*,

H L MacQueen and J Thomson, *Contract Law in Scotland* (3<sup>rd</sup> edn, 2012)

McBryde, *Contract*,

W W McBryde, *The Law of Contract in Scotland* (3<sup>rd</sup> edn, 2007)

PECL,

Principles of European Contract Law;

Parts I and II: O Lando & H Beale (eds) (2000), available at:

[http://frontpage.cbs.dk/law/commission\\_on\\_european\\_contract\\_law/pecl\\_full\\_text.htm#pecl1](http://frontpage.cbs.dk/law/commission_on_european_contract_law/pecl_full_text.htm#pecl1);

Part III: O Lando, E Clive, A Prüm and R Zimmermann (eds) (2003), available at:

[http://frontpage.cbs.dk/law/commission\\_on\\_european\\_contract\\_law/8Articles\(EF\).htm](http://frontpage.cbs.dk/law/commission_on_european_contract_law/8Articles(EF).htm)

PICC,

The UNIDROIT Principles of International Commercial Contracts (3<sup>rd</sup> edn, 2010), available at:

<http://www.unidroit.org/english/principles/contracts/principles2010/blackletter2010-english.pdf>

Proposed CESL,

See entry for CESL above

RoW(S)A,

Requirements of Writing (Scotland) Act 1995 (c. 7)

Rodger, "*Jus Quaesitum Tertio*",

A F Rodger, "Molina, Stair and the *Jus Quaesitum Tertio*" 1969 JR 34, 128 (two parts)

SME,

*The Laws of Scotland (Stair Memorial Encyclopaedia)*, 25 Volumes

Sutherland, "Third-Party Contracts",

P Sutherland, "Third-Party Contracts" in H L MacQueen and R Zimmermann (eds), *European Contract Law; Scots and South African Perspectives* (2006), pp 203-229

Sutherland and Johnston, "Contracts for the Benefit of Third Parties",

P Sutherland and D Johnston, "Contracts for the Benefit of Third Parties" in R Zimmermann, D Visser and K G C Reid (eds), *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004), pp 208-239

Vogenauer, "Contracts in Favour of a Third Party",

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)



# Chapter 1 Introduction

## Background

1.1 This Discussion Paper is the fourth publication in our project reviewing contract law, which began early in 2010. The Eighth Programme of Law Reform, published in February that year, announced the Scottish Law Commission's return to a subject with which it has frequently been concerned since its foundation in 1965. The Programme states:

“We propose to review the law of contract in the light of the publication in 2009 of the Draft Common Frame of Reference: Principles, Definitions and Model Rules of European Private Law (the DCFR). The DCFR provides a contemporary statement of contract law, based on comparative research from across the European Union and written in accessible and non-archaic English. The DCFR has a considerable amount to offer in the law reform process. It may be seen as an instrument to provide an important area of Scots law with a systematic health check, giving a basis for treatment where the law is found to be ailing or otherwise in need of remedial treatment. The DCFR is at least a good working platform for a series of discrete and relatively limited projects on contract law, akin in some ways to our work on trusts and having significance for the well-being of the Scottish economy.”<sup>1</sup>

## The DCFR

1.2 The DCFR is a document prepared by an academic group for the European Commission as the first stage in the possible production of what the Commission termed a Common Frame of Reference (“CFR”).<sup>2</sup> The academic group included a number of Scots lawyers, one of whom (former Scottish Law Commissioner Professor Eric Clive) played a leading role in the preparation of the final text of the document. The CFR was intended to be either a legislative 'toolbox' for the European Commission, that is, an aid to better, more consistent and coherent European Union legislation in the field of contract law, or an 'optional instrument' for use by parties contracting in the European Union in place of national law.

1.3 An Expert Group appointed to review the text of the DCFR for this purpose began work in May 2010.<sup>3</sup> The Group was instructed, however, to produce a text, not on contract law in general, but on sale of goods contracts only. On 11 October 2011 the European Commission published a proposal for a Regulation to which is annexed the Common European Sales Law (“the proposed CESL”).<sup>4</sup> This Regulation, if passed, will form part of the domestic law of each of the Member States and will be an optional instrument that parties can choose as the law governing their contract for the sale of distance and online goods or supply of digital content. The Regulation will be available for business-to-

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<sup>1</sup> SLC No 220, 2010, para 2.16. The three previous publications are set out in fn 16 to para 1.12 below.

<sup>2</sup> On the CFR project and its antecedents, see [http://ec.europa.eu/consumers/rights/contract\\_law\\_en.htm](http://ec.europa.eu/consumers/rights/contract_law_en.htm).

<sup>3</sup> See [http://ec.europa.eu/justice/contract/files/expert-group\\_en.pdf](http://ec.europa.eu/justice/contract/files/expert-group_en.pdf) and Decision setting up the Expert Group on a Common Frame of Reference in the Area of European Contract Law [2010] OJ L105/109. Professor Eric Clive was a special adviser to the Group.

<sup>4</sup> Proposal for a Regulation on a Common European Sales Law, COM(2011) 635 final, available at: [http://ec.europa.eu/justice/contract/files/common\\_sales\\_law/regulation\\_sales\\_law\\_en.pdf](http://ec.europa.eu/justice/contract/files/common_sales_law/regulation_sales_law_en.pdf).

consumer (“B2C”) contracts as well as business-to-business (“B2B”) contracts, in the latter case always provided that at least one of the parties is a small or medium-sized enterprise. Member States may choose, however, to allow the optional instrument to be used for domestic transactions, including ones which do not involve any small or medium-sized enterprise. We were involved with our colleagues in the Law Commission of England & Wales in the preparation of advice to the United Kingdom Government on this proposed CESL. The advice – which contains further background information on the nature of the proposed CESL – was published in November 2011 and may be consulted on each Commission's website.<sup>5</sup>

1.4 In September 2013 the Legal Affairs Committee (JURI) of the European Parliament passed a number of amendments to the proposed CESL, the broad thrust of which was to make the instrument apply only to cross-border distance and online sales contracts and supplies of digital content rather than to such sales and supplies in general.<sup>6</sup> This revision is consistent with the suggestion in the Law Commissions' advice of November 2011 that “efforts would be better spent on developing a European code for consumer sales over the internet, where there is stronger evidence that the current variety of contract laws inhibits the single market.”<sup>7</sup> On 26 February 2014 the European Parliament approved a legislative resolution on the proposed CESL,<sup>8</sup> and it will now be considered by the Council of Ministers.

1.5 Why are the DCFR and the ensuing developments in the European Union of interest to this Commission, with regard to the law of contract in particular?<sup>9</sup> First, the DCFR purports to be a modern or contemporary statement of the best rules of contract law for use in the European Union, and is based upon extensive comparative research and intensive collaboration by an international team of contract law experts. Seeing how Scots law measures up against this standard is thus an exercise of some interest. But it has a greater significance than that. As suggested in the Eighth Programme,<sup>10</sup> contract law is clearly a critical element in economic activity of all kinds, whether B2B, B2C, or between parties transacting with each other privately. It is thus very important that laws in a field of such significance for the Scottish economy, including the attraction of foreign business into Scotland, should be seen internationally as being of the highest quality. Scottish Ministers' interest in the contract law review proposed in our Eighth Programme was based primarily upon this consideration.

1.6 A second point is that if the DCFR is used in the European Union as a basis of any kind for harmonizing contract law or if an optional instrument such as the proposed CESL comes into existence for use by contracting parties as an alternative to domestic contract law, it will be necessary to ensure that Scots law at least compares favourably or keeps pace

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<sup>5</sup> See <http://www.scotlawcom.gov.uk/news/advice-on-european-sales-law/> and <http://www.justice.gov.uk/lawcommission/publications/1698.htm>.

<sup>6</sup> European Parliament Committee on Legal Affairs, Report on the Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law, 24 September 2013, accessible at: <http://www.europarl.europa.eu/document/activities/cont/201309/20130925ATT71873/20130925ATT71873EN.pdf>.

<sup>7</sup> The Law Commission and the Scottish Law Commission, *An Optional Common European Sales Law: Advantages and Problems: Advice to the UK Government* (Nov 2011), para 7.99. The argument on this aspect is most fully developed in Parts 2 and 4 of the Advice.

<sup>8</sup> See <http://www.europarl.europa.eu/news/en/news-room/content/20140221IPR36660/html/Common-European-Sales-Law-for-cross-border-transactions-backed-by-MEPs>.

<sup>9</sup> The DCFR is also relevant to the SLC projects on Prescription and Title to Moveable Property (DP No 144, 2010; SLC No 228, 2012), Supplementary and Miscellaneous Issues relating to Trust Law (DP No 148, 2011), and Moveable Transactions (DP No 151, 2011).

<sup>10</sup> See para 1.1 above.

with such emerging European norms. In our Discussion Paper on Interpretation of Contract we noted similar thinking occurring in other major European jurisdictions.<sup>11</sup> Our joint project on Insurance with the Law Commission of England & Wales has also helped to make us aware of the need to keep domestic law in good repair if it is to have any influence as a model in European or even wider international developments, or indeed to compete effectively with other systems as a choice of law.

1.7 A third point is that the comparative information in the DCFR facilitates our statutory task of keeping the law under review and obtaining information about the law of other countries in pursuit of that function.<sup>12</sup>

1.8 Finally, the DCFR is descended from a number of instruments – notably the United Nations Convention on Contracts for the International Sale of Goods (“CISG”), the UNIDROIT Principles of International Commercial Contracts (“PICC”) and the Principles of European Contract Law (“PECL”) – which were used by this Commission in some of the contract law projects in the 1990s. It is useful in our current project to consider how far these models have themselves been developed in more recent texts.

1.9 The existence of the proposed CESL does not mean that the DCFR has been superseded as the basis for our review of the law of contract. The former, in its current draft, is limited to distance and online contracts for the sale of goods and the supply of digital content, while our review is directed towards the general law of contract, including but by no means limited to sales and digital content supply contracts. The DCFR text starts on the general law of contract (its Books I-III), supplemented by subsequent provisions on several specific contracts including not only sale but also lease of goods, services, mandate, commercial agency, franchise, distributorship, loan, personal security, and donation (Book IV.A-H).<sup>13</sup> The full version includes extensive commentary on each of the model rules as well as comparative notes on the laws of each of the jurisdictions to be found in the European Union Member States (including Scotland). In contrast, the proposed CESL does not contain any such material. The DCFR, therefore, is not only more directly relevant than the proposed CESL to a review of general contract law but also considerably clearer about the reasoning and comparative observations underpinning its provisions, giving it significantly greater value as a law reform tool.

1.10 Having said all this, the proposed CESL does draw directly upon many of the general contract law provisions of the DCFR, especially with regard to third party rights in contracts, the subject of our present Paper.<sup>14</sup> It is clearly relevant to our project to know whether the proposed CESL has copied, modified or not used DCFR material, and we accordingly include and, where appropriate, discuss its relevant provisions within this Discussion Paper.

1.11 It should be emphasised that the objective of this review of contract law is not necessarily to adopt the rules in the DCFR or the proposed CESL as a legislative statement

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<sup>11</sup> DP No 147, 2011, para 1.5. See also the activity in Switzerland mentioned at para 1.15 below. Note also the Review of Australian Contract Law: Australian Government Attorney-General’s Department, accessible at <http://www.ag.gov.au/Consultations/Pages/ReviewofAustraliancontractlaw.aspx>.

<sup>12</sup> Law Commissions Act 1965, s 3.

<sup>13</sup> There are further Books on “benevolent intervention in another’s affairs” (V), delict (VI), unjustified enrichment (VII), acquisition and loss of ownership of goods (VIII), proprietary security in movable assets (IX) and trusts (X). There is also an introductory statement and discussion of the principles underlying the DCFR, namely, freedom, security, justice and efficiency, and an annex of definitions of key words and phrases.

<sup>14</sup> See Proposed CESL, Art 78, which is clearly a shortened version of DCFR II.-9:301-303.

for Scots law. First and foremost, review in light of the DCFR will, as the Eighth Programme provides,<sup>15</sup> operate as a health check for the existing Scots law of contract. The results will determine whether legislative intervention is required in pursuit of the general objectives of simplification and modernisation, ensuring that contract law provides an appropriate framework for economic activity in Scotland, be that entirely domestic, involving cross-border transactions or originating outside of Scotland. The check may also throw up issues that are not directly considered in the DCFR or the proposed CESL. The conclusion of our inquiry may be that the present law is satisfactory; or that it requires some patching; or that a full legislative statement would be useful (whether or not the DCFR or the proposed CESL is taken as the model for such a statement, and whether or not that statement changes the law as it presently stands).

### **Previous SLC Reports as starting points**

1.12 This Commission published a series of Reports on various aspects of contract law in the 1990s. Only one, the Report on Three Bad Rules in Contract Law,<sup>16</sup> has been implemented. The other four remain unimplemented:

- Report on Formation of Contract: Scottish Law and the United Nations Convention on Contracts for the International Sale of Goods (SLC No 144, 1993);
- Report on Interpretation in Private Law (SLC No 160, 1997);
- Report on Penalty Clauses (SLC No 171, 1999);
- Report on Remedies for Breach of Contract (SLC No 174, 1999).

The reasons for non-implementation are not easy to discern. There does not seem to have been any opposition to the substance of the Reports at the time. Those published in the later 1990s may have seemed more appropriate for consideration in the Scottish Parliament but the immediate priorities in civil law legislation after its establishment in 1999 were the abolition of feudalism and associated reforms of property law. With the passage of well over a decade since the contract Reports were published, we do not think it right now simply to press as far as we are able for their implementation without further consideration of the issues raised within them. Quite apart from the general evolution of the law and related practice in Scotland over that period, international – and, in particular, European – developments in contract law need to be taken into account. The Reports themselves were prepared under reference to various instruments, notably the CISG, the PICC and the PECL. These instruments have in turn been influential and also developed in substance in the preparation of the DCFR and the proposed CESL. There is, therefore, a case for reconsidering the topics of the Reports, but this time taking into account the current European texts as well as the preceding instruments. Accordingly the first stage of the review of contract law has been a return to our unimplemented Reports on the subject; we

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<sup>15</sup> See para 1.1 above.

<sup>16</sup> SLC No 152, 1996, implemented by the Contract (Scotland) Act 1997. Note also the RoW(S)A, which implemented the Report on Requirements of Writing (SLC No 112, 1988).

have so far published two Discussion Papers, on Formation and Interpretation of Contracts, and a Report on Execution in Counterpart.<sup>17</sup>

1.13 While we are now working on a Discussion Paper on Remedies for Breach of Contract (which will probably include the topic of Penalty Clauses), the opportunity has arisen to make progress on another smaller topic which we believe to be causing difficulties for the legal profession in Scotland, leading at least some to choose another law than Scots law to govern their contracts or aspects of them. The topic is the creation by contract of rights for persons other than the parties to the contract itself – third party rights in contracts or, in the Latin phrase which has been used for centuries to label this area of contract law, *jus (or ius) quaesitum tertio*.<sup>18</sup> As already noted, this topic is dealt with in the DCFR, and we think that this provides at least some guidance as to the correct way forward for Scots law.

1.14 We considered this topic in 1977, when a series of six consultative memoranda on the Constitution and Proof of Voluntary Obligations included one on Stipulations in Favour of Third Parties.<sup>19</sup> Whilst the Memorandum has served as a useful reference point for a number of issues, this Discussion Paper concentrates on formulating a law of third party rights fit for modern usage, rather than reviewing again the debate on the development of the *jus quaesitum tertio* and the opposing views of Stair and Lord Dunedin which were the principal focus in 1977. The Report on Formation of Contract, published in 1993,<sup>20</sup> drew upon the 1977 Memorandum, but this too is a point of reference rather than our basis for this Discussion Paper.

### Comparative material

1.15 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.<sup>21</sup> Third party rights have been the subject of recent law reform discussion in some of the codified jurisdictions such as France and Switzerland.<sup>22</sup> The DCFR, the proposed CESL, the PICC and the PECL<sup>23</sup> also all recognise third party rights in contract law, while it is still noteworthy that the UK's draft Contract Code of the 1960s and

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<sup>17</sup> DP on Interpretation of Contract (DP No 147, 2011); DP on Formation of Contract (DP No 154, 2012); Report on Formation of Contract: Execution in Counterpart (SLC No 231, 2013). The Scottish Government has undertaken to introduce a bill to implement the Report: see <http://www.scotland.gov.uk/About/Performance/programme-for-government/2013-14/Conclusion-Contracts-Bill>.

<sup>18</sup> In this Discussion Paper we follow the long-established tradition of referring to the *jus quaesitum tertio* (or JQT) rather than the *ius quaesitum tertio*, although the latter would probably be the preferred form for classicists (since classical Latin did not know the letter "j", which as a letter was a creation of medieval Latin).

<sup>19</sup> SLC Memorandum No 38 on Constitution and Proof of Voluntary Obligations: Stipulations in Favour of Third Parties, 1977, accessible at: <http://www.scotlawcom.gov.uk/publications/discussion-papers-and-consultative-memoranda/1970-1979/>.

<sup>20</sup> Report on Formation of Contract: Scottish Law and the United Nations Convention on Contracts for the International Sale of Goods (SLC No 144, 1993).

<sup>21</sup> MacQueen, "Third Party Rights in Contract", pp 318-319.

<sup>22</sup> On developments in France see S Vogenauer, "The Effects of Contracts on Third Parties: The *Avant-Projet de Réforme* in Comparative Perspective" in J Cartwright *et al* (eds), *Reforming the French Law of Obligations: Comparative Reflections on the Avant-Projet de Réforme du droit des Obligations et de la Prescription ('the Avant-Projet Catala')* (2009), pp 235-268; Ministère de la Justice (France), *Projet de Réforme du droit des Contrats* (July 2008), Arts 140-146; and for Switzerland see C Huguenin and R M Hilty (eds) *OR/CO 2020: Schweizer Obligationenrecht 2020 Entwurf für einen neuen allgemeinen Teil | Code des Obligations Suisse Projet relatif à une nouvelle partie générale* (Schulthess, 2013), especially Art 87; a reference for which we are grateful to Dr Ross Anderson, Advocate.

<sup>23</sup> DCFR II. – 9:301-303, PECL Art 6:110, PICC Art 5.2.1-6, CESL Art 78.

70s (which did not come to fruition)<sup>24</sup> provided for the creation and enforcement of third party rights despite the absence of such rights in English law at the time.<sup>25</sup> Even the uncodified common law jurisdictions, which have traditionally enforced the privity of contract doctrine, have recognised such rights by way of legislation. This is demonstrated, for example, in the Contracts (Privity) Act 1982 in New Zealand, the 1999 Act in England and Wales, and the Contracts (Rights of Third Parties) Act 2001 in Singapore. A draft Bill abolishing the doctrine of privity and replacing it with a system of third party rights is currently under consultation in Hong Kong following a Report on the subject by the territory's Law Reform Commission.<sup>26</sup> Additionally, an assortment of the Australian states and territories and Canadian provinces have abandoned the privity doctrine by statute.<sup>27</sup> Different jurisdictions in the United States have been able to move away from privity in their case law.<sup>28</sup> We can also see that the major mixed legal systems recognise third party rights: Louisiana and Quebec have drawn on French law in their codes,<sup>29</sup> and the influence of the BGB<sup>30</sup> can be seen in the Israeli codification.<sup>31</sup> South Africa, like Scotland an uncodified mixed system, also recognises third party rights in its common law, albeit that what survives in it from the historical European *jus commune* has also laid it open to criticism by modern lawyers.<sup>32</sup>

1.16 In addressing the potential scope for reform of the Scots law on third party rights, this Discussion Paper considers the merits of the third party right provisions of the DCFR, the PICC and the proposed CESL.<sup>33</sup> These harmonisation projects offer “detailed and balanced sets of rules that match the state of art achieved in national contract laws.”<sup>34</sup> We have not, however, included discussion of the PECL provisions on third party rights,<sup>35</sup> as it has been said that that these “deal with the doctrine in a fragmentary and inadequate manner by setting forth a single provision (Art 6:110) that draws its inspiration from Art 1121 *Code civil*.”<sup>36</sup> The DCFR developed the PECL rules quite considerably, drawing in particular upon the PICC, and it has consequently seemed appropriate to focus on these more recent texts.

1.17 The gist of these comparator instruments (as we shall refer to them collectively in the remainder of this Discussion Paper) has been summarised as follows:

“The proposals ... are unanimous in acknowledging the validity of contracts in favour of a third party. Furthermore they explicitly confirm that the beneficiary acquires an enforceable right. This right is not confined to specific performance and includes the

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<sup>24</sup> The joint contract code project, formulated by the Scottish Law Commission and the Law Commission of England & Wales between 1965 and 1973, culminated in a proposed code, the initial version of which was subsequently published: see H McGregor, *Contract Code: Drawn up on Behalf of the English Law Commission* (1993), especially pp 1-34.

<sup>25</sup> McGregor, *Contract Code*, Arts 641-649.

<sup>26</sup> See Law Reform Commission of Hong Kong, Report on Privity of Contract (2005); and the draft Bill is accessible at: <http://www.doj.gov.hk/eng/public/pdf/2012/consulte.pdf>.

<sup>27</sup> MacQueen, “Third Party Rights in Contract”, p 319. See also, for the relevant Australian law, *Trident General Insurance Co Ltd v McNiece Bros Pty* (1987-1988) 165 CLR 107 and, for the Canadian law, see *London Drugs Ltd v Kuehne & Nagel International Ltd* (1992) 97 DLR (4<sup>th</sup>) 261 and *Fraser River Pile & Dredge Ltd v Can-Dive Services Ltd* [1999] 3 SCR 108.

<sup>28</sup> See the Restatement (Second) of Contracts (1981), Sections 302-315.

<sup>29</sup> MacQueen, “Third Party Rights in Contract”, p 319.

<sup>30</sup> The German Civil Code (Bürgerliches Gesetzbuch).

<sup>31</sup> MacQueen, “Third Party Rights in Contract”, p 319.

<sup>32</sup> See, eg, Sutherland and Johnston, “Contracts for the Benefit of Third Parties”; Sutherland, “Third-Party Contracts”; see also para 2.51 below.

<sup>33</sup> DCFR II. – 9:301 – 303; PICC Art 5.2.1-6; CESL Art 78.

<sup>34</sup> Vogenauer, “Contracts in Favour of a Third Party”, p 387.

<sup>35</sup> PECL Art 6:110.

<sup>36</sup> Vogenauer, “Contracts in Favour of a Third Party”, p 387.

right to damages for non-performance and to other contractual remedies, if applicable, as well as the beneficiary's right to invoke clauses that exclude or limit his liability. The third party does not need to be in existence at the time the contract is made, nor does he have to be identified, but he must be identifiable with adequate certainty ...

The content of the right, the time of its coming into existence and its potential removal are very much at the disposal of the promisor and promisee [ie the contracting parties]. Unless they have agreed to the contrary, the right arises immediately, directly (ie without any further action on the part of the third party, such as acceptance or accession) and independently (ie it is not derived from a right previously acquired by the promisee). The original parties can revoke or modify the right so long as it has not become irrevocable. The different proposals ... suggest different moments in time after which the right is irrevocable: the beneficiary's declaration of acceptance, the beneficiary having reasonably acted in reliance on the right, or a declaration by one of the parties to the beneficiary that the right has been conferred. The beneficiary is free to revoke the right. The right is then deemed not to have accrued ... the promisor may assert against the beneficiary all defences arising out of the contractual relationship which the promisor could assert against the promisee."<sup>37</sup>

1.18 Our thinking on this topic has also been 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.<sup>38</sup> The 1999 Act introduced third party rights into English law for the first time. In general terms the Act is on the same lines as the PICC, the DCFR and the proposed CESL. Professor Hugh Beale, a former Law Commissioner, has said that whilst it is

“... perhaps too soon to claim that the Contracts (Rights of Third Parties) Act 1999 has been an outstanding success, in that as yet its use seems to be limited, I think we can say that it has certainly not been a failure. Rather I regard it as useful but still underused.”<sup>39</sup>

There has been little case law and considerable academic criticism, and it is often said that the Act is most commonly expressly excluded in commercial contracts.<sup>40</sup>

1.19 Be that as it may, the content of the 1999 Act appears to be relatively familiar at least to Scottish commercial lawyers having to consider third party rights and it is seen as holding certain advantages over the current Scots law on the subject. On the other hand, 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 be followed in every detail in Scotland. At the very least, however, the Act provides a useful cross-check to the DCFR and associated schemes, and we have given it very careful attention in consequence.

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<sup>37</sup> Vogenauer, “Contracts in Favour of a Third Party”, pp 387-388.

<sup>38</sup> LC No 242, 1996.

<sup>39</sup> Beale, “Review”, p 250.

<sup>40</sup> The cases are *Nisshin Shipping Co Ltd v Cleaves & Co Ltd* [2003] EWHC 2602 (Comm), and *Prudential Assurance Co Ltd v Ayres* [2007] EWHC 775 (Ch); the academic criticism by e.g. M Bridge, “The Contracts (Rights of Third Parties) Act” (2001) 5 *Edinburgh Law Review* 85; P Kincaid, *Privity: Private Justice or Regulation* (2001); R Stevens, “The Contracts (Rights of Third Parties) Act 1999” (2004) 120 *Law Quarterly Review* 292.

1.20 Neither the 1999 Act nor the other comparator instruments extend the scope of third party rights as far as German law, with its notion of a contract's 'protective umbrella' *vis-à-vis* third parties, or French law's *action directe* providing 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, which, it has been held, enables the buyer of a house to sue its architect in respect of defects in design.<sup>41</sup> In each case the law of contract developed to meet what appeared to be gaps in the law of delict.<sup>42</sup> We have not attempted in the present exercise to identify ways for a Scots law of third party rights in contract to fill gaps in delict; if such gaps exist, it will be for a reform exercise directed to that body of law to identify and fill them, taking such account of the then law of third party rights in contract as seems necessary.

1.21 Further, we have not addressed the question of whether the law of third party rights in contract is better than the law of negligence as a way of providing a just solution to the problem of negligent drafting of a will by a solicitor which deprives prospective beneficiaries of the benefits they would otherwise have had under the will.<sup>43</sup> At present such disappointed beneficiaries have a claim in delict,<sup>44</sup> so, whatever the merits of that particular solution, we see no need to design a law of third party rights in contract to meet the problem.

### **Structure of the Discussion Paper**

1.22 In Chapter 2 we outline the current law on the topic of third party rights in Scots law, and give a brief historical background and description of the state of the law on the topic in various other jurisdictions. Chapter 3 moves on to consider specific reasons why reform may be necessary, namely, those which have been raised by legal practitioners in various publications, and illustrates some of the uses of third party rights which could be better realised if Scots law in this area were more flexible than at present.

1.23 Chapter 4 addresses the nature of third party rights and discusses the appropriate terminology for use in any proposed reform. Chapter 5 contains a discussion of the requirements of identification and intention for a third party right in Scots law, before Chapter 6 turns to the central issue of the irrevocability of a third party right. Chapter 7 deals with the third party's power to renounce its right, the remedies which should be available to third parties in the event of a breach of their right, and the defences the contracting parties should have at their disposal against the third party. In Chapter 8 we discuss the relationship between the proposed general rule on third party rights and specific third party rights recognised elsewhere in the law, our provisional view being that any legislation emerging from this exercise would defer to other current statutes pertaining to third party rights in more specific situations. Chapter 9 provides an overview of the whole scheme of reform and Chapter 10 contains a list of our proposals and questions. Appendix A sets out the text of the 1999 Act and of the relevant parts of the various other instruments we have cited

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<sup>41</sup> DCFR Vol 1, p 617 (Comment C); and LC No 242, 1996, paras 7.17-7.51.

<sup>42</sup> For German law, see B S Markesinis *et al*, *The German Law of Contract: A Comparative Treatise* (2<sup>nd</sup> edn, 2006), pp 204-216; and for French law, B Nicholas, *The French Law of Contract* (2<sup>nd</sup> edn, 1992), pp 169-93 and S J Whittaker, "Privity of Contract and Tort Law: the French Experience" (1995) 15 *Oxford Journal of Legal Studies* 327.

<sup>43</sup> This issue was much discussed in LC No 242, 1996, which was published in the immediate aftermath of the House of Lords' decision in *White v Jones* [1995] 2 AC 207 that the solicitor could be liable in negligence.

<sup>44</sup> See *Robertson v Watt & Co*, 4 July 1995, unreported; *Holmes v Bank of Scotland plc* 2002 SLT 544.

elsewhere in the Paper; and Appendix B lists the members of our Advisory Group and the names of others from whom we have received particular assistance.

### **General options for reform**

1.24 At an earlier stage of our review of contract law,<sup>45</sup> we canvassed views on the most desirable legislative approach to law reform in the area of contract law, or in particular aspects of it: should we aim for comprehensive statutory statements of the area of law under review, or seek only to amend the existing law so far as necessary? Once again we would welcome views on this subject, but in the present paper we have decided to ask the specific question at the end rather than at the beginning. We therefore discuss this at the end of Chapter 9,<sup>46</sup> but we also raise the matter at this point so that readers may, if they wish, bear it in mind in the course of reading the paper.

### **Advisory Group**

1.25 We are very grateful to those who have provided advice to us in the course of the preparation of our Discussion Paper. 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 B, provided invaluable assistance in this regard. We were also greatly helped on particular points by a number of individuals, also listed in Appendix B.

### **Impact assessment**

1.26 It is essential for us to attempt to assess the impact, particularly the economic impact, of any reform proposal that we may eventually recommend in the Report which will follow on from this Discussion Paper. To help us in this, we would be most grateful for any comments that consultees have on the matter. We would be especially grateful for any evidence with which we can begin to quantify the issues raised, whether that evidence relates to the current situation or is concerned with the possible effects of any reform of the law. Clearly, assessment of the likely economic impact of a possible reform depends substantially on the economic impacts of the present law. Hard evidence of the latter can be as difficult to obtain and judge as the effect of any reform.

1.27 Contracts in favour of third parties have been described as “of huge economic importance,” particularly in the fields of life insurance and contracts of annuity.<sup>47</sup> In numerous jurisdictions, contracts providing for third party rights are also used in the context of company groups, liability insurance, bank deposits for the benefit of a third party, partnership agreements for the benefit of a third person, contracts made by municipalities for the benefit of inhabitants, indemnification terms in construction contracts, collective labour agreements, and exemption clauses for the benefit of third parties.<sup>48</sup> Regarding the commercial efficiency of third party rights, it has been said that:

“From the perspective of law and economics, the contract in favour of a third party is a mechanism for increasing efficiency. It enables the parties to create an

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<sup>45</sup> See paras 1.28-1.30 of DP No 154, 2012.

<sup>46</sup> See para 9.18 and question 52 in particular.

<sup>47</sup> Vogenauer, “Contracts in Favour of a Third Party”, p 386. See also DCFR, Vol 1, p 616.

<sup>48</sup> K Zweigert and U Drobniig (eds), *International Encyclopaedia of Comparative Law* (2002), Vol 7, ch 13, pp 28-38.

enforceable right for the third party by way of a single transaction, as opposed to conferring it first on one of the parties and then transferring it to the third party by way of a second, separate transaction.”<sup>49</sup>

Professor Huntley and Dr Dedouli note that the 1999 Act is thought of by legal practitioners as a means of “reducing unnecessary paperwork and saving time, cost and waste.”<sup>50</sup>

1.28 Our initial view is that the economic impact of our tentative proposals is unlikely to be adverse and may, in some respects, be positive. The strongest 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. There should also be some reduction in the expenditure of time and other resources for legal practitioners negotiating and drafting commercial contracts. We understand that at present the difficulties with the Scots law of third party rights cause at least some practitioners to shift to English law as the law to govern their contracts.<sup>51</sup> While this does not necessarily draw business away from Scotland, contracts governed by Scots law may be more likely later to be litigated or arbitrated in this jurisdiction, while an up-to-date thoroughly modernised law on third party rights might be an element in a package that would attract new business altogether for Scots lawyers and, as a concomitant, Scottish courts and arbitrators.

1.29 These are only preliminary and tentative views, and we remain open to other perspectives. To assist us in our task of impact assessment we ask:

- 1. Do consultees know of any information or statistical data, or have any comments on any potential economic impacts of either the current law relating to the third party rights or any proposed reform of that law?**

### **Legislative competence**

1.30 In our view, the proposals in this Discussion Paper would, if enacted, be within the legislative competence of the Scottish Parliament. Nearly all of them relate to the Scots private law of obligations,<sup>52</sup> which is not reserved in terms of the Scotland Act 1998. Some incidental issues are, however, discussed in Chapter 8, and we seek views on some specific questions at that point. We are also of the view that the proposals, if enacted, would not give rise to any breach either of the European Convention on Human Rights or European Union law.

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<sup>49</sup> Vogenauer, “Contracts in Favour of a Third Party”, p 386.

<sup>50</sup> Huntley and Dedouli, “Third Party Rights” 345.

<sup>51</sup> See further at paras 3.4-3.6 below.

<sup>52</sup> The meaning of ‘Scots private law’ is given in s 126(4) of the Scotland Act 1998 and includes the law of obligations.

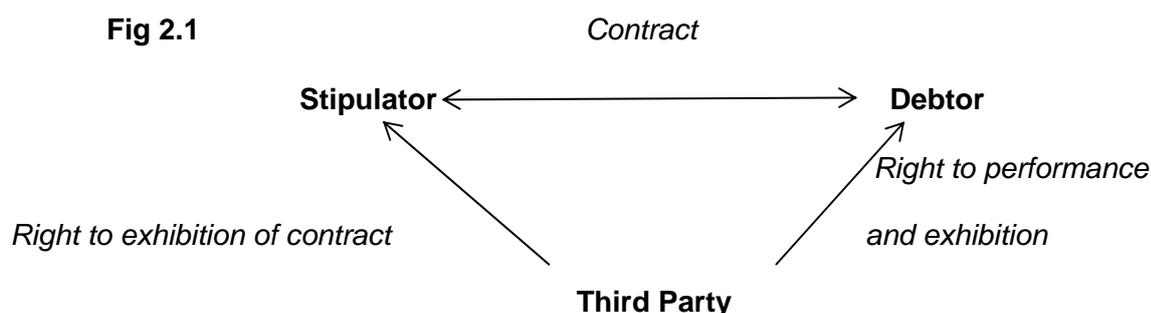
# Chapter 2 Third Party Rights in Scots Law

## Origins

2.1 Scots contract law has long recognised rights in favour of third parties. In 1591, for example, it was held in *Wood v Moncur*<sup>1</sup> that a provision in favour of a third party in a contract of excambion<sup>2</sup> could be invoked by that party (“albeit [he] was no contractor, yet there was a provision made in the same in his favours”).<sup>3</sup> In the first half of the seventeenth century Sir Thomas Hope recognised third party rights in his *Major Practicks*,<sup>4</sup> and the cases of *Renton v Ayton*<sup>5</sup> and *Supplicants v Nimmo*<sup>6</sup> provide further authority for the existence of such rights before 1650.

2.2 These cases and writings constitute the background to the first general statement of the Scots law on third party rights (termed the *jus quaesitum tertio*) by Stair in his *Institutions*, first published in 1681.<sup>7</sup> 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.<sup>8</sup>

2.3 The term *jus quaesitum tertio* (“JQT”) is still used in Scots law today. This Commission’s Consultative Memorandum 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). In Chapter 4 we discuss the question of the best terminology to use in this context, but for the moment our earlier language allows us to represent the basic relationship between these three parties thus:



<sup>1</sup> *Wood v Moncur* (1591) Mor 7719.

<sup>2</sup> ‘Excambion’ is an exchange of heritable property: G Watson (ed), *Bell’s Dictionary and Digest of the Law of Scotland* (7<sup>th</sup> edn, 1890, reprinted 2012), pp 422-423.

<sup>3</sup> *Wood v Moncur* (1591) Mor 7719, 7719

<sup>4</sup> Sir T Hope, *Major Practicks* (1608-33), II, 1, 30 (1616); II, 3, 37 (1612).

<sup>5</sup> *Renton v Ayton* (1634) Mor 7721.

<sup>6</sup> *Supplicants v Nimmo* (1627) Mor 7740.

<sup>7</sup> MacQueen, “Third Party Rights in Contract: Jus Quaesitum Tertio”, pp 221-223.

<sup>8</sup> Stair, *Institutions* I, 10, 5.

## Principles of voluntary obligations

2.4 A fresh analysis of third party rights may most usefully begin by considering some relevant general principles of the law of voluntary obligations, within which this topic must be set. Voluntary obligations are generally created by either the agreement of the parties or a unilateral promise. An agreement is normally achieved by a process of communication between the parties, usually analysed through the concepts of offer and acceptance. Any form of communication – written, oral or by conduct – will do for this purpose. But unilateral promises do not necessarily have to be communicated to a promisee to be binding: for example, the promise of reward to any person who carries out a particular act (such as finding a lost cat) may be enforced by a party unaware of the promise at the time of performing the act in question (such as locating the cat).<sup>9</sup> But, as Lord President Hamilton remarked in the context of a case where a promise was alleged to have been made to a particular promisee, “in my view, 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”.<sup>10</sup>

2.5 Parties often record their agreement in writing and indicate their agreement to it by signing or subscribing the document in question. Further, formal writing – that is, writing subscribed by the parties – must be used in the constitution of agreements for the creation, transfer, variation or extinction of a real right in land.<sup>11</sup> Such requirements of writing are satisfied by an exchange of a written offer and acceptance, each appropriately subscribed.<sup>12</sup> Unilateral gratuitous promises must similarly be in formal writing – that is, subscribed by the promisor – unless made in the course of business.<sup>13</sup> With agreements, the lack of formal writing may be cured by certain actings of one of the parties to its detriment with the knowledge or assent of the other always provided that the latter’s withdrawal would also have materially adverse effects on the former (statutory *rei interventus*). In the case of informal promises, actings by the promisee amounting to statutory *rei interventus* will likewise make them binding on the promisor.<sup>14</sup>

### *Future and conditional obligations*

2.6 Voluntary obligations may be dependent in various ways upon the occurrence or non-occurrence of external events.<sup>15</sup> 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 (eg 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*).

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<sup>9</sup> See *Regus (Maxim) Ltd v Bank of Scotland plc* [2013] CSIH 12, paras 33-34 (Lord President Gill).

<sup>10</sup> *Cawdor v Cawdor* [2007] CSIH 3, para 15.

<sup>11</sup> RoW(S)A s 1(2).

<sup>12</sup> RoW(S)A s 2(2).

<sup>13</sup> RoW(S)A s 1(2). It is submitted that “in the course of business” means both a promise by one business to another and a promise made by a business to its consumer customers and to any other non-business party (eg to repair damage caused by business operations to a neighbouring private home).

<sup>14</sup> For statutory *rei interventus* see RoW(S)A s 1(3), (4).

<sup>15</sup> See generally 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. We have also been much helped by advance sight of a draft discussion of this subject by Professor Martin Hogg forthcoming in *SME Reissue Obligations*.

2.7 Second, an obligation may be *contingent* or *conditional*, meaning that its existence or enforceability is dependent upon the occurrence of some uncertain event (the contingency or condition). The contingency may be *potestative*; that is, the event is one which it is in the power of one or other of the parties to the obligation to bring about. The condition may, however, be an event beyond the control of the parties.

2.8 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<sup>16</sup>), 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<sup>17</sup>). Where the effect of the condition is to suspend the very existence of the obligation, the parties are free to resile or withdraw from the arrangement during the period of suspension.<sup>18</sup> But where it is merely enforceability that is suspended, the obligation exists but neither party may act in such a way as to frustrate the fulfilment of the condition by the other where it is potestative. Thus if party B's car is on party A's land and A promises B £100 if the latter removes the car by 1 June, A remains liable if he prevents B gaining access to the land for the purpose before the relevant date. But if B promises to pay A £100 if the car is still there on 1 June, and then removes the car on 31 May, B is not liable to A for frustrating the fulfilment of the suspensive condition.<sup>19</sup> The law on conditions is not a way of converting discretionary powers into absolute duties. It may be implied that the obligation is discharged if the suspensive condition is not fulfilled within a reasonable time.<sup>20</sup>

2.9 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 (as for example in provision for the termination of an agency agreement in the event that a certain level of turnover is not achieved<sup>21</sup>). Here, clearly, a party may perform lawful acts in order to prevent the fulfilment of the condition. But in the agency case just mentioned, it was held that the principal was personally barred from terminating the contract where the agent's failure to achieve the turnover levels required was due to the principal's failure to furnish the agent with sufficient goods to fulfil orders. An obligation of good faith may underlie the operation of the law in the whole area of potestative conditions.<sup>22</sup>

2.10 Further illustrations of both types of conditions in the context of third party rights in contract will be given in what follows, as the concept plays a vital role in this area.

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<sup>16</sup> As in *WS Karoulias SA v The Drambuie Liqueur Co Ltd* 2005 SLT 813.

<sup>17</sup> 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 2.9 below.

<sup>18</sup> Thomson, "Suspensive and Resolutive conditions", 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.

<sup>19</sup> The examples elaborate one found in A F Rodger QC, "Potestative Conditions" 1991 SLT (News) 253 (part of a response to J Murray QC, "Potestative Conditions" 1991 SLT (News) 185). The leading case is *Mackay v Dick and Stephenson* (1881) 8 R (HL) 37.

<sup>20</sup> See *T Boland & Co Ltd v Dundas's Trs* 1975 SLT (Notes) 80.

<sup>21</sup> As in *Dowling v Methven & Sons & Co* 1921 SC 948.

<sup>22</sup> MacQueen and Thomson, *Contract*, paras 3.34 and 3.68.

### *Delivery or equivalent of obligations in writing*

2.11 In general, 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.<sup>23</sup> 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. 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.<sup>24</sup> Delivery by fax or email attachment or some other electronic means will become legally effective upon the now expected implementation of our Report on Execution in Counterpart.<sup>25</sup>

2.12 There are a number of exceptions to the requirement of delivery, of which the major example is the subscribed mutual contract. Here the parties' subscriptions sufficiently indicate the intention to be bound by the document, whoever has possession of it.<sup>26</sup> 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.<sup>27</sup>

### *Privity of contract and third party rights*

2.13 Third party rights in contracts between two or more others raise special issues because in general a contract creates enforceable rights and duties only between those who are party to its formation. Third parties are typically unaffected by the contract, whether in terms of acquiring rights or being subject to duties. The idea that a contract is a relationship exclusive to, or private between, the parties who made it which they alone can enforce is sometimes known as the principle of privity of contract.

2.14 Privity applies even if the third party's interests are affected in some way by the contract. Merely having an interest in a contract is not sufficient to give a third party any right in relation to it.<sup>28</sup> In a recent example of the application of this principle, a contract between solicitors and a client under which the former were to draw up a trust deed of which a known third party was to be a beneficiary, and then to advise on its administration, was held not to confer a contractual JQT upon that third party such that he could sue for damages for loss caused the solicitor's negligent failure to give appropriate advice. "[T]he contract ... was not one which directly conferred a right to any benefit upon [the third party]. At best, he was entitled to have the trustees have regard to him as being a possible recipient of the trust assets but nothing further than that."<sup>29</sup>

2.15 Privity is an important principle of the law of contract, but it yields to one even more fundamental, *viz* giving effect to the intention of the contracting parties. If upon interpretation of the contract it appears that the parties intended to confer rights upon a third person, then, subject to certain further requirements, the law will give effect to that intention and allow the third person to make claims under the contract. The intention may be implied as well as

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<sup>23</sup> McBryde, *Contract*, paras 4.32-4.43 and 10.20.

<sup>24</sup> McBryde, *Contract*, paras 4.12-4.30.

<sup>25</sup> SLC No 231, 2013. See fn 16 to para 1.12 above.

<sup>26</sup> McBryde, *Contract*, para 4.69.

<sup>27</sup> McBryde, *Contract*, para 4.02.

<sup>28</sup> *Finnie v Glasgow and South-Western Railway Co* (1857) 20 D (HL) 2.

<sup>29</sup> *Marquess of Aberdeen and Temair v Turcan Connell* [2008] CSOH 183, para 47 (Lady Smith).

express.<sup>30</sup> It is not enough, however, as already pointed out, that a third party benefits as the result of a contract; the contracting parties must *intend* that the third party have a right in the sense of an entitlement to claim or enforce the benefit in question.

2.16 A JQT can only arise when two or more parties *contract* to confer a benefit on a third. A unilateral promise cannot confer a *third* party right on anyone, there being only one party to the creation of the obligation in question, namely the promisor.<sup>31</sup> The promisee or promisees are, if anything, *second* parties, and their right or rights arise directly against the promisor. But, since the third party's acceptance of the right is not required for a JQT, it is possible to analyse it as a promise or set of promises made to the third party by the contracting parties within the framework of their contract. This was the approach of Stair, and it has been followed by several (although not all) modern commentators, including our predecessors in the mid-1970s.<sup>32</sup>

2.17 One consequence of the promissory analysis in Stair's thinking was that a JQT, once created, is irrevocable. For other commentators, however, the fact that JQT can only spring from a contract, and not from a unilateral promise, means that analysing the right in terms of promise is inapt, and they prefer to see it as a separate legal institution with its own unique character (*sui generis*).<sup>33</sup> We will return below to the possible significance of this debate. But it is worth noting here that the third party is not a contracting party, and the third party's right is thus not a contractual right, at least in a narrow sense.

2.18 The significance of allowing the creation of a JQT within a contract may be seen by contrasting it with some of the other legal institutions which enable third parties to acquire rights in relation to contracts made between others. The most obvious example of such another institution is assignation; here, the contract rights are created in one juridical act, and the assignation of a right to claim to a third party is a second independent juridical act by one of the original contracting parties. In JQT the contract rights and the third party rights are created within a single contract or juridical act. Assignations are said to be completed by intimation (by either cedent or assignee) to the other contracting party;<sup>34</sup> but the assignation creates rights and duties between cedent and assignee regardless of any intimation, the chief importance of which is in relation to competing assignees, with the first to intimate being the one who prevails.

2.19 In agency, one person (the agent) is authorised by another (the principal) to negotiate and complete contracts with third parties; but the agent acting within authority does not become liable to the third party, who is instead contractually bound to the principal, with

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<sup>30</sup> See further at para 2.39 below.

<sup>31</sup> See *Smith v Stuart* 2010 SC 490, para 15; also *Cawdor v Cawdor* 2007 SC 285, paras 13-14 and *Regus (Maxim) Ltd v Bank of Scotland plc* [2011] CSOH 129, paras 54-55 (point not discussed on appeal: [2013] CSIH 12). In *Smith v Stuart* the defender promised certain benefits to the pursuer in the event of the former making a contract for the sale of certain land. Even if the defender had made such a contract, the basis for any claim by the pursuer would still have been the promise, which was clearly quite separate from any such contract. It might have been possible, of course, for the contract to give effect to the promise by way of a provision for performance to the pursuer, in which case the latter's claim might have become one based on JQT rather than the earlier promise.

<sup>32</sup> T B Smith, *A Short Commentary on the Law of Scotland* (1962), pp 746-747; SLC Memo No 38, 1977; *SME* Vol 15, para 827; M Hogg, *Promises and Contract Law: Comparative Perspectives* (2011), pp 305-307; Huntley and Dedouli, "Third Party Rights" 307-321.

<sup>33</sup> Rodger, 143, 144; McBryde, *Contract*, para 10.07; Sutherland and Johnston, "Contracts for the Benefit of Third Parties", pp 216-217; Sutherland, "Third-Party Contracts", pp 209-210.

<sup>34</sup> It is worth noting that Proposal 5 of our DP on Moveable Transactions (DP No 151, 2011) considers the possibility of registration of an assignation as a means of completing title.

the agent dropping out of the picture altogether after completion of the contract. In JQT there is no need for either of the contracting parties to have authority to deal with the third party, and the former continue to be bound to each other in their contract as well as under whatever duties they may each have in relation to the third party's right.

2.20 There are some parallels between JQT and trusts, in that in the latter the truster delivers property irrevocably to trustees,<sup>35</sup> who become its owners subject to fiduciary obligations to administer it for the benefit of third parties usually known as the beneficiaries.<sup>36</sup> But JQT does not require any transfer of property between the contracting parties and puts neither of them under any fiduciary obligations to the third party. Further, while the privileged claim of the trust beneficiary prevails against the trustee's personal creditors in the former's insolvency, the third party in a JQT merely obtains a personal right to performance of the contractual terms in its favour.<sup>37</sup>

2.21 It is also worth commenting on the distinction between JQT and donation. Donation was classically seen in Scots law as first an obligation between donor and donee and only second as a transfer of ownership of property from donor to donee completed by delivery of the thing donated.<sup>38</sup> As the case law makes clear, JQT can be a mechanism by which party A makes a gift to party C through the medium of a contractually imposed obligation on party B to perform to C. Two points should be noted. First, the transfer of ownership to C by donation is to be distinguished from the creation of a personal right in C to delivery of the thing to be transferred. Further, donations may be subject to resolutive conditions such that even a transfer of ownership can be undone. The classic example is the donation *mortis causa*.<sup>39</sup> The condition here is that the donor does not revoke in his lifetime; the gift becomes irrevocable only if the donee outlives the donor. As Bankton neatly put it in translation of Justinian's *Institutes*, "[T]he giver therein prefers the grantee to his heirs and prefers himself to both".<sup>40</sup> Such donations are similar in many ways to legacies in wills, in particular in their revocability while the donor remains alive; but a crucial difference is that with donations there *is* a transfer of ownership to the donee, albeit one that may be reversed by the donor's revocation or the donee's predeceasing the donor, while with legacies there can be no proprietary effect until after the death of the testator.<sup>41</sup>

2.22 A final observation is that the law of JQT has often become clouded by its close functional links with the other areas of law just described, with insufficient attention being given to the different significance of such concepts as delivery, intimation and irrevocability in different legal contexts. In particular, where they arise in the law of assignation, trusts and donation, they may have more to do with real rights – or at least the resolution of competing

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<sup>35</sup> It is competent for the truster to be the sole trustee, provided that the trust's existence is intimated to a beneficiary: *Allan's Trs v Inland Revenue* 1971 SC (HL) 45. The case also discusses questions of JQT.

<sup>36</sup> A trust set up *inter vivos* by the truster merely for the administration of his or her own property is, however, revocable by the truster as sole beneficiary; likewise one where the beneficiaries are not in existence or ascertainable, or where the trust purposes are testamentary in nature in taking effect only on the truster's death (Gloag & Henderson, para 41.19). See also W A Wilson and A G M Duncan, *Trusts, Trustees and Executors* (2<sup>nd</sup> edn, 1995), para 11.10.

<sup>37</sup> Note, however, that in South African law the *stipulatio alteri* (the analogue of the Scottish JQT: see further at para 2.51 below) is also used for the constitution of trusts.

<sup>38</sup> On donation, see W M Gordon, "Donation", *SME Reissue* (2011); H L MacQueen and M Hogg, "Donation in Scots law" 2012 JR 1.

<sup>39</sup> See our Report on Succession (SLC No 215, 2009), paras 7.38-7.41, for reform proposals in relation to donation *mortis causa*.

<sup>40</sup> Bankton, *Institute*, I, 9, 18; cf Justinian, *Institutes*, II, 7, 1.

<sup>41</sup> *SME Reissue Donation*, para 7.

claims to the same thing – whereas in JQT we are typically concerned only with the existence of personal rights in the third party. It is necessary to keep this point in mind in what follows as an account of the current Scots law of JQT, although that is not to say that the JQT may never come into conflict with other rights, especially those of the contracting parties.

## Rights, not Duties

2.23 Contracting parties can only confer *rights* upon a third party. Contracts cannot impose *duties* upon third parties without that party's consent.<sup>42</sup> If such consent is given, the result again seems to be the making of a second contract between the parties to the original arrangement and the third party, not a JQT. The essence of JQT is the third party's acquisition of a right under a single contract between two (or more) others.

### *Immunities as rights?*

2.24 But it does also seem possible to confer immunity from liability upon a third party by way of contract.<sup>43</sup> Contracts often contain clauses restricting not only the liability of a contracting party but also that of others connected with him such as employees, agents, independent contractors, and subsidiary, parent or other associated companies. The courts have sometimes given effect to such clauses by way of a JQT in favour of the third party. In the early case of *Renton v Ayton*, Lady Ayton's claim of immunity from liability on the basis of an agreement between the pursuer and other parties was upheld.<sup>44</sup> Another case of the conferral of a third party immunity is *Magistrates of Dunbar v Mackersy*, in which the defender, as present owner of a property for which the magistrates now sought the payment of rates, successfully relied on a letter 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".<sup>45</sup> In the more recent decision of *Melrose v Davidson and Robertson* it was accepted 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.<sup>46</sup>

2.25 The Hohfeldian analysis of rights, to which the Scottish courts from time to time refer,<sup>47</sup> would seem to permit the classification of such immunisations from liability as one of

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<sup>42</sup> See, eg, *Howgate Shopping Centre Ltd v GLS 164 Ltd* 2002 SLT 820.

<sup>43</sup> McBryde, *Contract*, paras 8.80-8.82, explores some of the possible difficulties.

<sup>44</sup> *Renton v Ayton* (1634) Mor 7721.

<sup>45</sup> *Magistrates of Dunbar v Mackersy* 1931 SC 180.

<sup>46</sup> *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. See further *SME* Vol 15, para 846; *British Telecommunications Plc v James Thomson & Sons (Engineers) Ltd* 1999 SC (HL) 9; and, in relation to this case, J Convery "Contractual Structures and the Duty of Care" 1997 SLT (News) 113; H L MacQueen, "Concrete Solutions to Liability: Changing Perspectives in Contract and Delict" (1998) 64 *Arbitration: Journal of the Chartered Institute of Arbitrators* 285, 288-289; and Hogg, *Obligations*, paras 3.97-3.100.

<sup>47</sup> See, eg, *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 incidents, or components, of rights, its jural correlative being the disability of one or more parties to bring a claim or exercise a power against the benefited person.<sup>48</sup>

### Identification of the third party

2.26 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. In *Rose, Murison and Thomson v Wingate, Birrell & Co's Trustee*, for example, guarantors of an association of underwriters were held liable to persons assured by a member of the association. The relevant clause read: "We guarantee the liabilities arising on the account of JB [the underwriter] underwritten by us in his name." The persons assured were therefore not individually identified in the guarantees and in turn their assurance policies made no reference to the guarantees. The third parties could be identified, however, as members of a class – the persons insured by JB – and it was held that the purpose of the guarantees was to ensure the protection of their interests.<sup>49</sup> In *Thomson v Thomson* a contract of partnership provided that either partner might by will or otherwise nominate his widow, son or daughter to his share in the partnership. Lord Reid observed: "It appears to me that the original partners agreed that a nominee should have a right, by way of *ius quaesitum tertio*, to become a partner with the survivor on the same terms, *mutatis mutandis*, as those contained in their own contract of partnership."<sup>50</sup> Here again there is a group, albeit limited to three individuals, the enforcement of whose right is contingent upon the nomination of the original partner.<sup>51</sup>

#### *Third party as person fulfilling specified conditions*

2.27 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. An example may be found in *Kelly v Cornhill Insurance Company Ltd*.<sup>52</sup> A motor insurance policy insured any person driving the motor car on the order of or with the permission of the owner. Here the suspensive condition was the owner's order or permission to drive the car, which could be given to any person in the world. Provided that the other conditions for a JQT were satisfied, it could be argued that, although the third party

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.

<sup>48</sup> W N Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning* (1919) holds that rights may take the form of privileges (or liberties), claims, and powers as well as immunities. The jural correlatives of the first three are, respectively, no right, another's duty, and liability. It assists in understanding this to consider also jural opposites, viz, right-no right, privilege-duty, power-disability and immunity-liability. The scheme may be represented thus in tabular form:

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

The analysis is not beyond criticism: see further W A Wilson, "A Note on the Hohfeld Analysis" 1971 JR 162-169; *SME* Vol 11, paras 1073-1112.

<sup>49</sup> *Rose, Murison and Thomson v Wingate, Birrell & Co's Tr* (1889) 16 R 1132.

<sup>50</sup> *Thomson v Thomson* 1962 SC (HL) 28, 32.

<sup>51</sup> It was held that the condition was not satisfied by a universal bequest in a will of one of the partners.

<sup>52</sup> 1964 SC (HL) 46.

might be anybody, the fulfilment of the conditions would identify the person (or perhaps persons) who would ultimately have the right under the relevant contract provision. The case of *Thomson v Thomson*, referred to in the previous paragraph, suggests another possible example, namely that the third party be a person nominated as such by one of the contracting parties, by will or otherwise, without, however, any limit to widows, sons or daughters.<sup>53</sup>

2.28 We think that 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. 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 driver's insurer under his insurance policy. The possible commercial significance of this is discussed further in Chapter 3.

#### *Third party not in existence when the contract is formed*

2.29 As recognised by all the early Institutional Writers, the third party need not be in existence at the time the contract is made.<sup>54</sup> The leading case on the creation of a right for a third party yet to come into existence is *Morton's Trustees v Aged Christian Friend Society of Scotland*.<sup>55</sup> There M wrote to a committee offering financial support for a charitable society which it was seeking to set up. The committee accepted the offer and the society was duly brought into existence. It was held that the society had a right as a third party to the original contract which could be enforced against M's estate, even though it was not in existence when that contract was formed.<sup>56</sup>

2.30 Stair and other Institutional Writers argued that rights might be created in favour of an unborn child.<sup>57</sup> Erskine, however, analysed the right in such cases as "suspended till the birth of the child",<sup>58</sup> seeming to mean that the very existence of the right depended upon the fulfilment of the condition.<sup>59</sup> This seems correct in principle where the child is not even conceived, since the existence of a right requires the existence of a person to have that right.<sup>60</sup> If this is correct, the parties who have created the prospective right, the very existence of which is in suspense, are not bound to the third party and are free to agree to revoke.<sup>61</sup>

2.31 But there may be a question of whether the condition for the right coming into existence is fulfilled by the subsequent conception of a child, or if the child was *in utero* at the time of the contract with a provision in its favour. This would result from the principle of Scots law that *nasciturus pro jam nato habetur quando agitur de ejus commodo* (a child that

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<sup>53</sup> *Thomson v Thomson* 1962 SC (HL) 28.

<sup>54</sup> Stair, I, 10, 4; Bankton, *Institute*, I, 11, 6; Erskine, *Institute*, III, 1, 8.

<sup>55</sup> (1899) 2 F 82.

<sup>56</sup> No question was raised in the case about the Society's having a legal personality, although it may well have been an unincorporated association. According to the case reports, it came into existence as such in 1889. The Society continues to operate and is both a registered company (although registered only in 2002) and a Scottish registered charity.

<sup>57</sup> Stair, *Institutions* I, 10, 4; Bankton, *Institute*, I, 11, 6; Erskine, *Institute*, III, 1, 8.

<sup>58</sup> Erskine, *Institute*, III, 1, 8.

<sup>59</sup> See further at para 2.8 above.

<sup>60</sup> *SME* Vol 11, paras 1073, 1078. Cf Sutherland, "Third-Party Contracts", p 215. See too the rule of trust law that an *inter vivos* trust is revocable if the beneficiaries other than the trustee are not in existence or ascertainable (Gloag & Henderson, para 41.19).

<sup>61</sup> See para 2.8 above.

has been conceived will be treated as though born if subsequently born alive and if it is to the advantage of the child to be so regarded).<sup>62</sup> Since acceptance by a third party is not required for the creation of a right, there can be no difficulty in the right existing albeit that that party has no more than a passive capacity.<sup>63</sup>

2.32 There have been cases where the third party enforced its right more than a century after it was first formulated. Thus, as already noted, in *Magistrates of Dunbar v Mackersy*, an action for the payment of rates decided in 1931, the defender's immunity right arose from a letter addressed to predecessors in title and dated 30 January 1777.<sup>64</sup> Perhaps the most important modern commercial application of the rule allowing the creation of rights for as yet non-existent third parties arises, however, in the context of company groups, within which the member companies may undergo a constant process of dissolution and formation. While contracts between particular member companies and outsiders such as suppliers may be assigned to other members of the group when the particular member is dissolved, it may be more efficient to provide at the time of contracting that the contract can be enforced by other companies already in the group or others yet to be formed. We explore this issue in greater depth in the next Chapter.<sup>65</sup>

#### *Other instances of third parties with passive capacity only*

2.33 Stair also gave the cases of the child below the age of legal capacity (now 16) and the adult incapax as possible instances of parties who could have a right by virtue of another's promise to him or her without any need for acceptance by the promisee.<sup>66</sup> The English case of *Jackson v Horizon Holidays*<sup>67</sup> provides a possible modern example of a contract with a third-party right in favour of young children: a father booked a family holiday for himself and his family, including two 3-year old children. The Court of Appeal held that the father's claim for damages for the breach of contract constituted by a disappointing holiday could include an element for the disappointment of the other family members. In Scotland, it would seem, the children could have an independent claim to damages as third parties, albeit their actions would have to be raised for them by their guardians.<sup>68</sup>

2.34 The third party right of an incapax may be important in a number of situations. While there are no particular issues with the incapax who has a duly appointed attorney or guardian (who in that capacity may act on the incapax's behalf in making contracts which not only bind the latter's estate but give the incapax rights directly), difficult situations may arise

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<sup>62</sup> This principle, however, has operated mainly in the law of succession and delict.

<sup>63</sup> On the possibility of a person having passive capacity to be a right-holder, although lacking the active capacity to enforce the right in question, see *SME Vol 11*, paras 1045-1051; elaborated in D N MacCormick, *Institutions of Law: An Essay in Legal Theory* (2007), pp 78-82, 86-89. Note too our Report on the Legal Capacity and Responsibility of Minors and Pupils (SLC No 110, 1987), paras 3.22-3.25.

<sup>64</sup> *Magistrates of Dunbar v Mackersy* 1931 SC 180. It may be that the contract in *Inverlochy Castle Ltd v Lochaber Power Co* 1987 SLT 466 should also have been treated as giving rise to a JQT (rather than as being a contract running with the lands in question) since "it [was] clear from the language used in the agreement ... that the obligations undertaken by the defenders were conceived in favour of the then landowner or his heirs and successors" (Lord Ross at 470).

<sup>65</sup> See paras 3.4-3.18.

<sup>66</sup> Stair, *Institutions*, I, 10, 4.

<sup>67</sup> [1975] 1 WLR 1468.

<sup>68</sup> Note acceptance of the example as a case of third party rights in *Alfred McAlpine Construction Ltd v Panatown Ltd* [2001] 1 AC 518, 534-535 (Lord Clyde) and in *McLaren Murdoch & Hamilton Ltd v Abercromby Motor Group Ltd* 2003 SCLR 323, 343 (Lord Drummond Young) (both discussed further in Chapter 3 below). See also McBryde, *Contract*, para 10.15 and note further the potential applicability of the Package Travel, Package Holidays and Package Tours Regulations 1992 (SI 1992/3288) as amended.

for carers who have no duly authorised powers. An incapax cannot appoint the carer as an agent.<sup>69</sup> A carer who contracts for the benefit of the incapax – for example, by arranging personal services to be rendered to the incapax, or ordering repairs to the incapax’s property – may undertake personal liability under such contracts while also having a claim against the estate of the incapax for the expenses thereby incurred by reference to the doctrine of *negotiorum gestio* (or benevolent intervention).<sup>70</sup> But if the services or repairs are unsatisfactory in breach of the contract, the carer’s damages claim may be insufficient to take into account the interests of the incapax. For example, the incapax may suffer distress as a result of negligently administered services, or failure to render the services at all. Or the property of the incapax 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 incapax 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 incapax’s interests.

*Must the third party always be expressly identified in, or identifiable from, the contract?*

2.35 Professor McBryde asks whether it is always necessary that the third party be expressly identified in the contract for a JQT to arise. He figures the case of a person buying goods and services for a third person who as the ultimate consumer is the person “most directly affected by inadequate performance of the contract” and the only one to suffer loss. Was *Donoghue v Stevenson* actually a case of JQT rather than delict?<sup>71</sup> Would it have been more clearly so had Mrs Donoghue’s unknown friend<sup>72</sup> told the café owner at the time of purchase that the ginger beer was being purchased for another (whether or not she was named)? Suppose again that Mrs Donoghue had not consumed the contaminated drink but had merely observed the presence in it of the snail: then, while she would certainly have had no claim in delict, since she suffered no physical injury, might she have had a third party claim under her friend’s contract in respect of the defects in the goods, perhaps for the shock or disgust inflicted upon her by an arrangement intended to give her pleasure?<sup>73</sup>

2.36 Other examples of the kind can be readily imagined: for example, an arrangement by which the parents of a bride contract with a wedding photographer for the supply of multiple albums to be presented to various friends and relatives around the world unable to travel to the nuptials, but the photographer fails to turn up or to produce images of the anticipated quality.<sup>74</sup> A more complex example is the scaffolding sub-contractor whose scaffolding around a tenement building to enable a main contractor to carry out repair and renovation

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<sup>69</sup> L J Macgregor, *The Law of Agency in Scotland* (2013), paras 3.12-3.14.

<sup>70</sup> See *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 its expenses. The leading example in the relevant case law is *Fernie v Robertson* (1871) 9 M 437.

<sup>71</sup> McBryde, *Contract*, para 10.15. See also W W McBryde, “Contract Law – a Solution to Delictual Problems?”, 2012 SLT (News) 45. In *Donoghue v Stevenson* 1932 SC (HL) 31 the House of Lords held relevant Mrs Donoghue’s delictual claim of negligence against the manufacturer of a bottle of ginger beer the contents of which she had partly consumed before discovering that they included the decomposing remains of a dead snail. She thereafter suffered from gastro-enteritis. The bottle had been purchased for Mrs Donoghue by a friend.

<sup>72</sup> For the most recent discussion of the gender of Mrs Donoghue’s unidentified companion in Minghella’s Paisley café on 26 August 1928, see J Conn, “Gingerlore: The Legends of *Donoghue v Stevenson*” 2013 JR 265, 272-274.

<sup>73</sup> Damages can be awarded for distress caused by breach of contract: see McBryde, *Contract*, paras 22.104-22.105. It is undecided whether such a claim might be open to a third party upon whom the contracting parties intended to confer a right.

<sup>74</sup> *Cf Diesen v Samson* 1971 SLT (Sh Ct) 49.

work collapses, damaging the building. Even if the flat owners within the tenement building were not named or mentioned as a class in the scaffolding sub-contract, it seems clear that their existence and exposure to risk of loss must have been at least a consideration for the contracting parties.

2.37 If however the JQT can reach as far as this, then it does begin to border with the law of delict (in which however the purely economic losses of third parties following from the negligent performance of a contract between two others will usually not be recoverable). It would be similar to the German idea of the contract's 'protective umbrella' or the French *action directe*, mentioned in Chapter 1.<sup>75</sup> There is also a possible overlap with the problem of 'transferred loss', which is discussed in Chapter 3.<sup>76</sup> But the argument for such implicit third parties having rights will, it is suggested, have to overcome the rule that it is not enough that a party has an interest in or could receive a benefit from the performance of a contract between others. The possibility will also often, if indeed not always, be limited by the closely connected requirement that the contracting parties intended to create rights to those third party interests or benefits. While, as we will see, such an intention may be implied, the contractual structure may more often point to its absence.<sup>77</sup>

### **Contracting parties' intention to create third party rights**

2.38 It is not enough for a JQT that a contract simply refers to a third party since, as already noted, there must also be manifest an intention to confer an enforceable right upon that third party.<sup>78</sup> 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.<sup>79</sup>

2.39 The intention to confer a third party right may be express or implied in the contract. As Gloag remarked, "The most unequivocal 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."<sup>80</sup> But, as Professor McBryde also observes, "Full express terms have probably been uncommon, although not unknown when the draftsman deliberately sets out to create a right which may be enforced by a third party."<sup>81</sup>

2.40 The difficulty on this subject in the cases has thus been over when, in the absence of such an express and deliberate provision 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. The question has to be taken with the rule that the mere existence of a third party benefit from, or interest in, the contract is insufficient for the creation of a right.

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<sup>75</sup> See para 1.20 above.

<sup>76</sup> See paras 3.11-3.14 below.

<sup>77</sup> See paras 2.48-2.49 below, and the comments of Lord Drummond Young in *McLaren Murdoch & Hamilton Ltd v Abercromby Motor Group Ltd* 2003 SCLR 323, 343, quoted at para 3.13 below.

<sup>78</sup> McBryde, *Contract*, para 10.17.

<sup>79</sup> *Henderson v Stubbs Ltd* (1894) 22 R 51.

<sup>80</sup> Gloag, *Contract*, p 236.

<sup>81</sup> McBryde, *Contract*, para 10.12 (citing *Denny's Trs v Dumbarton Magistrates* 1945 SC 147, and also giving as an example "a takeover agreement or sale of a business where it is expressly provided that the workforce or pension trustees may enforce rights against the buyer, or a building contract which gives rights to an ultimate buyer or tenant").

2.41 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.”<sup>82</sup> Gloag gives several examples, starting with a case 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.<sup>83</sup> 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.<sup>84</sup>

2.42 The fact that the contracting parties have ongoing obligations between themselves as well as in relation to the third party does not, however, prevent the latter having an enforceable right. This can be illustrated by the case of *Mercedes-Benz Finance Ltd v Clydesdale Bank plc*.<sup>85</sup> 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 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 JQT to MB; he rejected CB’s argument that a JQT 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.

2.43 The implication of intention to create a JQT is often said to underpin a rather special line of cases beginning in the late nineteenth century concerned with the rights of co-feuars and co-disponees to enforce real burdens.<sup>86</sup> Broadly speaking, it was found that implied rights could arise in two situations:

“(1) where the superior feus out his land in separate lots for the erection of houses, in streets or squares, upon a uniform plan; or (2) where the superior feus out a considerable area with a view to its being subdivided and built upon, without prescribing any definite plan, but imposing certain general restrictions which the feuar is taken bound to insert in all sub-feus or dispositions granted by him.”<sup>87</sup>

2.44 Whilst the bases for these decisions were various,<sup>88</sup> the rules can be summarised as follows:

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<sup>82</sup> Gloag, *Contract*, p 236.

<sup>83</sup> *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.

<sup>84</sup> McBryde, *Contract*, para 10.14 (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).

<sup>85</sup> *Mercedes-Benz Finance Ltd v Clydesdale Bank plc* 1997 SLT 905.

<sup>86</sup> Gloag, *Contract*, pp 237 and 243-247; McBryde, *Contract*, para 10.13. For a relatively recent example, see the case of *Lees v North East Fife DC* 1987 SC 265.

<sup>87</sup> *Hislop v MacRitchie’s Trs* (1881) 8 R (HL) 95, 102.

<sup>88</sup> See generally *SME* Vol 18, paras 399-405.

- (a) the burdened property and the property seeking implied title to enforce as a third party share the same or similar burdens;
- (b) these burdens were imposed by a common author;
- (c) the property seeking title to enforce will only have it if the title of the burdened property contains notice that there is a common scheme of burdens; and
- (d) there is nothing in the title of the burdened property that negatives the existence of implied third-party rights of enforcement.<sup>89</sup>

2.45 We think that little general guidance can be taken from these cases on the process of implying the intention to confer third party rights in contracts. 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. Rather, they resulted from other evidence of a specified nature, contained in the relevant title deeds. It was only possible to speak of the right arising by implication because it could be excluded by inference or express provision in the relevant documents. With both co-feuars and co-disponees the implication of enforcement rights would not be made where the superior or disponer had reserved the right to waive or vary the burdens.

2.46 The explanation of these cases as instances of JQT has been forcefully criticised by Professor Kenneth Reid:

“[T]his analysis is both inadequate as an explanation and also ... has the potential to mislead. The analysis is inadequate because it fails to explain all the cases in which co-feuars’ rights arise. [A footnote adds: Thus suppose that A feus to B and B then subfeus to C and further suppose that D (who holds directly from A) is a co-feuar with enforcement rights against C. C has no contractual relationship with A. He is not the ‘second party’ to a perpetual feudal contract, and from the point of view of enforcement rights, D’s relationship to C is indistinguishable from A’s relationship to C. The problems are even more difficult when the *jus quaesitum* model is applied to burdens created in ordinary dispositions ...] It is potentially misleading because the very term *jus quaesitum tertio* hints at a connection with the law of contract which in truth barely exists. The model often presented is of a perpetual feudal contract between superior and vassal with the co-feuar as a *tertius*, but in the modern law the perpetual feudal contract is a shadowy, if not actually an illusory, concept, and the liability of a vassal to his superior is primarily a matter of property law.”<sup>90</sup>

Professor McBryde agrees that the cases “involve specialities of property law” and are not “directly concerned with contracts”.<sup>91</sup> It is also worth noting that, following the abolition of feudalism, the modern law in this area rests on the Title Conditions (Scotland) Act 2003. Applying typically to residential developments, the Act means that any third party rights now depend upon the relevant deeds fulfilling statutory requirements rather than any contractual

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<sup>89</sup> S Wortley, “Love thy Neighbour: the Development of the Law of Implied Third-Party Rights of Enforcement of Real Burdens” 2005 JR 345, 355.

<sup>90</sup> *SME* Vol 18, para 402.

<sup>91</sup> McBryde, *Contract*, paras 10.13-10.14.

intent.<sup>92</sup> These requirements include nomination and identification of, inter alia, “any person in whose favour the real burden is to be constituted (if it is to be constituted other than by reference to the person’s capacity as owner of any land)”.<sup>93</sup> By section 52(2) reservation of a right to vary or waive the burdens impliedly excludes enforcement rights; they may also be expressly excluded.<sup>94</sup>

2.47 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 cannot provide any general test for when the intention of contracting parties to confer rights upon a third party can be implied. Nevertheless, we think that there may be some parallels with other modern arrangements for the commercial leasing of immoveable property, and explore these further in Chapter 3.<sup>95</sup>

2.48 The requirement of intention to confer a right probably explains why, as is noted in the *SME*, there is often not a JQT in cases where there are a contract and a dependent sub-contract, or a series of connected sub-contracts and sub-sub-contracts.<sup>96</sup> Although the performances of the sub-contractors and the sub-sub-contractors may be ultimately for the benefit of the employer of the principal contractor, the purpose of such contractual arrangements is “usually ... to distance parties from each other rather than to bring them into a direct legal relationship. Thus the employer has only to pay, and can only sue, the main contractor; equally, the sub-contractor can only look to the main contractor.”<sup>97</sup>

2.49 It is not impossible, however, for a JQT to arise between parties linked through a chain of contracts and sub-contracts, albeit not directly.<sup>98</sup> In *Scott Lithgow Ltd v GEC Electrical Projects Ltd*,<sup>99</sup> an employer claimed a JQT in a sub-contract to which it was not a party on the basis that it was named in the sub-contract and that the sub-contractor’s work was for the advancement of the employer’s interests. Although there were no averments about the actual terms of the sub-contract, Lord Clyde allowed the case to go to proof on the

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<sup>92</sup> Indeed, s 61 of the 2003 Act provides that “[i]ncidental contractual liability which a constitutive deed (or a deed into which a constitutive deed is incorporated) gives rise to as respects a prospective real burden, ends when the deed has been duly registered and the real burden has become effective.” Generally, the 2003 Act is only applicable in relation to real burdens created after 28 November 2004.

<sup>93</sup> 2003 Act s 4(2)(c)(iii). The wording of sections 4, 8 and 53 of the 2003 Act, however, permits, in certain limited cases, the creation of implied enforcement rights after 28 November 2004. This will typically be in so-called ‘mixed tenure’ estates where a local authority owns some properties and others have been sold subject to the statutory right to buy scheme, providing that one related property, at least, was burdened by a deed registered before the appointed day.

<sup>94</sup> Under s 53 of the 2003 Act, all that is required for relevant third party enforcement rights are a “common scheme” and “related properties”. The result is to create countless enforcement rights in housing and other developments which previously did not exist because there was a reservation of a right to vary, and difficulties in practice in discharging burdens. Consideration of this problem by the Justice Committee of the Scottish Parliament has resulted in a reference to the SLC: see

[http://www.scottish.parliament.uk/S4\\_JusticeCommittee/Inquiries/20130904\\_SG\\_response\\_to\\_Title\\_Conditions\\_inquiry.pdf](http://www.scottish.parliament.uk/S4_JusticeCommittee/Inquiries/20130904_SG_response_to_Title_Conditions_inquiry.pdf) (Recommendation 11) and

<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=8732&mode=pdf> (col 26398 per Roseanna Cunningham MSP, Minister for Community Safety and Legal Affairs).

<sup>95</sup> See further at paras 3.37-3.47 below.

<sup>96</sup> *SME* Vol 15, para 836, and authorities cited therein. See also *Sears Properties Netherlands BV v Coal Pension Properties Ltd* 2001 SLT 761 (OH).

<sup>97</sup> *SME* Vol 15, para 836. There may, however, be claims between the distant parties in other areas of the law such as delict or unjustified enrichment.

<sup>98</sup> Note on third party rights in ‘contract chains’: Beale, “Review”, pp 226-228.

<sup>99</sup> 1989 SC 412 (OH).

basis that the evidence at the proof might show that the intention to confer a third party right indeed existed.

### **No requirement of third party acceptance**

2.50 There is no need for any acceptance or equivalent by the third party before its right can come into existence. Thus for Stair a third party right could be created in favour of an absent person, as well as for someone lacking the active capacity to carry out a legally effective act of acceptance.<sup>100</sup> Stair's position was consistent with his espousal of a 'declaration of will' theory under which obligations could be constituted by a seriously intended and objectively verifiable undertaking without any need for communication thereof to the other party. It is not thought that the position was changed by Lord Kinneir's statement in *Morton's Trustees v Aged Christian Friend Society of Scotland* that in a case where there is an express stipulation in favour of a third party, "though the person in whose favour the stipulation is made is not a party to the agreement, or at the time assenting to it, he may afterwards adopt the agreement in his favour and sue upon it."<sup>101</sup>

2.51 The lack of a need for acceptance by the third party contrasts Scots law with some other systems such as South Africa, in which the analogous institution of the *stipulatio alteri* requires the third party to accept the right provided for in the contract before it can become enforceable.<sup>102</sup> As Professor Phillip Sutherland has explained:

"What South Africans call a *stipulatio alteri* is really a complex of two contracts, the contract between the promisee and promisor according to which the promisor agrees with the promisee to keep open an offer to the third party and the second between the promisor and third party which comes into existence when the third party accepts the offer which the promisor has made to him."<sup>103</sup>

Professor Sutherland continues:

"But J C de Wet correctly criticised this construction for not being a third-party contract at all. The objection to the two-contract approach is not just theoretical. In many situations, acceptance will have to be artificially constructed to allow a third party a claim."<sup>104</sup>

2.52 In Scots law 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.<sup>105</sup> 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. Thus, as Stair pointed out: "[I]f a promise be made by one to another in favour of a third, importing the acceptance of that third, it is pendent and

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<sup>100</sup> Stair, *Institutions*, I, 10, 4-5.

<sup>101</sup> *Morton's Trs v Aged Christian Friend Society of Scotland* (1899) 2 F 82, 87.

<sup>102</sup> For an up-to-date account see D Hutchison and C-J Pretorius (eds), *The Law of Contract in South Africa* (2<sup>nd</sup> edn, 2012), para 9.3.3. See also the position in the Netherlands (Nieuw Burgerlijk Wetboek (NBW); the Dutch Civil Code, Art 6.254).

<sup>103</sup> Sutherland, "Third-Party Contracts", p 208.

<sup>104</sup> *Ibid.*

<sup>105</sup> An example may, we think, be provided by the Master Policy for Professional Indemnity Insurance provided through the Law Society of Scotland: see further at para 3.32 below.

revocable by these contractors, til the third accept.”<sup>106</sup> The third party’s right then rests entirely upon a further contract between that party and one or more of the originally contracting parties. There is no need in such circumstances to make the third party’s right dependent in any way upon the first-made contract, the legal significance of which is confined to the relationship of the original contracting parties. It would also be possible with this mechanism to subject the third party to enforceable duties.<sup>107</sup>

## Formalities

2.53 There has been little consideration of whether the JQT is subject to any requirements of writing, although our predecessors observed in 1988: “In all of the reported cases on *jus quaesitum tertio* the contracts have in fact been in writing.”<sup>108</sup> One of the possible implications of the promissory analysis of JQT, however, is that third party rights would be required to adhere to the Requirements of Writing (Scotland) Act 1995 rules on the formation of promises; that is, they would have to be in formally valid writing unless made in the course of business or if there had been appropriate actings upon the faith of the promise such as to bar the promising parties from withdrawing it.<sup>109</sup> This should of course present no barrier to the recognition of third party rights in commercial transactions like those to be discussed in the next chapter.<sup>110</sup> Further, the current rules on actings upon informal undertakings barring withdrawal therefrom despite the absence of writing (statutory *rei interventus*) are more liberal than the previous law requiring proof of promises by the promisor’s writ or oath.<sup>111</sup> This can be shown by considering how the pre-1995 Act case of *Smith v Oliver*<sup>112</sup> would be dealt with today: the church, far from failing (because unable, in the absence of the deceased Mrs Oliver’s writ or oath) to prove her promise to pay for the construction of its building, would now succeed in its claim against her estate, because it acted in reliance upon Mrs Oliver’s proved oral statements, was affected to a material extent by laying out funds and other resources on the project, and would also be adversely affected to a material extent if the estate was allowed to withdraw from performance of Mrs Oliver’s undertakings because they were not in formal writing.<sup>113</sup>

2.54 An alternative possibility is that if the underlying contract is not one that required to be in formal writing (ie is not one dealing with a real right in land), then nor should any third party right which that contract may also confer. Under the law before the 1995 Act, the rule limiting proof of gratuitous obligations to the writ or oath of the promisor was not applicable where the obligation in question was added to others contained in a mutual or onerous contract. In the leading case on the subject, parties reached a compromise in which one who was relieved of a possible claim of damages for failure to implement a lease also undertook to endorse a grocer’s licence which had been granted in his name. At first instance it was held that this undertaking could be proved parole, ie did not require reference to the undertaker’s writ or oath.<sup>114</sup> Lord Kyllachy said:

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<sup>106</sup> Stair, *Institutions*, I, 10, 6.

<sup>107</sup> Sutherland and Johnston, “Contracts for the Benefit of Third Parties”, p 219; Sutherland, “Third-Party Contracts”, p 212.

<sup>108</sup> Report on Requirements of Writing (SLC No 112, 1988), para 2.26.

<sup>109</sup> See discussion in Huntley and Dedouli, “Third Party Rights” 332-336.

<sup>110</sup> See Chapter 3.

<sup>111</sup> RoW(S)A ss 1(3), (4). See para 2.5 above.

<sup>112</sup> 1911 SC 103.

<sup>113</sup> H L MacQueen and M Hogg, “Donation in Scots Law” 2012 JR 1, 13-14.

<sup>114</sup> *Hawick Heritable Investment Bank v Hoggan* (1902) 5 F 75.

“A promise or undertaking is not in the eyes of the law gratuitous – that is to say, it is not a mere *nudum pactum*, if it be part of a transaction which includes *hinc inde* onerous elements, such, for example, as a waiver or discharge of claims, or objection to claims – claims or objections which, whether good or bad, it is desired to extinguish. In such a case the whole transaction – unless heritable rights are affected – may, I think it is clear, be the subject of parole proof.”<sup>115</sup>

2.55 It is not settled, however, whether this broad permissive approach outside transactions involving real rights in land continues to apply under the more formal regime of the 1995 Act. Professor Hogg opines:

“As the Act contains no provision exempting ... a unilateral promise from the requirement of writing merely because of its containment within a contract, it is to be presumed that the promise at least would require to be subscribed (which, in practice, would mean the whole contract would be subscribed).”<sup>116</sup>

The need for such a rule may well have been thought limited, given that promises made in the course of business are exempted from the requirement of formal writing.<sup>117</sup> But there may still be difficult situations needing to be dealt with. Professor Hogg gives the example of “a contract between two parties not undertaken in the course of business containing a gratuitous option in favour of one of the parties to purchase property”.<sup>118</sup> In a discussion of third party rights, this example might be elaborated to consider the possibility that the contract is, say, a short-term residential letting between an uncle and a student niece or nephew when the latter’s university career begins, with the option to buy the let property provided to the student’s parents if one or more of their other younger children later go to the same university. The letting does not need to be in formal writing; but does the grant of the option?

2.56 The Requirements of Writing (Scotland) Act 1995 imposes the requirement of formal writing on unilateral *gratuitous* obligations. There is currently no consensus in Scots law regarding whether a promise is always gratuitous, or whether it may be either gratuitous or onerous.<sup>119</sup> Whilst Professor MacQueen, Professor Black, David Sellar, Professor Huntley and Dr Dedouli, and Professor Hogg are all of the opinion that a promise is always gratuitous,<sup>120</sup> Professor Thomson and Professor McBryde think otherwise.<sup>121</sup> If Professor Thomson and Professor McBryde are right, then whenever a promisee has to fulfil some onerous condition before becoming fully entitled to the benefit of the promise, there is no need for that particular promise to be in writing. Since unconditional promises are perhaps rare, the requirement of formal writing thus would not have much practical bite. If a JQT is characterised as a promise, this analytical debate about what is meant by ‘gratuitous’ will apply in that context too, with uncertainty of outcome continuing until the courts have an

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<sup>115</sup> At 79.

<sup>116</sup> Hogg, *Obligations*, para 2.22.

<sup>117</sup> RoW(S)A s 1(2)(a)(ii).

<sup>118</sup> Hogg, *Obligations*, para 2.22.

<sup>119</sup> Hogg, *Obligations*, para 2.06.

<sup>120</sup> See H L MacQueen, “Constitution and Proof of Gratuitous Obligations” 1986 SLT (News) 1, 2; *SME* Vol 15, para 613; W D H Sellar, “Promise” in K G C Reid and R Zimmermann (eds), *History of Private Law in Scotland*, Vol 2, pp 252, 279-282; Huntley and Dedouli “Third Party Rights” 318-321; Hogg, *Obligations*, paras 2.06-2.11.

<sup>121</sup> J Thomson, “Promises and the Requirement of Writing” 1997 SLT (News) 284; W W McBryde, “Promises in Scots Law” (1993) 42 *International and Comparative Law Quarterly* 48. McBryde, *Contract*, para 2.03, is less definite on the point.

opportunity to provide a definitive ruling on the matter.<sup>122</sup> In our example of the student let with a third party's option to buy, does the fact that the third parties will have to raise finance in order to make any purchase mean that the uncle's obligation is not gratuitous and can therefore escape the requirement of formal writing after all?<sup>123</sup>

### The requirement of irrevocability

2.57 A key issue 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 to change the contents of the contract by agreement between themselves or to cancel it altogether. Just as a contract is made by the parties' agreement, so it can be unmade and remade by the same process. But if the parties succeed in creating a right for a third party, it would seem elementary that that right cannot be undone merely by the agreement of the contracting parties; in addition, the consent of the third party should also be necessary.<sup>124</sup>

2.58 The courts have tended to provide that before contracting parties can be held to have deprived themselves of their ordinary freedom to adjust their relations as they wish, there must be something more than just a term in favour of a third party. 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.

2.59 Some issues about the meaning of 'irrevocability' seem never to have been addressed by the courts, and have received limited attention from commentators. 'Revocation' would generally be taken as meaning 'termination' or 'cancellation'; but does it also cover 'variation' or 'alteration' or 'modification' of the third party's right short of outright cancellation? It does not seem to be necessary, however, that the whole contract be irrevocable: variation of their agreement by the contracting parties not affecting the rights of the third party is permissible.<sup>125</sup>

2.60 The leading case is *Carmichael v Carmichael's Executrix*.<sup>126</sup> 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, a consulting engineer

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<sup>122</sup> The 1995 Act does not support any idea that all unilateral obligations are *ipso facto* gratuitous: see s 1(2)(a)(i) referring to "unilateral obligation" whereas s 1(2)(a)(ii) refers to "gratuitous unilateral obligation". See the *obiter* comments of Lord President Gill on this topic in *Regus (Maxim) Ltd v Bank of Scotland plc* [2013] CSIH 12, paras 40, 41. On when a cautionary obligation is not gratuitous (because the transaction also involved co-extensive cautionary obligations of the debtor in favour of the first cautioner), see *Royal Bank of Scotland plc v Wilson* 2004 SC 153.

<sup>123</sup> On the characterisation of options see MacQueen and Thomson, *Contract*, para 2.61(6) and authorities cited therein.

<sup>124</sup> In the case of the incapable third party the consent may be given by the guardian or other responsible person. Note that in the case of the non-existent third party there is no right at all until the third party comes into existence or is recognised by the law as having done so.

<sup>125</sup> McBryde, *Contract*, para 10.06.

<sup>126</sup> *Carmichael v Carmichael's Ex* 1920 SC (HL) 195.

in Hong Kong called Hugh Fletcher Carmichael.<sup>127</sup> The policy provided that Hugh should pay the annual premiums each 22 October during Ian's minority and be 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 on his death to his executors. The object of this "deferred assurance on the life of a child" was "to encourage thrift in the young by giving the child on attaining majority an inducement to continue the assurance at a low rate of premium, and on the footing that there would be no liability to extra premium on account of family history or personal delicacy or on the ground of his being engaged in some hazardous occupation or residing in some unhealthy climate".<sup>128</sup> 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 Ian's 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 to his aunt, Miss Catherine M'Coll, his whole estate, and appointed her as his executrix. Ian never paid a premium before his death, since the next one would have fallen due to be paid on 22 October 1916. On 7 October 1916, the insurance company, confronted with the competing claims of Hugh Carmichael and Catherine M'Coll to the £1,000 payable under the policy, raised an action of multiplepinding in the Court of Session. The action proceeded to the House of Lords which, reversing a Court of Seven Judges split 5:2 below, eventually held in favour of Ian's executrix, i.e. that there was in existence an enforceable third party right under an irrevocable contract.

2.61 In *Carmichael* Lord Dunedin explained that irrevocability can be achieved in various ways: (1) delivery or intimation of the contract to the third party; (2) otherwise putting the contract out of the power of the contracting parties; (3) registration of the contract, for example in the Books of Council and Session; (4) third party's knowledge of the contract term in its favour; and (5) third party's reliance upon the contract term in its favour. The basis for the finding that a third party right existed in *Carmichael's* case was (4).

2.62 Lord Dunedin did not explore any underlying policy rationale for these rules on how to make a contract irrevocable, but the first three at least can be explained upon the basis that if these events occur it is objectively manifest that the contracting parties have moved beyond the stage of thinking about the creation of a right for the third party to a concluded intention that such a right should exist. There may, in other words, be some link with the implication of intention to create a right. The fourth and fifth rules, however, seem to be driven more by considerations of fairness and justice to the third party when other objective manifestations of the contracting parties' intention have not taken place.

2.63 With regard to the relevance of the contract terms, Lord Dunedin said:

"[T]he only real rule to be deduced is that the mere expression of the obligation as giving a *jus tertio* is not sufficient. ... Now, in examining the evidence, while, as I have already said more than once, the terms of the document are not conclusive,

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<sup>127</sup> Today there would be a question whether, on policy grounds, parents 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.

<sup>128</sup> *Carmichael v Carmichael's Ex* 1919 SC 636 (Seven Judges), 648 (Lord Salvesen).

that does not mean that they are not to be considered. On the contrary, they form a very important piece of evidence.”<sup>129</sup>

2.64 This view of the law, and Lord Dunedin’s speech in general, has long been the subject of academic criticism,<sup>130</sup> which some thought 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.”<sup>131</sup> The suggestion that Lord Reid’s use of the word ‘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;<sup>132</sup> but it seems to be at least implicit in his preceding sentence, whether or not it is a correct interpretation of the meaning that Lord Dunedin had intended to convey in *Carmichael*.

2.65 Professor McBryde argues, however, that, as a result of the principle requiring delivery of documents to give them obligatory force,<sup>133</sup> for a third party right to come into existence there must indeed be delivery to that third party, or some equivalent, of any document embodying a JQT.<sup>134</sup> The relevant equivalents to delivery laid down in *Carmichael v Carmichael’s Executrix* are very wide in scope.<sup>135</sup> They include intimation to the third party, the third party’s knowledge of the provision in its favour, and the third party’s detrimental reliance on that provision, as well as registration of the contract. In *Carmichael*, the House of Lords held it to be enough that the third party knew of the provision in his favour albeit not as a result of any formal intimation or direct communication by either of the contracting parties. It may have been relevant to that result that the third party was a young man who had just attained majority, and so full capacity; this, rather than lack of obligatory intention, could explain why his father, as the ‘natural custodian’ for an under-age son, had retained possession of the insurance policy which was the contract in the case, rather than deliver it to the son. Nor was any creditor of the father prejudiced by the son’s right.<sup>136</sup>

2.66 A further exception to the delivery requirement can perhaps be identified in the case of the undertaking ‘to all the world’ as potential third parties: that is, where contracting parties provide for payment or other performance to any other who fulfils certain conditions.<sup>137</sup> Suppose for example that the family of a missing person entered a mutual contract with a

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<sup>129</sup> *Carmichael v Carmichael’s Ex* 1920 SC (HL) 195, 203.

<sup>130</sup> See MacQueen, “Third Party Rights in Contract: *Jus Quaesitum Tertio*”, pp 245-250, for references. The late Lord Rodger of Earlsferry went so far as to say 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”).

<sup>131</sup> *Allan’s Trs v Lord Advocate* 1971 SC (HL) 45, 54.

<sup>132</sup> McBryde, *Contract*, para 4.36, note 82.

<sup>133</sup> See paras 2.11-2.12 above.

<sup>134</sup> McBryde, *Contract*, paras 4.34-4.38.

<sup>135</sup> As pointed out by McBryde, *Contract*, para 4.38; MacQueen, “Third Party Rights in Contract: *Jus Quaesitum Tertio*”, p 245.

<sup>136</sup> See McBryde, *Contract*, paras 4.50-4.56 for “deeds to the family” as one of the exceptions to the requirement of delivery. The first example of “writs effectual without delivery” in Stair, *Institutions*, I, 7, 14, is “writs granted by parents in favours of their children” (although he goes on to note that for policy reasons delivery is not presumed in such cases in competition with creditors of the parents, “otherwise creditors would be most insecure by parents making large bonds of provision, which they ordinarily keep by them”). The family would of course provide one very significant context for the creation of rights in favour of the absent, the unborn and *incapaces*.

<sup>137</sup> See paras 2.27-2.28 above.

newspaper by which they would be paid for the publication of their story and the newspaper would also provide a reward to any member of the public who provided information by which the missing person was traced. Suppose further that the reward was not publicised, in order not to encourage bounty-hunters, with the idea being that the publication of the family's story would by itself encourage others to come forward with relevant information.

2.67 Provided that the other conditions for a JQT were satisfied, it could be argued that, although the third party might be anybody, the need to fulfil the conditions is sufficient to identify the person (or perhaps persons) who will ultimately have the right under the relevant contract provision, and that delivery is not required or would be inapt. It may be enough for the third party to fulfil the conditions upon which the benefit may be claimed, even if without knowledge of the contractual provision at the time (although obviously at the enforcement stage the fact of fulfilment will have to be communicated and, if necessary, proved to the party undertaking to provide the benefit). It is possible that the contracting parties may be taken from the terms of their contract to have waived the need for delivery to make the third party right binding, just as in the case of the offer to the general public (or all the world), the offeror can be seen as waiving the need for any acceptor to communicate acceptance other than the fact of fulfilment of the offer's terms.<sup>138</sup>

2.68 It is also possible that Stair, perhaps especially mindful of the possibility of third party rights in favour of the absent, the incapax and the unborn, would have emphasised the need for flexibility on equivalents to delivery, and that this explains the obligation upon the contracting parties in his scheme, to "exhibit" the contract to the third party.<sup>139</sup> The obvious inference from that passage is that the contract in question has not previously been delivered to that party, yet third party rights exist. Further, the absence of a requirement of delivery between contracting parties who have subscribed a mutual contract might arguably carry the implication that enough has then been done to make the document binding on them in its entirety, and that this therefore includes the provision in favour of the third party (who, it will be recalled, need do nothing in Stair's scheme to complete the constitution of the right).<sup>140</sup>

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<sup>138</sup> See *Carlill v Carbolic Smokeball Co* [1893] 1 QB 256. See also DP No 154, 2012, para 4.15.

<sup>139</sup> Stair, *Institutions*, I, 10, 5.

<sup>140</sup> Stair accepted both the need for delivery of obligatory documents in general and the exception for mutual contracts (*Institutions*, I, 7, 14), but also wrote of the "action of exhibition and delivery": "The exhibition is but preparatory to the delivery, that thereby the thing in question may be known to the parties, judge and witnesses; and therefore *majori inest minus*, he that hath right to crave delivery hath much more right to crave the production, or the inspection. ... [T]he ordinary subject of this action is exhibition and delivery of writs; wherein the tenor and style of the action is, that the defender hath, or had, and fraudfully put away the writs in question. Whose having is probable by witnesses; and relates not unto the time of probation, but unto the time of the citation. For if after citation the defender had the thing in question, he ought to have acknowledged it; and if he justly or necessarily put it away or wanted it, he ought to have pleaded that as a defence, which therefore would exeeem the pursuer from probation of the libel, as being acknowledged by the defence, and so being omitted, and the pursuer proving his libel, the exception is not competent; but the defender is accounted as a fraudulent away-putter after citation ..." Stair continued: "Exhibition and delivery is competent to any party, in whose favours a writ is conceived, without necessity to prove that it was delivered. For that is presumed, if the writ be out of the granter's hand ..." The effect of the presumption was that if the writ was not in the granter's possession it was for that party to prove that this was not the result of legally effective delivery. Stair added: "For the better discovery of the havers of writs, the Lords, by a late act of sederunt, February 22, 1688, ordained defenders in exhibitions to depone if ever they had the writs in question, and when and how they ceased to have them, and whether or not they know who had them afterward, or who now hath them. Whereas before they did only depone they had them not since the citation in the exhibition, or did not at any time fraudfully put them away; whereby they were judges of what did import fraudulent away-putting: whereas this special way of their examination gives the Lords opportunity to judge whether the way they ceased to have them was fraudulent or not" (*Institutions*, I, 7, 14). Stair also discusses the action of exhibition in *Institutions*, IV, 33.

2.69 A final observation on the requirement of delivery in the context of third party rights is that it cannot apply at all where the obligation – unilateral, bilateral or multi-lateral – is not in writing. In that case, as between specific parties at least, the key seems to be communication between the parties or at least some objectively verifiable manifestation of a party's intention to be bound in an obligation to the third party. Although there are no examples in the case law of a JQT springing from an unwritten contract, it has not been suggested until recently that a JQT can arise only from a written one.<sup>141</sup>

*Revocation of a third party right: conditionality*

2.70 Professor McBryde distinguishes between what is needed to create a third party right in the first place, and the power or possibility that a right once created may come to an end before it is enforced, either in whole or in part, by the right-holder. He suggests 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).”<sup>142</sup>

2.71 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.<sup>143</sup> 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.”<sup>144</sup>

2.72 Professor McBryde points to the JQT case of *Love v Amalgamated Society of Lithographic Printers of Great Britain and Ireland*,<sup>145</sup> as an illustration of a right that was held to have been created although revocable by the parties who created it. The society operated a scheme which provided certain benefits for the relatives of sick members but which also provided that the rules of the scheme could be changed. In other words, the

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<sup>141</sup> McBryde, *Contract*, para 4.35; Huntley and Dedouli, “Third Party Rights” 332-336. See further paras 2.53-2.56 above.

<sup>142</sup> McBryde, *Contract*, paras 10.27-10.28.

<sup>143</sup> 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, ie 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. It may be this to which he is referring in the quoted phrase. But the offer in such a case is not any sort of promise at all, at least according to the cited decisions.

<sup>144</sup> McBryde, *Contract*, paras 10.27-10.28.

<sup>145</sup> 1912 SC 1078, discussed by McBryde, *Contract*, para 10.31. See also *SME* Vol 15, para 830; MacQueen & Thomson, *Contract*, para 2.78.

scheme which was constituted by the contract amongst all the members of the society was revocable. 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.<sup>146</sup>

2.73 Another example which seems not to have been noticed in this context in the previous literature is the more recent case of *Kelly v Cornhill Insurance Company Ltd*.<sup>147</sup> A motor insurance policy insured any person driving the motor car on the order of or with the permission of the owner. The owner gave his son unlimited permission to drive the insured vehicle, but clearly had the right to withdraw that permission. The question in the case was whether the permission was terminated by the death of the owner, the son having continued to drive the car after that event and having had an accident while the policy remained in force. The House of Lords held by a narrow majority that the son could enforce the policy. 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.

2.74 We think that the distinction between the rules on creation and termination of rights drawn by Professor McBryde is correct and amply borne out by authority as well as by principle. In particular, we agree 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 ceases to exist. As the *Love* case demonstrates, the resolutive condition may also be a potestative one; that is, one under the control of the contracting parties themselves. It was for the members of the society to determine what its rules were and these could be changed by appropriate action, including the rules on the provision of benefits to third parties.<sup>148</sup> So long as the power of a party to resolve the contract under the potestative condition is exercised in good faith, there should be no difficulty in recognising this possibility.<sup>149</sup>

2.75 There seems to have been no suggestion in *Love* that the very third party right itself did not come into existence at all until the suspensive condition of the member's sickness was fulfilled. Rather, the enforceability of the right under the contract as it stood was what was subject to the suspensive condition; and that right could also be terminated during its period in suspense 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 one of them exercising a contractual entitlement in good faith.<sup>150</sup>

2.76 A third party right may also be future in nature, that is, subject to some time limit which is certain to occur, such as some given future date (the right becomes enforceable on 25 December 2014), or an event such as the death of a contracting party who is a natural person (even although that date is uncertain, it will occur some time). The obligation exists

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<sup>146</sup> Gloag, *Contract*, p 242 notes, in contrast to *Love*, that the rule in the co-feuar cases already referred to, namely that the reservation by the feudal superior of a right to dispense with the building restrictions imposed in the feu-contracts he has granted (ie 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.

<sup>147</sup> 1964 SC (HL) 46. Also discussed at para 2.27 above.

<sup>148</sup> For an example of such a revocation of a benefit provided for employees of local authorities, see *Cadoux v Central Regional Council* 1986 SLT 117.

<sup>149</sup> See para 2.9 above.

<sup>150</sup> See para 2.8 above.

but is not enforceable until the date or event in question occurs.<sup>151</sup> An example of the latter might be a donation of money to the third party to take effect on the death of a party who has contracted with another to make the payment required.<sup>152</sup> There may also be a provision about the death of the third party at a point before the right could be claimed. For example, in *Carmichael* the son's right became enforceable on his reaching the age of 21 (i.e. it was suspended rather than future, because it was not certain at the time of contracting that the son would reach the age of 21). The contract also provided that the son's death before the age of 21 would bring this suspended right to an end. If the son had died before, rather than after, he reached his majority, that resolutive condition would have prevented any right from being transmitted to his estate, which would instead have reverted to his father.

2.77 It must be recognised, however, 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 observes:

“[A] condition which undermines the very idea that a binding commitment was being undertaken in the first place would seem to be impermissible in the sense that it would prevent fulfilment of the requirement that a speaker must commit to a future act. Thus if the condition stipulated related to whether or not the person making the commitment still wished to perform the commitment at a future date, this would bring in to question whether any commitment was seriously being undertaken to begin with. So, for instance, the statement ‘I promise to pay you £100 next Monday, if I have not changed my mind by then’ would not seem capable of being considered a promise because the condition attached undermines the very notion that any definite commitment has been undertaken to begin with. On the other hand, a condition which permits the promisor to revoke the promise at some future point, but is not so sweeping as to be suggestive of a lack of an original intention to be bound at all, might be argued to be a permissible condition. Thus a promise of the type ‘I promise to pay you £1,000 on 1<sup>st</sup> January, but I retain the power to revoke this promise should I deem the changed nature of our relationship so to warrant’ might fall within the category of valid promises, albeit that a fairly wide power of revocation is retained by the promisor.”<sup>153</sup>

We think however that the *Love* and *Kelly* cases clearly fall 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 suspended promise, ie 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

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<sup>151</sup> See para 2.6 above.

<sup>152</sup> See also *Fox v British Airways plc* [2013] EWCA Civ 972, in which, under a contract of employment, upon the death in service of an employee a lump sum became payable at the discretion of the employer's pension fund trustees to any member or members of one or more of various classes of beneficiary, namely: the employee's family; his dependants; any individual or individuals, charity, society or club nominated by the employee during his lifetime; and his personal representatives. These third party benefits were all contingent on the employee's death while still in the employer's service. The interposition of the trust between the contract and the third party benefit probably means that this would not have been a case of JQT in Scots law (see *Allan's Trs v Lord Advocate* 1971 SC (HL) 45), while in England & Wales the 1999 Act does not apply to contracts of employment (see further para 8.4 below).

<sup>153</sup> M Hogg, *Promises and Contract Law*, pp 33-34.

whether or not a third party right is intended and to what conditions, suspensive or resolute, the existence and enforceability of that right has been subjected by the contracting parties.

2.78 We should note finally that the authority of *Love* was questioned by the late Professor David Walker on the grounds of its inconsistency with *Carmichael* (although it ought to have been noted that the earlier decision was cited in the later without any suggestion of disapproval).<sup>154</sup> But Gloag, a predecessor of Professor Walker in Glasgow's Regius Chair of Law, had no difficulty with the decision,<sup>155</sup> and as already noted it is accepted in all the modern literature on third party rights.<sup>156</sup> The case has also been occasionally cited or referred to in subsequent Scottish decisions, without any suggestion of disapproval, although without any real discussion of its third party right aspects.<sup>157</sup> It – and *Kelly v Cornhill Insurance Company Ltd*<sup>158</sup> – are perhaps simply not well enough known to the legal profession in Scotland in this context.

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

2.79 While the third party need not take any steps in order to complete its right, for example communicating acceptance of the right to the contracting parties or to the debtor, in principle the third party may reject the right or refuse any attempt of the debtor to perform. As Professor McBryde has written, "express or implied waiver or rejection of the right by the third party must be possible. The benefit [conferred by the right in the third party's favour] may be unwanted or may be subject to undesired conditions."<sup>159</sup> This reflects the maxim that even benefits cannot be imposed on another: *beneficia non obtruduntur*.<sup>160</sup> Stair wrote of the 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..."<sup>161</sup> This would seem likely to be the effect of a rejection of a third party right. 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.<sup>162</sup>

### Position of the contracting parties

2.80 There has been little analysis of the obligations between the contracting parties in relation to the enforcement of the third party's rights apart from the point already mentioned, that their own continuing interest in the contract does not preclude the existence of a JQT. Stair's obligation upon them to 'exhibit' the contract to the third party has been interpreted by

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<sup>154</sup> D M Walker, *The Law of Contracts and Related Obligations in Scotland* (3<sup>rd</sup> edn, 1995), para 29.14; *Carmichael v Carmichael's Ex* 1920 SC (HL) 195, 197.

<sup>155</sup> Gloag, *Contract*, pp 242-243.

<sup>156</sup> See para 2.72 above.

<sup>157</sup> See also *McDowall v McGhee* 1913 2 SLT 238; *Muir v Associated Iron Moulders of Scotland* 1914 2 SLT 463 (Glasgow Sheriff Court); *Alderwick v Craig* 1916 2 SLT 161; *McLaren v National Union of Dock Labourers & Riverside Workers in Great Britain & Ireland* 1918 SC 834; *Aberdeen, Banff, and Moray Master Slaters' Association v Dickie & Son* 1925 SLT (Sh Ct) 59; *Mercedes-Benz Finance Ltd v Clydesdale Bank Plc* 1997 SLT 905. In several of these cases *Love* was cited only in argument and not by the court itself; and most of the early references are in connection with the then law relating to trade unions.

<sup>158</sup> 1964 SC (HL) 46. Also discussed at paras 2.27 and 2.73 above.

<sup>159</sup> McBryde, *Contract*, para 10.32.

<sup>160</sup> S Vogenauer and J Kleinheisterkamp (eds), *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* (2009), p 608.

<sup>161</sup> Stair, *Institutions*, I, 10, 4.

<sup>162</sup> McBryde, *Contract*, para 10.32.

modern writers as a duty to help the third party realise its right.<sup>163</sup> Whether this could extend, for example, to the stipulator bringing an action of implement against the debtor in relation to the performance to be rendered to the third party or, perhaps, carrying out that performance itself where the debtor has failed to do so or can no longer do so, is untested.

### **Assignability of the third party's right**

2.81 At least when a third party's right takes the form of a vested claim to some performance from one or more of the contracting parties, it is in principle capable of being assigned to a fourth party,<sup>164</sup> subject to the limitations of *delectus personae* and any prohibition upon assignation by the third party in the contract.<sup>165</sup> Where the third party's right is future or suspended at the time of assignation, it has been argued that the fourth party's right can be completed by accretion; that is, by the fulfilment of the contingency upon which the third party's right depends.<sup>166</sup>

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

2.82 Although there is little authority directly in point, it seems correct in principle to suppose that if there is a defect in the contract's formation rendering it void or voidable, then the third party's right is equally void or voidable.<sup>167</sup> Where the original contract is illegal, the right conclusion may be less clear if part only of the contract is illegal and that does not include the conferment of the third party right. But if the third party right is dependent upon the illegality then it seems clear that it too is unenforceable. It may, however, be that a JQT can still arise from a contract unenforceable by the contracting parties themselves. For example, in *Love v Amalgamated Society of Lithographic Printers of Great Britain and Ireland*,<sup>168</sup> statute provided that the Court could not entertain proceedings for directly enforcing "any agreement for the application of the funds of a trade union to provide benefits to members."<sup>169</sup> It was held that this did not preclude the dependants of members from enforcing the right which the agreement conferred upon them.

2.83 Bankton provides some possible guidance on the question of the contract's being discharged by frustration: "[I]f the contract becomes void, by supervening accident, betwixt the parties contracters, the third parties interest, that depended upon it, ceases".<sup>170</sup> But again it would seem correct in principle to suppose that "[t]he question of how frustration affects third party rights must ... depend on the impact which the frustrating events have had on the particular obligations 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".<sup>171</sup>

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<sup>163</sup> SLC Memo No 38, 1977, para 6; MacQueen and Thomson, *Contract*, para 2.72.

<sup>164</sup> Alternatively, the third party may declare a trust over its right, a possibility which we discuss at para 6.38 below.

<sup>165</sup> On the subject in general, see R G Anderson, *Assignation* (2008); and for a short overview see, Gloag & Henderson, paras 8.14-8.16.

<sup>166</sup> R G Anderson, *Assignation*, paras 11.46-11.53; cf G L Gretton, "Assignment of contingent rights" 1993 JR 23.

<sup>167</sup> McBryde, *Contract*, para 10.09; *SME* Vol 15, para 839; Sutherland, "Third Party Contracts", pp 225-228.

<sup>168</sup> 1912 SC 1078, discussed in this context by J Casey, "Collective Agreements: Some Scottish Footnotes" 1973 JR 22, 36-41; R L C Hunter, "Collective Agreements, Fair Wages Clauses and the Employment Relationship in Scots Law" 1975 JR 47.

<sup>169</sup> Trade Union Act 1871, s 4 (3) (a).

<sup>170</sup> Bankton, *Institute*, I, 11, 7.

<sup>171</sup> *SME* Vol 15, para 839.

## Third party remedies and exclusion clauses

2.84 A person with a JQT 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. The view that a damages claim is competent, however, is the direction which the law is apparently taking.<sup>172</sup> 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.”<sup>173</sup>

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 accordingly remains in a state of some uncertainty.

2.85 The contract may seek to exclude or limit any third party's claim of damages. It is a moot point whether or not the controls of the Unfair Contract Terms Act 1977 apply to such an exclusion.<sup>174</sup> It has been suggested that, because the controls generally apply expressly in favour of contracting parties only, they cannot help third parties. Some of the controls can, however, apply to non-contractual notices,<sup>175</sup> and exclusion clauses against third parties might fall into that category. If so, the controls come in where the third party's claim is in respect of a contractual duty of care: for example, where a parent buys tickets to enable the whole family to have a ride on the negligently maintained or operated Ferris wheel and they, having suffered injury as a result of the negligence, are then confronted with a widely-drawn clause purporting to exclude liability in damages to any user of the device.<sup>176</sup> But where the breach is something other than failure to take care – supplying safe but shoddy goods, services defective without negligence, other forms of inflicting economic loss irrecoverable in delict – then the exclusion clause will apply according to its terms.

## Prescription

2.86 In principle the JQT must be extinguished by prescription. But the topic is not directly addressed by the Prescription and Limitation (Scotland) Act 1973 (“1973 Act”). The

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<sup>172</sup> *SME* Vol 15, para 837; McBryde, *Contract*, paras 10.23-10.24; Sutherland, “Third-Party Contracts”, pp 221-225. The assumption that the third party may claim damages for breach of its right underlies the discussion of the applicability of JQT in the ‘black hole’ or ‘transferred loss’ cases discussed at paras 3.11-3.14 below.

<sup>173</sup> *Scott Lithgow Ltd v GEC Electrical Projects Ltd* 1989 SC 412, 438-439.

<sup>174</sup> The Unfair Terms in Consumer Contracts Regulations 1999 do not apply in this situation. The question is not discussed in our joint advice with the English Law Commission on Unfair Terms in Consumer Contracts (2013) and no change in the position can be expected when that advice is implemented in the Consumer Rights Bill which is currently before Parliament.

<sup>175</sup> Unfair Contract Terms Act 1977 s 16.

<sup>176</sup> H L MacQueen, “Third Party Rights in Contract: English Reform and Scottish Concerns” (1997) 1 *Edinburgh Law Review* 488-493.

relevant parts of the Act are those dealing with obligations, which may be extinguished by either the short or the long negative prescription.<sup>177</sup>

2.87 The short negative prescription applies to obligations as defined in Schedule 1 of the 1973 Act.<sup>178</sup> Paragraph 1(g) of the Schedule is the most likely of the obligations so defined to apply to a JQT: “any obligation arising from, or by reason of any breach of, a contract or promise, not being an obligation falling within any other provision of this paragraph”. The obligation of a JQT, it is suggested, arises from a contract, whether or not it is also to be understood as being itself the result of a promise. The obligation will therefore expire five years from the time the JQT became enforceable<sup>179</sup> (which, in the case of a claim of reparation for non-performance under the right will be when loss, injury or damage was suffered by the third party as a result of the non-performance),<sup>180</sup> unless the third party has made a relevant claim in implement of the obligation or there has been a relevant acknowledgement of the obligation’s subsistence by the debtor(s) in it.<sup>181</sup>

2.88 The long negative prescription applies to any kind of obligation, including, but not limited to, those specified in Schedule 1 of the 1973 Act.<sup>182</sup> Thus, if the JQT is not covered by the short negative prescription, it will certainly be extinguished if no relevant claim or acknowledgement is made in relation to it for twenty years after it became enforceable.<sup>183</sup>

2.89 The enforceability of the JQT may, as we have seen, be dependent upon suspensive and resolute conditions.<sup>184</sup> As Professor Johnston explains, “[w]here an obligation is subject to a suspensive condition ... it is not enforceable until the condition has been purified, and for that reason time cannot begin to run until purification of the condition.”<sup>185</sup> With resolute conditions, “in principle the obligation is immediately enforceable but subject to defeasance in the event that the resolute condition materialises. The prescriptive period therefore begins at once.”<sup>186</sup> In a future obligation (where the term is a date or event certain to occur), prescription will not begin to run until the term arrives.<sup>187</sup>

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<sup>177</sup> See in general, D Johnston, *Prescription and Limitation* (2<sup>nd</sup> edn, 2012).

<sup>178</sup> 1973 Act s 6. Obligations relating to land are excluded from s 6 by Sch 1 para 2(e).

<sup>179</sup> 1973 Act s 6(3).

<sup>180</sup> 1973 Act s 11.

<sup>181</sup> 1973 Act s 6(1). On “relevant claim” see further 1973 Act s 9 and on “relevant acknowledgement”, s 10.

<sup>182</sup> And so includes obligations relating to land (see fn 181 immediately above). Note also 1973 Act s 8 applying the long negative prescription to any right relating to property, whether heritable or moveable, not being a right specified as imprescriptible under Sch 3 to the Act or falling within ss 6 and 7 of the Act as a right correlative to an obligation to which either of these sections applies. For discussion of the distinction between the application of ss 7 and 8, see D Johnston, *Prescription and Limitation*, *supra*, paras 7.09-7.14, especially at paras 7.13 (“Personal rights relating to property are correlative to obligations and therefore fall within section 7. Real rights of ownership in land are excluded from the operation of section 8. So it follows that the scope of section 8 in relation to heritable property is confined to real rights less than ownership”) and 7.14(6) (“Ownership of, and other rights in relation to, moveables”).

<sup>183</sup> 1973 Act s 7. Relevant claims and acknowledgements are as defined in ss 9 and 10 of the 1973 Act.

<sup>184</sup> See above, paras 2.8-2.9.

<sup>185</sup> D Johnston, *Prescription and Limitation*, *supra*, para 4.08(1).

<sup>186</sup> *Ibid*, para 4.08(3).

<sup>187</sup> *Ibid*, para 4.08(5). On future obligations see para 2.6 above.

# Chapter 3 Third Party Rights in Practice

## Introduction

3.1 The Scots law of *jus quaesitum tertio* as set out in the previous Chapter has long been thought to be problematic. The consensus amongst current legal practitioners appears to be that the still relatively new English law on third party rights is vastly preferable. For example, Brodies LLP and Lindsays LLP have respectively described Scots law on third party rights as “massively inflexible” and “historic and inflexible”.<sup>1</sup> Our Advisory Group confirmed that the *jus quaesitum tertio* is used very infrequently in current practice. This Chapter will address the various adverse practical consequences which members of the Scottish legal profession have indicated arise from Scots law’s perceived failings in the area of third party rights, as well as explaining some of the commercial situations in which third party rights can be particularly useful. We have also found much helpful material in a review of the operation of the Contracts (Rights of Third Parties) Act 1999 by Professor Hugh Beale, a former Law Commissioner of England & Wales.<sup>2</sup> 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 Norton Rose LLP, Pinsent Masons LLP (prior to that firm’s merger with the Scottish firm McGrigors LLP), Allen & Overy LLP and Baker & MacKenzie LLP. 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.

3.2 The major difficulty with Scots law is the requirement of irrevocability for the constitution of the right. Although as we have attempted to show in the previous Chapter it is possible to put together an argument that this requirement is less than it seems at first blush, in the absence of legislation it will probably require a decision of the Supreme Court reconsidering the meaning and authority of the House of Lords’ decision in *Carmichael v Carmichael’s Executrix*<sup>3</sup> to confirm the correctness (or otherwise) of such arguments. It is entirely understandable that practitioners should not wish to peril their clients’ money and other resources upon such an outcome eventually being achieved. They must deal with the law as it has been generally understood to be since *Carmichael*, which means either finding some means of making contractual provisions in favour of third parties irrevocable, or resorting to having the contract governed by some other law which makes the creation of third party rights easier, or finding some other legal device by which the desired result can be achieved.

3.3 It may also be that the successful creation of a third party right which is thought by definition to be irrevocable in Scots law deprives contracting parties, and in particular commercial contracting parties, of the flexibility they believe they need in contractual

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<sup>1</sup> D Mathie, *Third Party Rights – Scots Law stuck in the 17<sup>th</sup> Century*, August 2010, accessible at: <http://www.brodies.com/blog/2010/08/26/third-party-rights-scots-law-stuck-in-the-17th-century/> and Lindsays LLP Bulletin, November 2012, accessible at: <http://www.lindsays.co.uk/news-and-features/bulletins/bulletin/corporate-and-technology-bulletin---november-2012/#Drafting>.

<sup>2</sup> Beale, “Review”.  
<sup>3</sup> 1920 SC (HL) 195.

matters. For example, Lindsays LLP have described this issue as problematic, because “as a JQT is irrevocable once granted, it can be extremely difficult to amend or extinguish a third party right created in this manner.”<sup>4</sup> Any uncertainty as to the continuing authority of the case of *Love v Amalgamated Society of Lithographic Printers of Great Britain and Ireland*<sup>5</sup> is obviously unhelpful in this regard.

## Company groups

3.4 In August 2010 Douglas Mathie, then of Brodies LLP, specifically called upon the Scottish Law Commission to reform third party rights in Scots law, his main concern being what he termed the “group loss v. single group contracting entity” problem.<sup>6</sup> Mr Mathie illustrated this issue by way of an example: if a bank has a complex group structure, and suffers a loss due to problems caused by a supplier's failure to provide an effective computing system, the supplier can potentially use the defence of only contracting with one member of the group, leaving the companies in the group which did not directly contract with the supplier without a remedy. Further, the group member with a remedy can recover only its own losses.

3.5 Mr Mathie felt it to be relatively simple to prevent such a situation through use of the 1999 Act. He indicated that Scots law is “massively inflexible” in comparison, the key point being that “once you create a third party right under an IQT [*sic*] it can be very difficult to amend it or kill it”.<sup>7</sup> In other words, the irrevocability of the third party right is a problem in the sense that, once the right is created, the parties cannot vary or cancel it. By contrast the 1999 Act 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. Mr Mathie noted:

“Recently I had a contract that had to be Scots law, but also needed to create flexible third party rights. The 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.”<sup>8</sup>

3.6 Providing for different issues within a single case or transaction to be governed by different laws is known as *dépeçage* in international private law. It is recognised and permitted in contracts under the Rome I Regulation.<sup>9</sup> It is generally accepted, however, that whilst *dépeçage* can offer a certain flexibility and adaptability, a degree of caution should be exercised in deploying the doctrine. It cannot be used to circumvent the mandatory rules of the system the laws of which would otherwise apply. Commenting on the equivalent provision in the Rome Convention 1980 (the predecessor of the Rome I Regulation), Professors Giuliano and Lagarde also point out that “the choice must be logically consistent, i. e. it must relate to elements in the contract which can be governed by different laws without giving rise to contradictions”.<sup>10</sup> The consensus amongst commentators is that parties should strive for unity of the contract in terms of the laws to which its rights and obligations

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<sup>4</sup> Lindsays LLP Bulletin, November 2012 (see fn 1 to para 3.1 above).

<sup>5</sup> 1912 SC 1078.

<sup>6</sup> D Mathie, *Third Party Rights – Scots Law Stuck in the 17<sup>th</sup> Century*, 2010 (see fn 1 to para 3.1 above).

<sup>7</sup> *Ibid.*

<sup>8</sup> *Ibid.*

<sup>9</sup> Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations (Rome I) Art 3(3).

<sup>10</sup> See the Report on the Rome Convention on the Law Applicable to Contractual Obligations, prepared by Professors Mario Giuliano and Paul Lagarde, accessible in the Official Journal of the European Communities, 31.10.80, at C282/17(4).

are subject to wherever possible.<sup>11</sup> An obvious difficulty is that a Scottish court has no judicial knowledge of English law and therefore any term of a contract governed by English law in a Scottish case has to be subject to detailed averment and proof by the party relying on it. That would entail possible delay and expense in the event of any action seeking to enforce the term in Scotland. Thus, the *dépeçage* solution may be undesirable both in principle and in practical effects. The difficulty identified by Mr Mathie could most readily be avoided in future if there was appropriately modernising legislation on third party rights in Scots law.

3.7 Another alternative solution where contracting parties wish to confer rights upon others is to make the contract multi-partite, ie make all parties involved party (or privy) to the contract. Lindsays LLP mention this as one alternative to using the JQT.<sup>12</sup> The practical difficulty here is the need for all parties involved to participate in the execution of the document. That practical difficulty may be reduced once the proposals in our Report on Execution in Counterpart are implemented by the Scottish Parliament.<sup>13</sup> But, as Professor Beale points out, the interests of some of the parties involved in such cases are only in being sure that the agreement is properly carried out.<sup>14</sup> In England, the 1999 Act is thought of as a viable and useful replacement of such multi-partite agreements.<sup>15</sup> The contract need only be executed by the principal parties, and the third party or parties need do no more to have their rights. One common example is where a company contracts for IT maintenance: in this case, a single company will often contract for the service with the intent that the benefits under the contract are to be enjoyed not just by itself but by all the companies in its group.<sup>16</sup>

3.8 Similarly, the 1999 Act enables the sharing of intellectual property licence rights within company groups.<sup>17</sup> It is common for a company to take out licences to use particular intellectual property rights for both itself and the other members of its group, and, in such situations, the 1999 Act is often used to extend to the other companies not only the right to use the intellectual property in question, but also the associated warranties from the licensor, and any indemnification for the authorised users against liability to third parties for infringement.<sup>18</sup> Flexibility is thereby created in relation to all aspects of the licence, from use of the intellectual property to any liabilities arising from that use.

3.9 It may also be noted that a doctrine of third party rights which allows for the creation of such rights in favour of parties not yet in existence at the time of the contract, as do present Scots law and the 1999 Act, is also of considerable utility in the context of company groups.<sup>19</sup> It is commonplace for new companies to be created within such groups. To take Mr Mathie's bank example again, it is possible to create rights that will extend to new companies in the group when they come into being so that they can acquire rights against the group's software supplier. But the dissolution of existing companies within the group is equally commonplace. The problem then arising is the revocability of these companies'

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<sup>11</sup> See, eg, P A Karrer and A C Imhoff, "Party Autonomy in International Arbitration in Switzerland: Scope and Specific Limitations" (1997) 3 *International Business Law Journal* 353, 357, 359; J Betto, "International Sub-Contracts: How to Exclude the French law of 1975" (1999) 4 *International Business Law Journal* 411, 420.

<sup>12</sup> Lindsays LLP Bulletin, November 2012 (see fn 1 to para 3.1 above).

<sup>13</sup> SLC No 231, 2013.

<sup>14</sup> Beale, "Review", p 245.

<sup>15</sup> *Ibid.*

<sup>16</sup> *Ibid.*, p 244.

<sup>17</sup> *Ibid.*, p 243.

<sup>18</sup> *Ibid.*, p 244.

<sup>19</sup> See paras 2.29-2.32 above, and s 1(3) of the 1999 Act.

rights so that the *Carmichael* argument that there never were such rights in the first place can be raised. An answer to the question may be provided by the case of *Love* (ie the third party right is good where a contract creates revocable rights in favour of a third party which have not been in fact revoked at the point in time where the question of enforcing the right arises); but, as we have seen, it is not clear at the moment how far the authority of that case can be taken.

3.10 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, and we now turn to look at some of these.

(1) *Transferred loss in construction contracts*

3.11 The JQT has been referred to in several cases involving groups of companies and so-called 'transferred loss' or 'black-hole' damages claims arising from construction contracts.<sup>20</sup> The typical scenario has been where one company in a group (A) contracts with a construction firm (C) to build or carry out repairs to a building which is owned by another company in the group (B). The work is undertaken defectively, causing loss. The loss, however, is incurred, not by A, the party with the right to sue C for breach of contract, but by B, the building owner. B's loss, therefore, is not recoverable in contract nor, being economic in nature, is it recoverable in delict (or tort, in England). On the other hand, A, the party with the right to sue for breach of contract, has no loss for which it can recover damages. The 'black hole' is that the party with the loss has no right, while the party with the right has no loss.

3.12 In a line of decisions the House of Lords developed a solution for these problems by which A is allowed to include within its claim of damages against C for breach of contract a sum representing B's loss – a 'transferred loss' claim. It is thought that if necessary B also has a claim against A for the money so recovered, but the nature and basis of that claim remains unresolved. Nonetheless, in one of the House of Lords cases, a Scottish Law Lord, Lord Clyde, stated:

"At the heart of the problem is the doctrine of privity of contract which excludes the ready development of a solution along the lines of a *jus quaesitum tertio*. It might well be thought that such a solution would be more direct and simple. In the context of the domestic and familial situations, such as the husband instructing the repairs to the roof of his wife's house, or the holiday which results in disappointment to all the members of the family, the *jus quaesitum tertio* may provide a satisfactory means of redress, enabling compensation to be paid to the people who have suffered the loss. Such an approach ... may also be available in Scotland (*Carmichael v. Carmichael's Executrix* 1920 SC (HL) 195)."<sup>21</sup>

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<sup>20</sup> In addition to the construction cases cited and discussed in this section, see the professional negligence cases raising the same general issue: *Marquess of Aberdeen and Temair v Turcan Connell* [2008] CSOH 183 and *Upton Park Homes Ltd v Macdonalds Solicitors* [2009] CSOH 159. Another construction case involving a company group in which the transferred loss issue was touched upon but not investigated in detail is *The Harbro Group Ltd v MHA Auchlochan* [2013] CSOH 8; rev'd [2014] CSIH 14. We expect to investigate remedies for transferred loss in a forthcoming DP on remedies for breach of contract.

<sup>21</sup> *Alfred McAlpine Construction Ltd v Panatown Ltd* [2001] 1 AC 518, 534-535.

3.13 Lord Clyde's suggestion was taken up in Scotland in the sheriff court case of *Clark Contracts v Burrell (Construction Management) Ltd (No 2)*,<sup>22</sup> where Sheriff J A Taylor held (in the nomenclature that we have adopted above) that A and C's contract was intended to confer an enforceable right upon B, which could accordingly claim damages for its loss. There was thus no need in the case for a 'transferred loss' claim by A. The point was, however, not fully argued before Sheriff Taylor, and in the slightly later Outer House case of *McLaren Murdoch & Hamilton Ltd v Abercromby Motor Group Ltd*,<sup>23</sup> Lord Drummond Young took a different view, expressed as follows (citations omitted):

"[39] In Scots law, the *jus quaesitum tertio* may clearly provide a remedy in a significant number of cases. If, for example, a man concludes a contract for a holiday on behalf of himself, his wife and his children, the requirements of the *jus quaesitum* will almost certainly be met, and the individual members of the family will then be able to sue for their own losses. The *jus quaesitum tertio* is of limited utility, however, owing to certain of the restrictions that have been built into its application. In the first place, the parties to the contract must intend to benefit the third party. In the second place, the third party who is to benefit must be identified in the contract. These restrictions would exclude from the application of the *jus quaesitum tertio* any case in which one party to a contract was unaware that the other intended to benefit a third party, such as a member of his family or a company in the same group. They would also exclude any case where the contract was for work on a particular property which was thereafter transferred to a third party. For these reasons the *jus quaesitum tertio* in its present form is of relatively limited utility in dealing with the problem of the legal black hole. No doubt the applicability of the principle might be extended by removing the two restrictions referred to above, but that is clearly beyond the competence of the Outer House. In any event, while it is always tempting to develop solutions to legal problems by extending the existing institutions of Scots law, it is not obvious that the *jus quaesitum tertio* is appropriate for such extension by removing the two restrictions referred to above. Both restrictions are founded on the fundamental principle that the terms of a contract must be based on the parties' agreement; that is why the parties must intend to benefit the third party and identify him sufficiently in their agreement. Consequently it does not seem appropriate that a contract should confer a direct benefit on any person who was not contemplated by the parties as a beneficiary at the time when they entered into their agreement. For these reasons I am of opinion that the *jus quaesitum tertio*, at least as it has developed in Scots law, is incapable of providing a general solution to the problem of the legal black hole."<sup>24</sup>

3.14 If the JQT is to provide a solution to what is otherwise this 'black hole' of non-liability, it seems clear that the principal contract must identify a third party company or companies in the group in some fashion, and it must be objectively clear that the parties to the contract intend that third party or parties to have a right enforceable by way of a damages claim for defective performance. Again, however, the really critical legal question will be, not so much these tests as mentioned by Lord Drummond Young (about which the parties should be able to negotiate), but rather the question of whether it is necessary for the contractual provision

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<sup>22</sup> 2003 SLT (Sh Ct) 73.

<sup>23</sup> 2003 SCLR 323.

<sup>24</sup> *McLaren Murdoch & Hamilton Ltd v Abercromby Motor Group Ltd* 2003 SCLR 323, 343.

in favour of the third party somehow to be made irrevocable before any right can come into existence at all.

## (2) Indemnities

3.15 Another case involving company group structures in which an argument based on JQT was presented, albeit unsuccessfully, is *Strathford East Kilbride v HLM Design*.<sup>25</sup> Ford Motor Company (F) contracted with HLM Design, a firm of architects, to design and supervise the construction of a dealership facility. Strathford (SF), a company affiliated with F, was to lease the premises and operate the dealership after construction was complete. F's contract with HLM provided that the "Owner" was to be "indemnified by HLM against all costs, charges and expenses arising from actions of HLM including but not limited to inaccuracies of design which necessitate corrective or remedial work". "Owners" was defined twice in the contract: (1) as F; (2) as including "F, its affiliates and/or subsidiaries". SF raised an action against HLM in which it averred the appearance in the facility of significant structural defects caused by HLM's negligence. The claim was based on delict and also upon an indemnity claimed by SF on the basis of a JQT, as a party included within the definition of "Owner" in the contract. Lord MacLean refused both claims, holding that HLM did not owe a duty of care in respect of the financial loss suffered by the pursuers, and that in the contract "Owner" meant whichever party concluded the contract with HLM and was not intended to create a JQT in favour of SF. But his decision was essentially on the interpretation of the contract before him and not a rejection of any possible applicability of JQT in the network of construction and development contracts manifested in the case. In particular, there appears to have been no issue raised about irrevocability.

3.16 In North Sea oil drilling contracts, there are usually cross-indemnities between companies and contractors which are intended to apply to other companies in the group, subcontractors, employees etc. It is often difficult to ascertain at the start of a project which members of a group of companies (or subcontractors, or employees) will operate on a particular platform.<sup>26</sup> Whilst careful drafting will allow the relevant parties to be sufficiently identified for the purpose of third party rights, Professor McBryde comments that "no draftsman is a prophet, and the unforeseen may happen."<sup>27</sup> This view is supported by Lindsays LLP, who have criticised the *jus quaesitum tertio* doctrine on account of the fact that the third party must be named or identifiable as part of a defined group of persons, citing this as a reason why the doctrine is "inflexible".<sup>28</sup> This is the basis for their critique of the proposition that in Scots law contracting parties must intend to confer a benefit on the third party, not just a simple interest.

3.17 Yet, it is not entirely clear why the third parties in such scenarios cannot be identified as members of a class of persons. This would allow for (in the case of the North Sea situation above) a class of persons to be defined as, for example, "all subcontractors, present and future". Another solution may be for the contract to provide for the contracting parties to nominate or authorise/permit or otherwise later identify persons to be holders of

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<sup>25</sup> 1997 SCLR 877 (Lord MacLean).

<sup>26</sup> McBryde, *Contract*, para 10.19. The example was first discussed in LC No 242, 1996, para 8.3.

<sup>27</sup> McBryde, *Contract*, para 10.19.

<sup>28</sup> Lindsays LLP Bulletin, November 2012 (see fn 1 to para 3.1).

third party rights, as in the House of Lords decisions, *Thomson v Thomson*<sup>29</sup> and *Kelly v Cornhill Insurance Co Ltd*.<sup>30</sup>

3.18 It does seem, however, that if the solution was as simple as relying on identification by class, the 'group loss' issue already discussed above would not be thought of as practically problematic. There may be also be a difficulty that third parties identified by way of membership of a class must be such at the time the contract is formed, and the difficulty is not necessarily solved by the possibility of conferring a prospective right on an as yet non-existent person; in this scenario the person exists without yet being a member of the class. An example might be a company that is in existence at the time the contract containing the third party right term has been concluded, but does not become a sub-contractor until later. Another difficulty may be that the use of labels such as 'sub-contractors' to identify a class may turn out to be a limitation in not reaching all the third parties who should be covered. Again this may perhaps be met by setting out not a label defining a class, but rather the factual conditions upon which a third party becomes entitled to an indemnity under the contract.<sup>31</sup>

### (3) Restrictive covenants across a company group

3.19 Finally, yet another company group scenario within which third party rights may be deployed is set out in the *SME*:

"There have been a number of cases in which employees have been taken bound upon leaving their employers not to act so as to compete with or damage the interests of, not only the employer, but also the employer's associated or subsidiary companies. The Scottish courts have not yet ruled on whether such a provision in a restrictive covenant may give to such an identified third person other than the employer a title to sue for breach of the covenant. If the argument advanced above with regard to exclusion clauses — that the doctrine of *jus quaesitum tertio* may extend to negative benefits — is accepted, then it may also be applicable to restrictive covenants which seek to protect third parties from the damaging activities of persons formerly employed by an associated person. This would give the third party a title to sue for infringement and obtain interdict and/or damages, as appropriate."<sup>32</sup>

It is worth noting at this point that the 1999 Act would probably not be able to deal with this kind of case, because contracts of employment are excluded from its scope.<sup>33</sup>

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<sup>29</sup> *Thomson v Thomson* 1962 SC (HL) 28 (discussed at para 2.26 above).

<sup>30</sup> *Kelly v Cornhill Insurance Co Ltd* 1964 SC (HL) 46 (discussed at paras 2.27 and 2.73 above).

<sup>31</sup> See paras 2.27-2.28 above.

<sup>32</sup> *SME* Vol 15, para 849 (footnotes omitted). Para 849 continues (citations supplied): "It is, of course, another question whether a covenant seeking to protect the interests of a third party as well as those of the covenantee is unenforceable because it is not reasonable. In *Group 4 Total Security Ltd v Ferrier* [1985 SC 70] the Lord Ordinary (Lord Ross) thought that in the context of a group of companies it might be reasonable to look to protect the interests of the group as a whole. On appeal the Second Division thought it necessary to wait to a later stage of procedure before pronouncing on the reasonableness of such a clause, and this approach was also taken in the later case of *WAC Ltd v Whillock* [1990 SLT 213]."

<sup>33</sup> Contracts (Rights of Third Parties) Act 1999 s 6. See further at para 8.4 below.

2. Are there other situations involving company groups beyond those identified in paragraphs 3.4-3.19 in which third party rights might be of use to contracting parties?

### Construction projects and collateral warranties

3.20 Collateral warranties are most commonly found in construction contexts. They provide a solution to a problem arising from a strict approach to privity of contract. For example, a building developer may conclude 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 architect's work. The purchaser of one of the flats, however, will often be protected by a separate collateral warranty made by the architect in the purchaser's favour. 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.<sup>34</sup> Collateral warranties will often also be sought from sub-contractors and suppliers of materials for the project. They can also be used as a way of preventing the occurrence of the problem of "transferred loss", already discussed above.

3.21 Although there is some uncertainty as to exactly what constitutes a collateral warranty in Scots law (an uncertainty recently explored in, but not eliminated by, a discussion in the Second Division of the Court of Session),<sup>35</sup> it has been noted by Macroberts LLP that collateral warranties are preferred in Scottish legal practice (as opposed to use of the *jus quaesitum tertio* doctrine) due to the perceived weakness of Scots law on third party rights.<sup>36</sup> This has also been mentioned by Gateley LLP<sup>37</sup> and Brodies LLP.<sup>38</sup> Collateral warranties are common in Scottish legal practice, and are used frequently in the context of construction contracts such as that described above, as well as, for example, in leases in shopping centres,<sup>39</sup> in which context the collateral warranties tend to provide that the tenants of individual properties in the shopping centre can claim for defects in the properties against the developer of the site, who would otherwise only have a direct contractual relationship with the owner of the centre (the tenants' landlord). The utility of collateral warranties can also be seen in a number of 'community of interest'-type cases.<sup>40</sup>

3.22 Collateral warranties, however, raise practical problems, as expressed in a blog published by Brodies LLP:

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<sup>34</sup> The Joint Contracts Tribunal, *Collateral Warranties*, accessible at: <http://www.jctltd.co.uk/category/collateral-warranties>. See also Beale, "Review", p 240.

<sup>35</sup> *Royal Bank of Scotland plc v Carlyle* [2013] CSIH 75, commented upon by M Hogg in his Obligations Law blog, accessible at: <http://www.obligations.law.ed.ac.uk/2013/09/17/promises-assurances-and-collateral-warranties-new-judicial-observations/>. It is understood that the case is to be taken to the UK Supreme Court.

<sup>36</sup> Macroberts LLP Bulletin, July 2011, accessible at: <http://www.macroberts.com/images/JCTNewsJuly11SMFWrkingNrhOfBorderJCTSBCCContractDiff.pdf>. See also M Macauley, "Warranted Inferences" (1999) *Building* (Issue 09), accessible at: <http://www.building.co.uk/professional/legal/warranted-interference/8160.article> (requires subscription).

<sup>37</sup> Gateley LLP *Construct*, Autumn 2011, accessible at: <http://www.gateleyuk.com/news-and-events/publications/item/construct-autumn-2011/>.

<sup>38</sup> 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>.

<sup>39</sup> See, eg, *Macdonald Estates Plc v Regensis (2005) Dunfermline Ltd* 2007 SLT 791.

<sup>40</sup> See, eg, *The Scottish Coal Company Ltd v Trs of Fim Timber Growth Fund III* [2009] CSOH 30.

“The time and cost implications of issuing collateral warranties can be considerable. Even on a traditional project there could be six consultants and a main contractor. If collateral warranties are required for a funder, purchaser and tenant, this means that the developer will have to negotiate, produce and circulate twenty one collateral warranties. Where sub-contractor collateral warranties are required, there are even greater logistical difficulties.”<sup>41</sup>

3.23 Our Advisory Group told us that collateral warranties are often sought after the primary contract or contracts have been performed, and that there can be considerable difficulty in getting the documents executed by parties who feel that their involvement with the project is over and that the warranties will simply increase the risk of liability to parties with whom they did not contract. For example, where a building has several different tenants, as will commonly be the case in commercial developments, separate warranties must be issued for every tenant, and this process, especially when conducted after the contract has been performed and during the letting of the building, is both time consuming and vulnerable to omission by oversight.<sup>42</sup>

3.24 Such difficulties could be somewhat eased were the primary contracts and sub-contracts to include within their texts the warranties expressed as rights for third parties such as the future tenants of the development. A possible (albeit unsuccessful) example of an attempt to achieve such an outcome may be apparent in the case of *Strathford East Kilbride v HLM Design*, described in the previous section of this Chapter.<sup>43</sup> When the 1999 Act came in, Mark Macaulay of Maclay Murray & Spens LLP suggested that either it be extended to Scotland to offer more certainty in the field of third party rights in construction contracts, or, preferably, the existing Scots law be clarified.<sup>44</sup>

3.25 Professor Beale in 2010 noted a recent change in England & Wales in which some of the standard forms of building contract had developed third party right forms taking advantage of the 1999 Act as an alternative to the established collateral warranty forms. The Scottish Building Contract Committee has published forms of collateral warranties and also, since 2005, for effectively the same thing achieved by way of third party rights within a building contract. In the third party rights form, the rights may be conferred on prospective purchasers and tenants of the development as well as upon its funders; but the form makes no direct provision for the irrevocability of the right. As in England & Wales (according to Professor Beale),<sup>45</sup> there does not appear to be a form giving employers third party rights against sub-contractors although there are collateral warranty forms for that situation.

3.26 Our understanding is, however, that in general the collateral warranty forms continue to be used much more commonly in practice.<sup>46</sup> As Richard Pike of Stephenson Harwood LLP notes:

“Significantly, third party rights have not been fully embraced by banks and other funders of construction projects. As banks provide the finance they are able to set

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<sup>41</sup> See fn 38 to para 3.21 above.

<sup>42</sup> Beale, “Review”, p 243.

<sup>43</sup> *Strathford East Kilbride v HLM Design* 1997 SCLR 877 (Lord MacLean); discussed at para 3.15 above.

<sup>44</sup> M Macaulay, *Third Party Rights in Scotland and England: Converging or Diverging Law?* 1999 SLT (News) 111-113.

<sup>45</sup> Beale, “Review”, p 241.

<sup>46</sup> H Jones, “Collateral Warranties: Claims are on the Increase” (7 October 2013) *Construction News*.

the form of protection they require. If this is in the form of a collateral warranty then it is logical to use these in respect of all interested parties throughout the project.”<sup>47</sup>

But Scottish practice may change if third party right forms become used more often south of the border. Professor Beale notes evidence that this is happening in ‘big City projects’,<sup>48</sup> and that “[t]he British Property Federation has made the Act its default mechanism to create third party rights under its recently introduced Consultancy Agreement”.<sup>49</sup> It should not be assumed that practice is uniform, or that what happens today will necessarily continue tomorrow or into the indefinite future. There are issues about the meaning of terms commonly found in collateral warranties, such as the “net contribution” and “no greater liability” clauses which have recently been the subject of litigation in the Outer House of the Court of Session.<sup>50</sup>

3.27 A relevant development in England & Wales as we prepared this Discussion Paper was the decision of the Technology and Construction Court of the Queen’s Bench in *Parkwood Leisure Limited v Laing O’Rourke Wales Limited* that collateral warranties are construction contracts so that disputes arising under them are subject to the procedure of adjudication and mandatory rules about payments under the Housing Grants, Regeneration and Construction Contracts Act 1996.<sup>51</sup> This outcome is seen to be problematic, and Peter Scurlock of Eversheds LLP has accordingly suggested, on the basis that “whilst a third party beneficiary’s rights are conferred directly by the relevant construction contract, any such third party is, by definition, not a party to that contract”, that

“[T]he “better the devil you know approach” to favouring collateral warranties over third party rights is no longer viable; this is because, as it turns out, no-one actually knew what they dealing with when it came to collateral warranties. Third party rights, on the other hand, confer all the benefits of collateral warranties without the potential uncertainties inherent in predicting whether or not the Construction Act will apply. When this is added to the inevitable cost savings and reduction in administrative hassle that will result from avoiding the usual warranty paper chase, the case for preserving the status quo of collateral warranties is rapidly diminishing. After 14 years, third party rights may finally have their day.”<sup>52</sup>

Other practitioners of course simply take the view that the case is either special on its facts (the warranty in question was granted while the construction project was in progress rather than as usual after its completion), or wrong and liable to be reversed on appeal or by a later

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<sup>47</sup> R Pike, “Collateral Warranties and Third Party Rights” (2012) *Construction Newsletter*, 6-7.

<sup>48</sup> Beale, “Review”, p 243 (citing A Minogue, “Know Your Rights” (2006) *Building* (Issue 47)).

<sup>49</sup> Beale, “Review”, p 241 (citing F Ho, “Third Way” (2006) *Solicitors Journal* 150, 151). See also Olswang LLP, Legal and Regulatory News, December 2009, accessible at: <http://www.olswang.com/articles/2009/12/managing-construction-risk-in-development-agreements-december-2009/>.

<sup>50</sup> See respectively *Royal Bank of Scotland plc v Halcrow Waterman Limited* [2013] CSOH 173 (commented upon by Lindy Patterson QC of Dundas and Wilson LLP, December 2013, accessible at: [http://www.dundas-wilson.com/publications/dw\\_cms\\_10212.pdf](http://www.dundas-wilson.com/publications/dw_cms_10212.pdf)); *Friends Provident Life Assurance Ltd v Sir Robert McAlpine Ltd*, argued before Lord Woolman in November 2013. Net contribution clauses limit the granter’s liability to that share of the claiming party’s loss for which it is to blame (ie seek to exclude the possibility of joint and several liability), while no greater liability clauses limit the granter’s liability to the beneficiary of the warranty to what would have been its liability under the principal contract or sub-contract under which the granter actually performed. Such clauses also appear in the SBCC third party rights forms.

<sup>51</sup> *Parkwood Leisure Limited v Laing O’Rourke Wales Limited* [2013] EWHC 2665 (TCC).

<sup>52</sup> [http://www.eversheds.com/global/en/what/articles/index.page?ArticleID=en/Property\\_and\\_Construction/Propcos\\_briefing\\_third\\_party\\_rights](http://www.eversheds.com/global/en/what/articles/index.page?ArticleID=en/Property_and_Construction/Propcos_briefing_third_party_rights) (published 11 December 2013).

court.<sup>53</sup> Its implications for future use of third party rights under the 1999 Act may therefore not be quite so dramatic as suggested by Peter Scurlock. Only time – and further litigation – will tell.

3.28 None the less, allowing parties a proper choice between collateral warranties and third party rights, as in England & Wales, seems to be commercially expedient. As one member of our Advisory Group put it, “collateral warranties are not free from uncertainty”,<sup>54</sup> and third party rights can provide a useful alternative in both practical and legal terms. Of course, parties wishing to rely on collateral warranties instead of third party rights should not be precluded from doing so by any third party rights legislation. Indeed, Professor Beale points out that one potential drawback of using the 1999 Act is its dependence upon the contractor and sub-contractor’s ability to determine at the outset what rights all third parties will get in the event of a breach. In contrast, different warranties can be issued much later to different purchasers or tenants according to their bargaining power and the current state of the market, as well as any other commercial considerations relevant at the time.<sup>55</sup>

3. **Do consultees agree that collateral warranties are currently relied on rather than third party rights in Scots law? If so, is this problematic in practical terms? Would a modern set of rules on third party rights be utilised in place of collateral warranties should such rules be introduced?**

### **Other uses of third party rights legislation**

3.29 In addition to the foregoing, Professor Beale discusses a number of commonplace commercial contexts in which third party rights can be used to the benefit of all parties involved.<sup>56</sup>

#### *Insurance*

3.30 Numerous insurance contracts are intended for the benefit of third parties.<sup>57</sup> For example, in a life insurance contract, A and B may contract to provide that in the event of A’s death, B (the insurer) will pay a certain sum to C, A’s spouse. Prior to the 1999 Act, however, such third parties had no direct rights against the insurers in England & Wales unless there was a specific statutory exception in their favour – for example, under the Fire Prevention (Metropolis) Act 1774, the Married Women’s Property Act 1882, and the Road Traffic Act 1948.<sup>58</sup> As the Law Commission for England and Wales pointed out in its Report leading up to the 1999 Act, this left many standard kinds of insurance policies protective of third party interests unable to be enforced by those third parties: for example, life insurance policies for the benefit of dependants other than spouses and children (cohabitants and step-children, for instance); insurance taken out by companies to cover subsidiaries or their contractors and sub-contractors; and employers taking out private health insurance for their

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<sup>53</sup> See <http://www.mills-reeve.com/pubs/xpqPublicationDetailMR.aspx?xpST=PubDetail&pub=1647> (published 16 December 2013).

<sup>54</sup> Garry Borland, Advocate.

<sup>55</sup> Beale, “Review”, p 243.

<sup>56</sup> See Beale, “Review”, *passim*; Sutherland and Johnston, “Contracts for the Benefit of Third Parties”, pp 234-237.

<sup>57</sup> Beale, “Review”, pp 235-239.

<sup>58</sup> Beale, “Review”, p 235.

employees.<sup>59</sup> Professor Beale has noted with concern that the 1999 Act is often excluded in the context of insurance contracts, although if nothing at all is said on the matter then, provided its requirements are otherwise met, the Act applies.<sup>60</sup>

3.31 Third party rights in insurance contracts must by contrast always have been possible in Scots law provided that the policies in question met the requirements for the existence of a JQT.<sup>61</sup> There are, however, surprisingly few Scottish cases about insurance and JQT apart from *Carmichael v Carmichael's Executrix*<sup>62</sup> and *Kelly v Cornhill Insurance Co Ltd*<sup>63</sup> – surprising because in other jurisdictions third party rights doctrine is often said to have first become really significant in practice as a result of the rise of insurance in the nineteenth century,<sup>64</sup> and Scotland was at that time a major insurance centre through such well-known institutions as Standard Life and Scottish Widows. In Scotland, as in England & Wales, statute added what amounts to safeguards for third parties beyond the scope of JQT, usually to protect the third party's claim against those of other creditors of an insolvent contracting party.<sup>65</sup> We are not aware of any practice of excluding the JQT in insurance policies issued subject to Scots law.

3.32 Legislative clarification on the ability of third parties to enforce terms of insurance contracts in their favour may thus be less likely to create concern in Scotland than it has in England & Wales. Reinforcement of the third party's position through general legislation will allow for greater certainty in this context. Insurers will of course remain free to exclude third party rights in general (they will, however, remain subject to the mandatory rules found in other more specific legislation), although we find it difficult to see the commercial sense in denying rights to the third parties for whose benefit the policies in question are otherwise clearly intended.<sup>66</sup> In some cases, of course, the third party rights may turn out to be contractual: for example, the Law Society of Scotland enters with insurers the Master Policy for Professional Indemnity Insurance for the benefit of its member firms ("practice units"), but since each firm pays its duly calculated share of the global premium for the Policy the rights of each depend upon its own contract with the insurers. The overall structure of the Master

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<sup>59</sup> LC No 242, 1996, para 3.25.

<sup>60</sup> Beale, "Review", p 236.

<sup>61</sup> Note, however, Gloag, *Contract*, p 235: "A member of the public, as such, acquires no right to sue merely on the ground that the contract contains provisions which, if carried into effect, would be beneficial to him. On this ground, it may be suggested, the Scotch Courts would follow the English decision that where the owner of a motor car had insured against third party risks, a person who had been injured by him had no title to sue the insurance company, and, in the bankruptcy of the insurer, had no specific or preferable claim to the money which the company had paid." The English cases were *In re Harrington Motor Co* [1928] 1 Ch 105 and *Hood's Trs v Southern Union Insurance Co* [1928] 1 Ch 793, the results of which were, however, reversed a year after Gloag's comment was published, by the Third Parties (Rights against Insurers) Act 1930 (still in force but due to be replaced by the Third Parties (Rights against Insurers) Act 2010). In *Allan's Trs v Lord Advocate* 1971 SC (HL) 45 the insurance policy provided for payment to the insured to be held in trust for the third party. This was correctly held not to amount to a JQT, although a trust was constituted. Whether this was a typical arrangement in Scottish insurance policies is not known to us.

<sup>62</sup> 1920 SC (HL) 195.

<sup>63</sup> 1964 SC (HL) 46.

<sup>64</sup> J Hallebeek and H Dondorp (eds), *Contracts for a Third-Party Beneficiary: A Historical and Comparative Account* (2008), pp 84-87.

<sup>65</sup> Eg Married Women's (Policies of Assurance) (Scotland) Acts 1880 and 1980; Road Traffic Act 1988; Third Parties (Rights against Insurers) Acts 1930 and 2010 (the latter not yet in force).

<sup>66</sup> Beale, "Review", p 235 notes the damage to an insurer's commercial reputation in point-blank refusal to pay a claim because the beneficiary is not party to the contract, but draws attention to the possibility of a different attitude when insurance schemes are in "run-off", ie where no fresh business of the kind in question is being accepted. Such schemes are often transferred by the original insurer to other companies.

Policy's operation is in other words an instance of the two-contract analysis of a third party right rather than of a right conferred by one contract alone.<sup>67</sup>

### *Settlement agreements*

3.33 Professor Beale has written that a “closely related use of the [1999] Act may occur in settlement agreements.”<sup>68</sup> The use of the Act in this context is summarised as follows:

“It may not always be clear which company in a group or involved in a project is the correct defendant, or whether several defendants may be jointly and severally liable for a particular loss. Rather than join all the possible parties in any settlement of the claim, the settlement may be expressed for the benefit of all the possible defendants.”<sup>69</sup>

3.34 We do not know whether the JQT has ever been used in such a fashion in settlements in Scotland, although we think it could be. Clear legislation on third party rights in Scots law could certainly be similarly utilised in such situations.

### *Outsourcing financial services*

3.35 It is thought in England that when financial services are outsourced (sub-contracted), the firm that employs the subcontractor will be responsible for deficiencies on the work carried out, and that there is consequently no need to resort to the 1999 Act.<sup>70</sup>

3.36 Regulators may not, however, have direct control over the subcontractor, and to deal with this the 1999 Act was used to give the former Financial Services Authority<sup>71</sup> the right to demand access to and information from the firm to which the financial services work is outsourced.<sup>72</sup> This process was accomplished using the ‘MIFID Connect’ Guidelines,<sup>73</sup> which state that the firm in question must ensure access to both itself and its auditors.<sup>74</sup> The relevant competent authorities must be able to exercise their rights of access and, in order that this be so, they can be given third party rights of action in any outsourcing agreement where necessary.<sup>75</sup> Clear legislation on third party rights in Scotland would enable the Financial Conduct Authority to exercise similar powers in the context of outsourcing north of the border.

### *Community of interest cases*

3.37 In Chapter 2 we drew attention to the cases of third party rights to enforce real burdens involving co-feuars and co-disponees which have been said to be examples of JQT

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<sup>67</sup> For the two-contract analysis see paras 2.50-2.52 above. We are grateful to David Cullen, Registrar of the Law Society of Scotland, who discussed the Master Policy with us and enabled us to review the relevant contractual documentation.

<sup>68</sup> Beale, “Review”, p 234.

<sup>69</sup> *Ibid.*

<sup>70</sup> *Ibid.*, p 245.

<sup>71</sup> The Financial Services Authority has since been abolished and its former functions have, in part, been divided between two separate bodies: the Financial Conduct Authority and the Prudential Regulation Authority.

<sup>72</sup> Beale, “Review”, p 245.

<sup>73</sup> These are available on the Markets in Financial Instruments Directive website, accessible at: <http://www.mifidconnect.co.uk/guidelines>.

<sup>74</sup> Beale, “Review”, p 245.

<sup>75</sup> *Ibid.*

being found to exist on the basis of the implied intention of the original contracting parties.<sup>76</sup> While it is doubtful whether these cases are truly ones of JQT, and the law on the matter is now to be found in statute making no use of the concept of third party rights in contract, it is still possible to observe kindred situations to which that statute does not apply and which therefore potentially fall within the ambit of the common law; in particular, commercial leases in shopping centres and other similar developments where all the tenants are subject to the same basic obligations with regard to such matters as maintenance, repair and decoration of the lease subjects or common areas. If the landlord chooses not to enforce these obligations against a particular tenant, may the other tenants step in as third parties holding rights to do so?

3.38 In other jurisdictions these situations have been dealt with as exceptions to the basic rule of privity as a result of which third parties have rights to enforce contract terms. In the Canadian case of *Re Spike et al v Rocca Group Ltd et al*, an exception to the application of the principle of privity of contract is the situation of shopping centres where there is a 'community of interest' amongst the tenants. The general principles are as follows:

"Generally speaking, covenants in restraint of trade are void at common law; however, such covenants may be deemed to be lawful if in the mutual interests of the parties concerned, and not otherwise contrary to the public interest; that such covenants may be included in leases, and particularly in shopping centre leases which enure to the benefit of all tenants; that such covenants are mutually and reciprocally enforceable as between landlord and tenant, and as between tenants if it is sufficiently clear from the respective leases that a community of interest is thereby created."<sup>77</sup>

3.39 The doctrine was further refined in *Salmon Arm Pharmacy Ltd v RP Johnson Construction Ltd* by the Honourable Mr Justice Finch when he noted that consideration as to whether or not the doctrine of 'community of interest' is applicable seems to arise only where:

"(a) one tenant seeks to enforce a contractual obligation owed by another tenant to the landlord;

(b) both tenants have restrictive covenants in their leases which limit the use to which the tenants can put their premises; and

(c) both tenants have the benefit of restrictive covenants by which the landlord promises not to allow the use of any portion of the shopping centre for a purpose which competes with that of another tenant."<sup>78</sup>

3.40 *Re Spike et al v Rocca Group Ltd et al* was noted by the then Carnwath LJ in the English Court of Appeal decision of *Williams v Kiley (T/A CK Supermarkets Ltd)* but was not considered in detail.<sup>79</sup> In *Kiley*, a letting scheme was found to exist in relation to a parade of shops. In the leases of the five shops in the parade there was clear evidence of the intention to create "reciprocity of obligation" necessary for a scheme. The use covenants were not

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<sup>76</sup> See paras 2.43-2.47 above.

<sup>77</sup> *Re Spike et al v Rocca Group Ltd et al* (1979) 107 DLR (3d) 62, 66.

<sup>78</sup> *Salmon Arm Pharmacy Ltd. v R.P. Johnson Construction Ltd* [1994] BCJ No 1266 (CA), para 24.

<sup>79</sup> *Williams v Kiley (T/A CK Supermarkets Ltd)* [2002] EWCA Civ 1645, paras 8-9.

merely identical in form; each had been carefully constructed in order to dovetail with the other leases in the group of shops so as to protect each tenant against competition with his neighbours. The covenants were not directed simply to protecting the interests of the lessor. Terms in the lease for settling disputes between lessees, together with the lack of any right for the lessees to require enforcement by the lessor, also demonstrated an intention to create rights enforceable by the lessees themselves.<sup>80</sup> Scottish courts might well have been able to derive from this material in particular the implication or inference that the lessees were intended to have enforceable rights against each other. Further, the area to which the scheme applied was apparent not only from the plans to the leases, but also from the fact that references to the uses in the leases all directly related to the others in the group.<sup>81</sup>

3.41 Two observations caution against an unduly wide reading of *Kiley*. Firstly, as Carnwath LJ remarked, the leases in question contained unusually precise covenants.<sup>82</sup> A letting scheme was found having regard to the particular leases before the court and a breach was found on the particular facts of the case. Secondly, counsel for the appellant did not argue that the covenant relied upon constituted a breach of competition law, a point raised by Buxton LJ;<sup>83</sup> any similar case in the future will, arguably, turn more on questions of competition rather than contract or property law.

3.42 We understand that in practice the scope for tenants enjoying third party rights against each other in commercial developments/multi-let properties (shopping centres, industrial estates, business and retail parks) is somewhat limited. Multi-let properties are generally occupied by a range of tenants for varying durations, each with a lease on slightly different terms. Obligations imposed on tenants, on the whole, vary from case to case, according to the bargaining positions and power of the parties. Thus, one tenant may have a full repairing obligation whilst another may have a very limited one. Where there is a concern that the proposed arrangements may not deliver, there is normally scope to place additional obligations on the landlord to address the concern. For example, a tenant who is concerned as to how other tenants of the landlord will use its premises may seek additional obligations on the landlord not only imposing certain obligations on other tenants but also relating to the enforcement or procuring of performance of such obligations.

3.43 Moreover, it is questionable how any community of interest scheme would operate in practice. Leases for 20 years or less cannot be registered on the Land Register (although we understand that it is common practice with commercial short leases to register them in the Books of Council and Session).<sup>84</sup> Unless there is the ready access to the other leases by such means, it could be difficult for one tenant to establish the precise obligations owed by other tenants in the development.

3.44 Notwithstanding the foregoing, we see no reason why such commercial developments should, as a rule, be specifically excluded from third party rights law. Arrangements, as they presently operate, rely heavily on obligations owed to one party (ie the landlord) and may be vulnerable in cases where, for example, a landlord becomes insolvent, or there is some change in the overall circumstances affecting the operation of the

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<sup>80</sup> *Ibid*, paras 21-22.

<sup>81</sup> *Ibid*, paras 24-25.

<sup>82</sup> *Ibid*, para 23.

<sup>83</sup> *Ibid*, paras 47-52.

<sup>84</sup> Registration of Leases (Scotland) Act 1857, s 1.

development. It is not inconceivable that in small commercial developments certain terms of the various leases may mirror one another. Such terms will be readily identifiable if the leases are registered. 'Keep-open' clauses, the name commonly given to the obligation often seen in retail leases for a tenant to trade continuously throughout the duration of the contract, provide an example. The value of these for tenants as well as landlords is abundantly clear: they will benefit from a centre that is vibrant and attracting customers as a whole. A tenant who, however, is struggling financially or finding the particular unit not commercially viable, may seek to close operations there altogether in an effort to minimise ongoing losses or effect a disposal. Naturally, any failure by the landlord to act will concern neighbouring tenants.<sup>85</sup> Finally, the supposition that a concerned tenant may negotiate additional obligations on a landlord fails to address the scenario where a landlord is unwilling to ensure a tenant fulfils their obligations after the concerned tenant has signed their lease.

3.45 We are aware that in some residential developments deeds of conditions drawn up by the developer do at least purport to confer third party rights upon proprietors within the development to enable them to enforce the obligations in the deed against other proprietors. These may indeed use the phrase "jus quaesitum tertio" to describe what is intended. An example from Edinburgh may be found in the Deed of Conditions dated before the Title Conditions (Scotland) Act 2003 came into force and published on the Internet by the Sinclair Residents Association of Edinburgh.<sup>86</sup> This sets out to "declare various reservations, real burdens, conditions, prohibitions, declarations, obligations and stipulations incumbent respectively upon the proprietors hereinafter defined in order to create a jus quaesitum tertio in favour of them", and further provides:

"The foregoing reservations, burdens, conditions, provisions, declarations and others herein written are declared to constitute a Common Plan or Scheme with the effect of conferring on each of the Proprietors the right to enforce the said reservations, burdens, conditions, provisions, declarations and others against all other Proprietors so far as each Proprietor may in every case have a patrimonial interest so to do."

The original developer (Teague Homes (Scotland) Ltd) also reserved a "right, so long as they remain Proprietor of any part of the Development ... to alter or modify in whole or in part the foregoing conditions". This raises the question of the relationship between this clause, which would have had the effect of preventing a JQT arising,<sup>87</sup> and the express clause conferring third party rights. The rights of the other proprietors was presumably intended to take effect only after Teague ceased to be involved in the development.

3.46 The situation illustrated by this example from a residential development shows one important contrast with the commercial developments previously discussed. In the latter the landlord has a continuing interest and provides the mechanism for enforcing the tenants' obligations. In the residential development, however, the developer's plan is eventually to withdraw from the site, and when that happens enforcement of their maintenance and other obligations is for the individual proprietors. While that is not a problem-free solution, it does provide a mechanism by which the appearance and character of a development may be

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<sup>85</sup> Such clauses in the context of shopping centres were enforced by landlords bringing actions of specific implement in the leading cases of *Retail Park Investments Ltd v Royal Bank of Scotland plc* 1996 SC 227 and *Highland & Universal Properties Ltd v Safeway Properties Ltd* 2000 SC 297.

<sup>86</sup> Accessible at <http://sinclairresidents.org.uk/history/title-deeds-sinclair-close-gardens-place/>. The Deed precedes the coming into force of the Title Conditions (Scotland) Act 2003.

<sup>87</sup> See para 2.77 above.

maintained; and some of the difficulties can be obviated, as in our example, by the formation of a Residents Association which can place much of the burden of upkeep on a property management or factoring company.

3.47 The conclusion which we would provisionally draw at this stage is that there is no need in our present project to make special provision for “community of interest” cases. The Title Conditions (Scotland) Act 2003 now deals with those cases for which the common law of JQT was developed (perhaps distorted) in the nineteenth century. There is no need for us now to strive to accommodate other cases which might be thought to raise similar issues in either the commercial or other sectors. If parties to such transactions wish to make express use of third party rights, they ought of course to be free to do so. We would welcome further information on such use of the existing law of JQT and guidance on any pitfalls which a reformed law of third party rights in contract should avoid.

4. **Do consultees agree that, while parties to “community of interest” transactions should continue to be free to make use of third party rights law, there is no need to make special provision for such cases in any reform of the law?**

## Chapter 4 Concepts and Terminology

4.1 The nature of the third party right impacts in particular upon the appropriate terminology which should be associated with the right. Indeed, the very term *jus quaesitum tertio* will probably be opaque to those who have not previously studied the doctrine of third party rights (or Latin). It regrettably but certainly contributes to the perception of Scots law on this subject as “somewhat archaic”.<sup>1</sup> In this Chapter we consider the terminology of Scots law in such light as is cast by our comparator instruments: the DCFR, the PICC, the proposed CESL, and the 1999 Act. Our aim is to produce a modern terminology capable of comprehension by those without a high level of legal knowledge, in line with our commitment to producing law which is easy to understand.

### Rights and benefits

DCFR	PICC	CESL	Contracts (Rights of Third Parties) Act 1999
<p>II. – 9:301: Basic rules</p> <p>(1) The parties to a contract may, by the contract, confer a <i>right or other benefit</i> on a third party.</p>	<p>Article 5.2.1</p> <p><i>Contracts in favour of third parties</i></p> <p>(1) The parties (the “promisor” and the “promisee”) may confer by express or implied agreement a <i>right</i> on a third party (the “beneficiary”).</p>	<p>Article 78</p> <p><i>Contract terms in favour of third parties</i></p> <p>1. The contracting parties may, by the contract, confer a <i>right</i> on a third party.</p>	<p>Section 1: Right of third party to enforce contractual term.</p> <p>(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 <i>right</i> 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.</p>

4.2 The Latinity of the *jus quaesitum tertio* has often entailed some imprecision in the English language terminology for the institution. While *jus* is most readily translated in this context as ‘right’, it is not uncommon for discussions to proceed in terms of the contract conferring a ‘benefit’ upon a third party, with the question thereafter being whether or not the benefit in question is incidental rather intentional on the part of the contracting parties, with the right arising only if these parties so intend.<sup>2</sup>

<sup>1</sup> The words of Garry Borland, Advocate, a member of our Advisory Group.

<sup>2</sup> Gloag, *Contract*, p 235; McBryde, *Contract*, paras 10.10-10.11; *SME* Vol 15, para 835.

4.3 The DCFR, PICC, and the proposed CESL speak in terms of the contracting parties' active *conferral* of a *right* on the third party. This implies, however, that, as with any juridical or juristic act, intention to confer the right in question is necessary. Yet, determining the existence of the intention should simply be a matter of the interpretation of the contract in accordance with the usual rules on that subject.

4.4 Provision to the effect that there must be intention on the part of the contracting parties to provide the third party with a *right* also makes clear that those who *incidentally* benefit from a contract are not able to enforce its terms unless the contracting parties have provided for this in advance. We think that the mere fact of a third party benefit from a contract should not be by itself enough to create a right; 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. This is a simpler way to deal 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. We have noted the concerns expressed by Lindsays LLP on this point as cited in Chapter 3,<sup>3</sup> but think that the problem highlighted by the firm can be better dealt with in the rules concerning identification of third parties, to be discussed below.<sup>4</sup>

4.5 The DCFR may seem to muddy the waters on the contracting parties' intention by providing for the possibility of conferring a benefit other than a right. But the approach here is not so much to broaden the scope for third party rights as to prevent argument about what can amount to a right. The DCFR commentary on this point explains:

"The word 'right' alone might not be read as covering for example the benefit of an immediate renunciation of a right against the third party, or the benefit of a limitation of liability clause in favour of the third party, or the benefit of an immediate grant of permission or authority to a third party. It might also be open to argument that a 'right' which is available or removable at the sole discretion of someone else is not really a right so much as a mere expectation or interest. The use of the word 'benefit' avoids these problems."<sup>5</sup>

4.6 We have, however, already 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.<sup>6</sup> We deal further below with the policy question of whether it is desirable that such clauses should be allowed to take effect to protect third parties from liabilities that might otherwise arise.<sup>7</sup> The benefit of a right renounced seems also to fall into the Hohfeldian category of an immunity, while there seems no reason why the third party who has received an immediate grant of permission or authority from one or other of the contracting parties should not be seen as thereafter having a right to do what has been so permitted or authorised. An example of the latter may indeed be seen in the case of *Kelly v Cornhill Insurance Company Ltd* described in Chapter 2, in which a third party right was recognised without difficulty by the court.<sup>8</sup> As we have also sought to explain in Chapter 2,

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<sup>3</sup> See para 3.16 above.

<sup>4</sup> See paras 5.3-5.15 below.

<sup>5</sup> DCFR Vol 1, p 616 (section A).

<sup>6</sup> See para 2.25 above.

<sup>7</sup> See paras 5.22-5.25 above.

<sup>8</sup> See paras 2.27 and 2.73 above.

the law already recognises in many areas that a right may be created despite remaining subject to revocation or withdrawal by the party who set it up in the first place.<sup>9</sup>

**5. Should any legislation on third party rights that may follow from this Discussion Paper and any subsequent Report be expressed in terms of rights or benefits or both?**

**The parties**

4.7 The terms currently used most often in Scots law to describe the parties to a JQT are stipulator, debtor and tertius.<sup>10</sup> The Scottish Law Commission's 1977 Discussion Paper on *Constitution and Proof of Voluntary Obligations – Stipulations in Favour of Third Parties* supported the use of such terminology. The *SME* asserts, however, that the term 'third party' is preferable to 'tertius', "on the basis that it can no longer be assumed that lawyers will have even the elementary Latinity required for an immediate comprehension of the significance of the word 'tertius'."<sup>11</sup> It could perhaps also be argued that, even if the meaning of 'debtor' is generally understood in broad terms at least, the Roman law baggage inherent in the term 'stipulator' is almost certainly unlikely to be recognised by the average lawyer today; alternatively, if it is so recognised, the Roman law baggage will not prove particularly helpful. The term also has echoes of the South African *stipulatio alteri*, which is not the best comparison for Scots law in this context.<sup>12</sup> It is thus anything but obvious that the contracting parties in a third party situation should continue to be referred to in these terms.

4.8 The search for alternative language in which to speak about the parties and their rights can begin with our comparator instruments, as set out in the following table:

DCFR	<p>II. – 9:301: Basic rules</p> <p>(1) The <i>parties to a contract</i> may, by the contract, confer a right or other benefit on a <i>third party</i>.</p>
PICC	<p>Article 5.2.1 <i>Contracts in favour of third parties</i></p> <p>(1) The <i>parties (the “promisor” and the “promisee”)</i> may confer by express or implied agreement a right on a <i>third party (the “beneficiary”)</i>.</p>
CESL	<p>Article 78 <i>Contract terms in favour of third parties</i></p> <p>1. The <i>contracting parties</i> may, by the contract, confer a right on a <i>third party</i>.</p>

<sup>9</sup> See paras 2.57-2.78 above.

<sup>10</sup> See para 2.3 above, and also MacQueen and Thomson, *Contract*, para 3.26.

<sup>11</sup> *SME* Vol 15, para 825.

<sup>12</sup> See para 2.51 above.

Contracts (Rights of Third Parties) Act 1999	<p>Section 1: Right of third party to enforce contractual term.</p> <p>(1) Subject to the provisions of this Act, a person who is not a party to a contract (a “<i>third party</i>”) 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.</p> <p>(7) In this Act, in relation to a term of a contract which is enforceable by a third party – “<i>the promisor</i>” means the party to the contract against whom the term is enforceable by the third party, and “<i>the promisee</i>” means the party to the contract by whom the term is enforceable against the promisor.</p>
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4.9 It will be seen that on this topic these comparator instruments all refer to the right-holder as ‘the third party’ (although the PICC also terms that party ‘the beneficiary’). We think that since the term ‘beneficiary’ is commonly used with some technical significance in the law of wills and trusts it is probably best not to use it also in the law of contract. The simple descriptive term ‘third party’, on the other hand, bears its meaning on its face in the contractual context, and we are inclined to think that it is the best term to use in our discussion.

4.10 With reference to the persons who make the contract, however, the comparator instruments fall into two groups. The DCFR and the proposed CESL speak of ‘the parties to the contract’ or ‘the contracting parties’, while the PICC and the 1999 Act use the terminology of ‘promisor’ and ‘promisee’ for the contracting parties.

4.11 Promissory terminology to describe the persons making the contract, as found in the 1999 Act and the PICC, seems inapt for Scots law. That language is appropriate for the institution of unilateral promise but not for the distinct concept of contract, which is generally defined in terms of agreement which the parties to it intend to have legal effects.<sup>13</sup> As we have already discussed,<sup>14</sup> the Scottish JQT has often been defined in terms of a unilateral promise or set of promises made to the third party by the parties to the contract; but in that analysis it is the third party who is the promisee while the contracting parties are the promisors. It would seem to invite continuing confusion to replace ‘stipulator’ with ‘promisee’ and ‘debtor’ with ‘promisor’ in any reform of the law. While the debtor is indeed a promisor in the traditional Scottish analysis, the promise is made to the third party, not the other contracting party. Moreover, the other contracting party (the stipulator) is also to be seen as making a promise (to exhibit the contract, in Stair’s language) and so also as a promisor rather than as a promisee.

4.12 It may, therefore, be better to follow the models of the DCFR and the proposed CESL and refer simply to the ‘contracting parties’. This will also avoid the difficulties that might arise in determining which party is stipulator and which debtor where a contract provides for a complex range of third party rights under which the performances to be rendered to the third party will be owed by different contracting parties. We think that determining what rights the third party has against each of the contracting parties is essentially a matter of

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<sup>13</sup> DP No 154, 2012.

<sup>14</sup> See paras 2.16-2.17.

interpreting the contract, and that attaching labels in accordance with what these different rights may entail is simply to add unhelpful complexity to the analysis.

4.13 Our preliminary conclusions regarding the terminology which should be used when discussing third party rights may be summarised as follows:

Currently Used Term	Suggested Reformed Term
<i>Jus quaesitum tertio</i>	Third party right
Debtor	Contracting party
Stipulator	Contracting party
<i>Tertius</i>	Third Party

- 6. Do consultees agree with the suggested terminology for the parties and for the right, and that these might be suitable for use in any legislation on third party rights in Scots law? Would these terms be easily understood in practice? Are there better alternatives?**

4.14 We do not think it necessary to spell out in any reforming legislation whether or not the third party right is promissory in character. The terminology suggested above certainly makes clear that the third party is not a contracting party, or one of the parties to the contract from which its right takes its origin. If, however, we were to propose that the third party right be expressly recognised as flowing from a unilateral promise or a set of such promises within the contract, there would be the possible consequence that, whatever the position with the contract, the third party right would have to be constituted in formal writing (ie writing subscribed by the grantor, in this case, whichever of the contracting parties was undertaking duties to the third party). While, as already noted,<sup>15</sup> the exceptions to that requirement set out in the Requirements of Writing (Scotland) Act 1995 would go a long way to limiting the possible inflexibilities that might otherwise be created, it seems better not to introduce the possibilities in the first place. It would also be useful to side-step the debate about the distinctions, if any, between unilateral and gratuitous obligations.<sup>16</sup>

- 7. Do consultees agree it is preferable for any legislation dealing with third party rights to avoid as far as possible any explicit juristic characterisation of the right?**

4.15 It may be, however, that not describing the third party right as promissory will be insufficient to preclude argument that the 1995 Act applies nonetheless. We think that, if this outcome is seen as undesirable, it might be useful to provide expressly that formal writing is not needed to constitute a third party right.

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<sup>15</sup> See paras 2.53-2.56 above.

<sup>16</sup> We discuss unilateral and gratuitous obligations at paras 2.4-2.5 above.

8. Is it a correct perception that a requirement that third party rights be constituted in formal writing (ie subscribed by the grantor(s)) is undesirable in the interests of maintaining flexibility?
9. Should any legislation on third party rights make clear that formal writing is not required for their constitution?

4.16 The comparator instruments make no characterisation of the juristic nature of the third party rights which they recognise. There are, however, some provisions of indirect relevance, as follows:

DCFR	PICC	CESL	Contracts (Rights of Third Parties) Act 1999
<p>II. – 9:302: Rights, remedies and defences</p> <p>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:</p> <p>(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; ...</p>	<p>No relevant provision</p>	<p>Article 78</p> <p><i>Contract terms in favour of third parties</i></p> <p>3. When one of the contracting parties is bound to render a performance to the third party under the contract, then:</p> <p>(a) the third party has the same rights to performance and remedies for nonperformance as if the contracting party was bound to render the performance under a contract with the third party;</p> <p>...</p>	<p>Section 1: Right of third party to enforce contractual term.</p> <p>(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).”</p>

4.17 It will be seen from the above that the DCFR’s provisions on the third party’s remedies analogise the position with that under a binding unilateral undertaking in favour of the third party, whereas the proposed CESL and the 1999 Act do so as if the third party was a party to the contract. The difficulty for both the proposed CESL and the 1999 Act is that each sits within a system which does not recognise the enforceability of unilateral undertakings as such: the former because it does not provide for unilateral undertakings, the

latter because to be enforceable such undertaking has to be either made by deed or given for consideration from the promisee.<sup>17</sup> The DCFR, on the other hand, is like Scots law in making unilateral undertakings enforceable without acceptance or consideration.<sup>18</sup> Non-performance of the undertaking will give rise to all the remedies listed in the DCFR, which include cure of a defective performance by the debtor, specific performance, damages and interest.<sup>19</sup>

4.18 We will deal in detail with the third party's remedies in Scots law (and indeed the defences based upon the contract with which those claims may be met) in Chapter 7.<sup>20</sup> The point which we wish to make here is that a system which recognises the enforceability of unilateral promises may readily make use of that concept at least by way of analogy in the context of third party rights while not needing to make a rather uncomfortable transformation of one who is definitely not a party to the contract into such a party after all for certain purposes. Further, the use of such analogies removes the need to elaborate specific rules on the topics in question for third party rights. As Professor Hogg has remarked, "it is not preferable to categorise rights within the field of obligations law as *sui generis* unless none of the existing characterisations is apt to describe such rights."<sup>21</sup> In the interests of being part of a clear and coherent system of obligations easily utilised in practice, we think there is considerable benefit in a reformed third party right being placed as far as possible within existing categories in the law of obligations, rather than being a 'stand alone' right the nature and implications of which have to be fully worked out in a complete legislative scheme.

**10. Is it useful in the interests of legislative economy to draw analogies as may be appropriate with other legal institutions such as the unilateral promise (eg to define without elaborating the remedies available to the third party)?**

**Conditional obligations**

4.19 We have discussed in Chapter 2 how a third party right in Scots law may currently be conditional upon some uncertain future event, including what may be the power of the contracting parties to vary or cancel the right, or an onerous performance by the third party.<sup>22</sup> This aspect of the definition of the third party right is also found in the provisions of the DCFR and the PICC as set out below:

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<sup>17</sup> H Beale (general ed), *Chitty on Contracts* (31<sup>st</sup> edn, 2013), para 3.013.

<sup>18</sup> DCFR II.-1:103(2)). The undertaker must intend to be legally bound or to achieve the relevant legal effect, the act must be sufficiently certain, and notice of the act must reach the person to whom it is addressed (II.-4:301). The intention is to be determined from the party's statements or conduct as reasonably understood by the person to whom the act was addressed (II.-4:302; II.-8:201).

<sup>19</sup> See generally DCFR III.-3. The remedy of "withholding performance" (DCFR III.-3:401) is unlikely to be of use to a third party, while DCFR III.-3:501(1) provides that the remedy of termination applies only to contractual obligations and contractual relationships, thereby excluding third party rights.

<sup>20</sup> See paras 7.9-7.14 (remedies) and paras 7.15 onwards (defences).

<sup>21</sup> M Hogg, *Promises and Contract Law*, p 291.

<sup>22</sup> See paras 2.6-2.9 above.

DCFR	PICC	CESL	Contracts (Rights of Third Parties) Act 1999
II. – 9:301: Basic rules  (2) The nature and content of the third party's right or benefit are ... subject to any conditions or other limitations under the contract.	Article 5.2.1  (2) The existence and content of the beneficiary's right against the promisor are ... subject to any conditions or other limitations under the agreement.	No relevant provision	No relevant provision

4.20 It may be, however, that it is unnecessary to have a specific provision on this matter in any Scottish legislation, since it really follows as a matter of the general law of obligations of which third party rights clearly form part. On the other hand, a general provision like those above may be a useful pointer to what is a crucial aspect of the law in this field.

11. **Should there be any general or more specific provision to the effect that a third party right may be conditional upon some performance by the third party or some other uncertain future event?**

# Chapter 5 Identification and Intention

5.1 According to Professor McBryde, the requirements for a contract to create a right in favour of a third party can be summarised as follows:

1. a contract;<sup>1</sup>
2. an intention, express or implied, in that contract to benefit a third party;<sup>2</sup>
3. identification of the third party, who need not be named or even in existence;<sup>3</sup>
4. there must normally be delivery, or an equivalent, to the third party.<sup>4</sup>

This summary provides us with a convenient set of headings for the discussion that follows in this and the following Chapter, although there is no need for us to dwell on No 1, which is a *sine qua non* and so entirely uncontroversial for present purposes.

5.2 The comparator instruments show parallel (although not identical) rules. We begin, however, not with the question of intention to benefit the third party, but with the requirement that the contract identify in some way the third party who is to have the right, which seems to us to be a logically prior matter.

## Identification of the third party

DCFR	PICC	CESL	Contracts (Rights of Third Parties) Act 1999
II. – 9:301: Basic rules  (1)... The third party need not be in existence or identified at the time the contract is concluded.	Article 5.2.2  <i>Third party identifiable</i>  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 78  <i>Contract terms in favour of third parties</i>  1. ... The third party need not be in existence or identified at the time the contract is concluded but needs to be identifiable.	Section 1(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.

<sup>1</sup> McBryde, *Contract*, para 10.09.

<sup>2</sup> *Ibid*, paras 10.10-10.16.

<sup>3</sup> *Ibid*, paras 10.17-10.19.

<sup>4</sup> *Ibid*, para 10.20.

### *Third party identified in, or identifiable from, the contract*

5.3 Our discussion begins with the general requirement to identify the third party and we then examine two particular scenarios, the first involving a third party who is not yet in existence at the time when the right is conferred and the second concerning a third party who, while in existence, is not within the specified class of third parties at that time. At the general level, it is already the law in Scotland that the third party must be identified in the contract.<sup>5</sup> The third party can be identified specifically<sup>6</sup> or be a member of a class of persons, all as provided for in the contract.<sup>7</sup> Professor McBryde also raises the question of whether a third party may be identifiable otherwise than through contractual provision, for example in the cases of a third party for whom a gift is purchased by the donor or services provided under a contract between two others.<sup>8</sup>

5.4 As the table above shows, the comparator instruments are also in general agreement that the third party must be identified in, or identifiable from, the contract. The 1999 Act also requires that the third party be expressly identified but identification may be as a member of a class of persons or a person answering a particular description. The PICC states that the third party must be identifiable with “adequate certainty” and the proposed CESL also simply requires that the party is identifiable. The DCFR is the only measure which expressly states that the third party need not be identified but by this it seems simply to refer to the identity of the specific person who can finally claim the right; the commentary adds that “[i]t goes without saying, however, 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.”<sup>9</sup>

5.5 There is thus no complete consensus on specific formulations of the point to be found in the 1999 Act, the DCFR, the PICC and the proposed CESL. It has been said that the 1999 Act’s requirement of express identification, when compared with the DCFR and CESL, offers “greater certainty at the expense of a narrower conception of which third parties have the right of enforceability.”<sup>10</sup> But the DCFR and the proposed CESL do require ‘identifiability’, while the 1999 Act allows identification by class or description as well as by name. The gap is essentially about the scope of ‘identifiability’. The commentators already quoted also remark:

“[W]hile it is correct that the CESL or DCFR ... might allow non-expressly identified third parties to have a right of enforceability ... where that would not be possible under English law (because English law requires express identification), the basic approach is one of upholding the intentions of the parties, so that in nearly all cases ... one would expect the same results on the test of enforceability to be arrived at under the CESL or DCFR ... as under English law.”<sup>11</sup>

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<sup>5</sup> See paras 2.26-2.37 above.

<sup>6</sup> 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.

<sup>7</sup> 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.

<sup>8</sup> See paras 2.35-2.36 above.

<sup>9</sup> DCFR Vol 1, p 617 (Comment D).

<sup>10</sup> A S Burrows and C Busch, “Contract Terms in Favour of Third Parties” in G Dannemann and S Vogenauer (eds), *The Common European Sales Law in Context: Interactions with English and German Law* (2013), p 505.

<sup>11</sup> *Ibid.*

5.6 There are many instances in which it is practically useful to allow parties to conclude a contract without knowing exactly who the third party will be. We have already mentioned the case of the company group in which the contracting company wishes to confer rights upon other companies in the group or to achieve the settlement of a claim against it which may also involve other group members.<sup>12</sup> Other examples include a contract for the payment of a pension providing for the pensioner to be nominated by one of the parties at a later date; 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.<sup>13</sup>

5.7 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 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 would very much appreciate comments from consultees on whether identifying third parties as members of a class of persons is a mechanism which is frequently employed and practically usable in contracts.

5.8 We also think 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. In the context of Scots law, however, it may be preferable to speak of the person who fulfils or meets certain conditions laid down by the contract. *Kelly v Cornhill Insurance Co Ltd* provides our best example of this from the existing case law.<sup>14</sup>

#### *Third party not in existence*

5.9 It is currently clear in Scots law that a third party need not be in existence at the time that the right in their favour is created. In allowing this Scots law seems to be in line with the comparator instruments, all of which expressly provide that the third party need not be in existence when the contract is entered into. The rule has undoubted practical utility, above all, perhaps, with regard to yet-to-be incorporated companies.<sup>15</sup> This is perhaps of special value where a third party right is created in favour of a class.

5.10 It is therefore suggested that the validity of third party rights in favour of parties who are not in existence at the time that the right in their favour is created should continue. The existence of this right will of course be subject, as previously discussed, to the suspensive condition that the third party does subsequently come into existence; that is, until the third party comes into existence, there can be no right at all. Where there is a class some of whom exist while others have yet to come into existence, the existent ones do of course enjoy whatever rights the contracting parties may have conferred upon them regardless of whether or not further entitled persons come into existence.

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<sup>12</sup> See paras 3.7 and 3.33-3.34 above.

<sup>13</sup> DCFR Vol 1, p 617.

<sup>14</sup> See para 2.27 above.

<sup>15</sup> Macgregor, *Report on the Draft Common Frame of Reference*, Appendix, 5.2.1.

*Third party in existence but not a member of the class in question*

5.11 The further issue possibly identified earlier in this context, however, needs to be addressed. To recapitulate, the question is whether it is possible to create a third party right for a class which is joined – through, for example, the fulfilment of some condition such as becoming a sub-contractor, or an employee of a particular company, or the owner of a building – by a person who was in existence at the time the contract was formed but who was not then a member of the class in question.<sup>16</sup> We think that in principle there is nothing to prevent such a conclusion in the present law. The third party right has been created subject to certain suspensive conditions and becomes enforceable upon fulfilment of those conditions. But for the avoidance of doubt it may be useful to make specific statutory provision on the matter.

- 12. Do consultees agree that the third party must be identified by or identifiable from the contract, in particular as a member of a particular class of persons or as a person fulfilling or meeting conditions laid down in the contract?**
- 13. Do consultees agree that a right in favour of a third party who is not in existence at the time that the right is set up should continue to be valid and enforceable by any such third party which subsequently comes into existence?**
- 14. Should it be provided for the avoidance of doubt that 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 then a member of the intended class, may become so upon joining the class if the contracting parties so intended?**

5.12 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. As already noted, the typical examples might be the purchase of goods with the buyer's intention to give the goods to a third party being made known to the seller in the course of negotiations, or the seller being instructed to deliver to the donee, or the contract for the supply of services which are to be carried out on a third party's property to the knowledge of the supplier (ie the 'transferred loss' scenario). Another possible example is provided by the 'community of interest' in commercial developments such as shopping centres, the modern parallel to the old co-feuar and co-dispensee cases. 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.<sup>17</sup>

5.13 If a wider approach to identifiability was to be allowed, it would be important to remain cognisant of the control factor that would still be provided by the requirement of the contracting parties' intention to confer a right upon the third party (which might be very difficult to establish in the absence of any reference to that person in the contract). The rule

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<sup>16</sup> See paras 2.27-2.28 and 3.16-3.18 above.

<sup>17</sup> For a discussion of "community of interest" see paras 3.37-3.47 above.

should not become a back-door to making third party benefits enforceable third party rights unless the parties clearly intended the latter to arise.<sup>18</sup>

5.14 If the law was to allow identification other than by way of the contract, there would also be issues about what might constitute relevant evidence about third parties not mentioned in the contract itself. If Andy buys a round of drinks in a pub, is that enough to identify the rest of his group in the premises as third parties to the contract? Assuming, as seems highly probable, that this is an oral contract, evidence as to its existence and terms could be sought from a wide range of sources. But stricter evidential rules apply in interpreting the meaning of written contracts.<sup>19</sup> Suppose that Plank & Pole Ltd enter into a written contract with a property factor to erect scaffolding around the 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 third parties? Might some evidence, for example as to pre-contractual negotiations or post-contractual conduct, be inadmissible?<sup>20</sup> In the ‘community of interest’ cases the relevant evidence has been about the landlord’s imposition of the same or very similar duties upon all the other tenants or parties in the development or centre of activity, which may be to go further into “surrounding circumstances” than would ordinarily be seen as permissible.

5.15 One possibility in law reform on this point is not to limit ‘identifiability’ to what can be determined from the contract itself, but to leave it, as in the DCFR and the proposed CESL, as an open-ended test limited only by the requirement that the third party be one upon whom the contracting parties intended to confer a right. But this may well be too open to the charge of uncertainty. We therefore ask:

- 15. Subject to the over-arching requirement that the existence of any third party’s right must depend upon the contracting parties’ intention, should the identification or identifiability of the third party come from the contract only, or should it be possible to refer to extra-contractual evidence by which a third party can be identified?**
- 16. If so, what kinds of evidence might be allowed?**

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<sup>18</sup> We think it is possible that contracting parties may intend to confer a benefit upon a third party under the contract without also intending that the benefit be a directly enforceable right of the third party. *Allan’s Trs v Inland Revenue Commissioners* 1971 SC (HL) 45 provides one example.

<sup>19</sup> See DP No 147, 2011; we note there that claims for rectification may give rise to certain exceptions (which is discussed in particular at paras 5.23-5.27 and 7.43-7.46).

<sup>20</sup> See DP No 147, 2011, cited just above, especially at paras 7.12-7.15 and 7.18.

## Intention of contracting parties to confer a right

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.
PICC Article 5.2.1 <i>Contracts in favour of third parties</i>	(1) The parties (the “promisor” and the “promisee”) may confer by express or implied agreement a right on a third party (the “beneficiary”).
CESL Article 78 <i>Contract terms in favour of third parties</i>	1. The contracting parties may, by the contract, confer a right on a third party.
Contracts (Rights of Third Parties) Act 1999, Section 1(1)	(1) Subject to the provisions of the Act, a person who is not a party to a contract (a “third party”) may in its own right enforce a term of the contract if –  <div style="margin-left: 40px;">                     (a) the contract expressly provides that he may, or                       (b) subject to subsection (2), the term purports to confer a benefit on him.                 </div> (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.

5.16 While for all the comparator instruments intention (including the intention not to confer any third party rights) may be made clear by express provision in the contract, only the PICC states in terms that an intention to create a third party right may be implicit in a contract. But under the DCFR, it is stated generally that “[t]he terms of a contract may be derived from the express or tacit agreement of the parties”, and there is no reason to doubt that the text does indeed accept the possibility of an implied intention to confer a right upon a third party, that again being a matter of the interpretation of the contract made by the contracting parties.<sup>21</sup>

5.17 The 1999 Act distinguishes between the third party rights that arise because (i) a contract expressly provides for third party enforcement of a term in it; or because (ii) 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.<sup>22</sup> This seems to be so even although 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

<sup>21</sup> See the commentary to the DCFR Vol 1, p 617 (section E). The proposed CESL states (in Arts 66 and 68) that the terms of a contract are derived from the agreement of the parties and any contract term implied where it is necessary to provide for a matter not explicitly regulated by the parties’ agreement. Whether a third party right could be implied under such a provision must be rather doubtful.

<sup>22</sup> 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).

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”.

5.18 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 pointing to a benefit which a court will then find some term ‘purports’ to confer upon that party, so giving the latter an enforceable right unless there is some other express term against that (which, given that the third party was unanticipated, is unlikely). In other words, the Act still creates undesirable uncertainty for contracting parties about their potential liabilities. We are inclined to think that such uncertainty could be avoided in Scotland, however, if any legislation on third party rights were to be expressed in terms of the intention (express or implied) of the contracting parties to create an enforceable right for the third party rather than in terms of a third party benefit from the contract.

5.19 While it is obviously important not to create more uncertainty about the law than is absolutely necessary, we consider that serious issues of uncertainty would also arise if it were only possible to create third party rights by way of express provision to that effect. Most of the reported litigation is about whether or not the intention to confer a right can be implied. If that were no longer possible, a result might well be as many expensive arguments that a right was expressly provided for as there have been that a right is to be implied. While professionally advised contracting parties wishing to create third party rights would no doubt have suitable terms included in their contracts, others less well supported might find their intentions defeated by the inadequacy of their drafting or their oral statements.

5.20 The possibility of an implied intention to create a third party right is already part of Scots law, 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 title conditions by co-feuars and co-disponees; and it may still allow tenants in commercial leases where there is the ‘community of interest’ described in Chapter 3 to enforce common obligations where landlords are, for whatever reason, unwilling or unable to do so.<sup>23</sup> The evidence of the intention to create rights in such cases might be indirectly from other express terms like those in the *Kiley* case in England (terms in the lease for settling disputes between lessees, together with the lack of any right for the lessees to require enforcement by the lessor),<sup>24</sup> 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. But this would fall within the province of the judges deciding particular cases, and need not be elaborated in any general legislation.

5.21 Our provisional view is, accordingly, that it should continue to be possible for the contracting parties’ intention to create a right for a third party to be implied as well as expressed in the contract.

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<sup>23</sup> It will of course be possible for the leases themselves to provide expressly for co-lessees to have enforcement rights.

<sup>24</sup> See para 3.40 above.

17. Do consultees agree that 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 be continued?

**Should a third party right taking the form of an exclusion of liability be competent in Scots law?**

DCFR	PICC	CESL	Contracts (Rights of Third Parties) Act 1999
<p>II. – 9:301: Basic rules ...</p> <p>(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.</p>	<p>Article 5.2.3</p> <p><i>Exclusion and limitation clauses</i></p> <p>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.</p>	<p>Article 78</p> <p><i>Contract terms in favour of third parties</i></p> <p>...</p> <p>2. ... The right may take the form of an exclusion or limitation of the third party's liability to one of the contracting parties.</p>	<p>Section 1(6):</p> <p>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.</p>

5.22 All the comparator instruments make express provision to the effect that a contract term excluding or limiting the liability of the third party to one or more of the contracting parties is an example of an enforceable third party right. By doing so, they avoid any need for Hohfeldian analysis of whether such an immunity can be treated as a right of or a benefit to the third party.<sup>25</sup>

5.23 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.<sup>26</sup> There is, however, support for the enforceability of such terms. For example, Laura Macgregor writes that they are particularly useful in business contexts involving multiple actors, such as construction projects.<sup>27</sup> Our Advisory Group confirmed that such clauses should be enforceable as third party rights.

5.24 Professor Hugh Beale explains that before the enactment of the 1999 Act, English practitioners tended to rely on methods such as the so-called 'Himalaya clause' in maritime contracts;<sup>28</sup> that is, the deployment of agency and trust devices whereby the protection of

<sup>25</sup> See para 2.25 above.

<sup>26</sup> See para 2.24 above.

<sup>27</sup> Macgregor, *Report on the Draft Common Frame of Reference*, Appendix, 5.2.1.

<sup>28</sup> These are clauses which benefit third parties in maritime matters. Such clauses developed as a result of the decision of the English Court of Appeal in *Adler v Dickson (No. 1) (The Himalaya)* [1955] 1 QB 158. For further

exclusion or limitation of liability clauses in these contracts was extended to employees and sub-contractors. Such methods were, however, “prone to difficulty and occasionally failure”.<sup>29</sup> This situation was “largely resolved”, according to Professor Beale, by section 1(6) of the 1999 Act, which is also now frequently utilised by commercial parties to provide protection to the officers and employees of companies.

5.25 In light of the clear benefits which section 1(6) appears to offer in England, we consider that an opportunity to provide the same convenience and efficiency to Scottish parties should not be missed, and that any legislation reforming third party rights should contain an equivalent to the provisions in the comparator instruments. There would be no adverse implications of allowing these clauses to be enforced, and they would not detract from the overall character of the reformed third party right. The question of whether these terms should be valid does not appear to be particularly controversial.

- 18. Do consultees agree that it should be expressly provided that an exclusion or limitation of the third party’s liability to one or more of the contracting parties can be an example of a third party right?**

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information, see W Tetley, “The Himalaya Clause – Revisited” (2003) 9 *Journal of International Maritime Law* 40, accessible at: <http://www.mcgill.ca/files/maritimelaw/himalaya.pdf>. To our knowledge, Himalaya clauses have never been discussed in the Scottish courts.

<sup>29</sup> Beale, “Review”, p 231.

## Chapter 6 Irrevocability

6.1 We have seen in earlier Chapters that there is deep uncertainty in present Scots law on the subject of irrevocability in the context of third party rights in contract.<sup>1</sup> There are two inter-linked issues. One is the question of formation: how to bring the right into existence in the first place. The second is the 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. Quite apart from the general uncertainty, the requirement is thus burdensome in two directions, and plainly conflicts with the need both to facilitate commercial and other transactions and 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.

6.2 As the following table shows, the DCFR, PICC, CESL and the 1999 Act all reflect these policy drivers and do not require that a third party right be irrevocable as a matter of either its formation or its possible termination or alteration before performance falls due. They thus offer powerful support to the notion that a requirement of irrevocability is not seen as necessary for a modern law of third party rights.

<p>DCFR II. – 9:303: Rejection or revocation of benefit</p>	<p>(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.</p> <p>The contract determines whether and by whom and in what circumstances the right or benefit can be revoked or modified after that time.</p> <p>(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.</p>
<p>PICC Article 5.2.5 <i>Revocation</i></p>	<p>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.</p>
<p>CESL Article 78</p>	<p>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.</p>

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<sup>1</sup> See paras 2.57-2.78 and 3.1-3.5 above.

<p>Contracts (Rights of Third Parties) Act 1999, Section 2: Variation and rescission of contract</p>	<p>(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 –</p> <p>(a) the third party has communicated his assent to the term to the promisor,</p> <p>(b) the promisor is aware that the third party has relied on the term, or</p> <p>(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</p> <p>(2) The assent referred to in subsection (1)(a) –</p> <p>(a) may be by words or conduct, and</p> <p>(b) if sent to the promisor by post or other means, shall not be regarded as communicated to the promisor until received by him.</p> <p>(3) Subsection (1) is subject to any express term of the contract under which –</p> <p>(a) the parties to the contract may by agreement rescind or vary the contract without the consent of the third party, or</p> <p>(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).</p>
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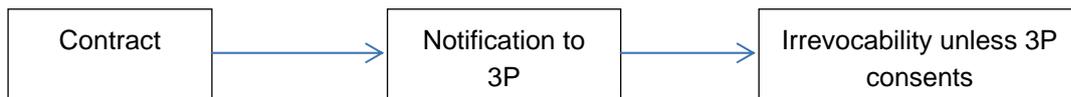
6.3 The comparator instruments do, however, provide a variety of rules restricting the circumstances in which the third party's right may be revoked or modified by the contracting parties. It is important to note that these do not deal with revocation (ie termination or cancellation) alone but extend also to the modification or variation of the third party's right by the contracting parties. Variation as distinct from revocation has not been much discussed in Scots law. But it seems clear that a modern law of third party rights should deal with both possibilities, and, in the discussion that follows, this approach will be adopted.

6.4 It has been said that the differences between the DCFR, CESL and the 1999 Act on these points are unlikely to be of consequence: all should yield essentially the same results in practice.<sup>2</sup> Comparing the various schemes diagrammatically, as we do below, however, reveals some significant differences between them. We move in what follows from the simplest – the PICC and the proposed CESL – through the DCFR, which is a more elaborate version of the two previous texts, to, finally, the distinctive scheme of the 1999 Act.

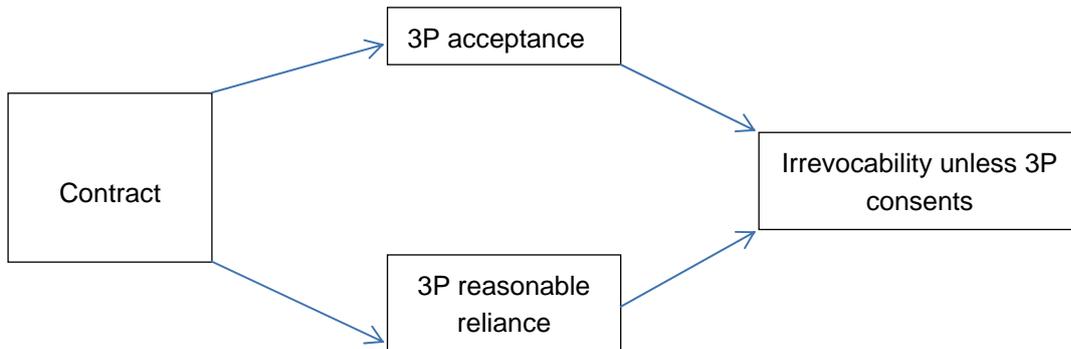
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<sup>2</sup> A S Burrows and C Busch, "Contract Terms in Favour of Third Parties", p 507.

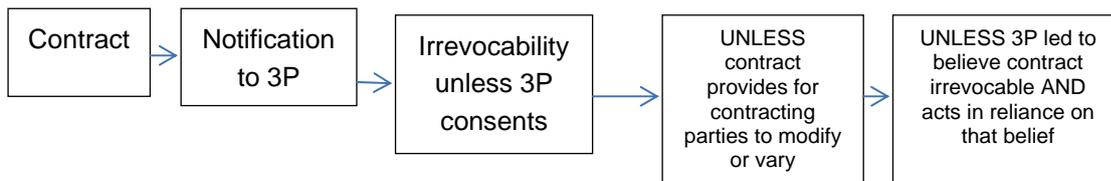
**Fig 6.1 CESL**



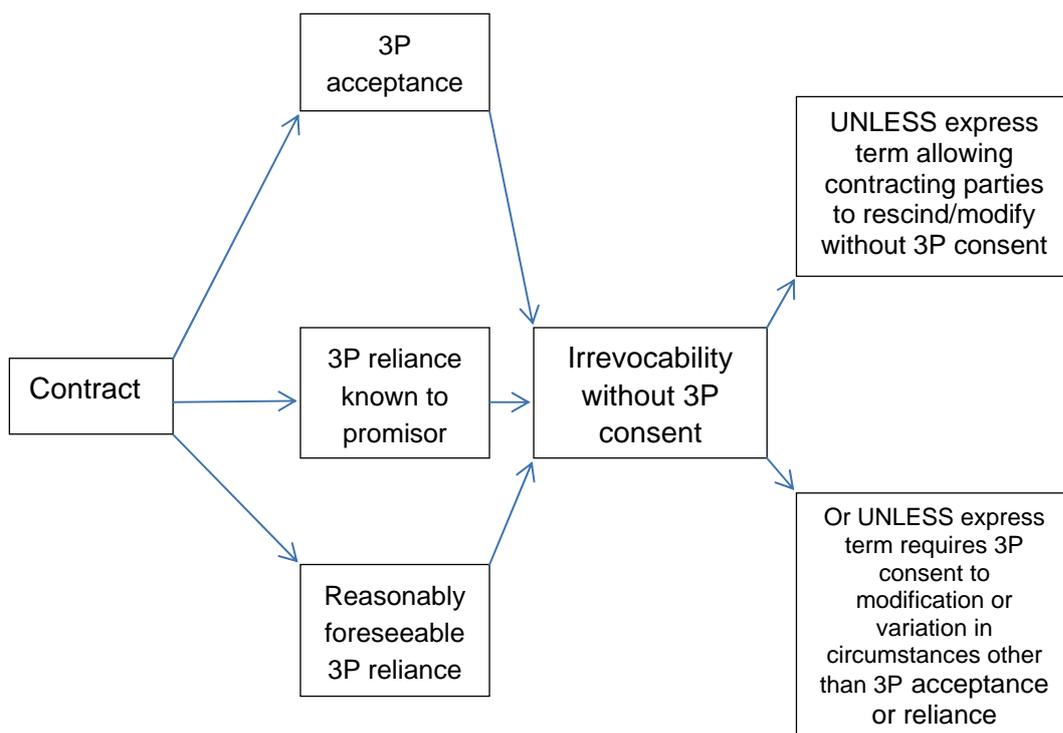
**Fig 6.2 PICC**



**Fig 6.3 DCFR**



**Fig 6.4 1999 Act**



6.5 These diagrams make clear that in varying ways the factors which might be thought to make a third party right irrevocable or unmodifiable have included notification (or as it might be put in Scots law, intimation) to the third party, or 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 vary 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 revoke 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.

### **Abolition of irrevocability as a requirement of constitution**

6.6 What guidance does all this give us in the possible reform of the requirement of irrevocability for third party rights in Scots law? The comparator instruments suggest, first, that there is no need to impose a requirement of irrevocability before the right can exist at all. The starting point is the freedom of contracting parties to vary or cancel their contract and the question is, when, if ever, is that freedom lost if the contract provides for a third party right? Given what we have learned about the problems which a requirement of initial irrevocability poses for the use of third party rights in legal practice,<sup>3</sup> we therefore ask:

- 19. Do consultees agree that 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?**

### **When should a third party right crystallise?**

#### *(1) The effect of express contract terms*

6.7 The next issue is when a third party right may become irrevocable or unmodifiable; or, to put the matter in another way, when the contracting parties may cancel or alter the third party's right. There has to be a point at which a third party's right crystallises and becomes enforceable, if necessary by court action, and at which the contracting parties are no longer entitled (if they ever were) to bring the right to an end or vary it. It seems to us that the first and foremost consideration in this question ought to be whether a contract has been concluded including 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 subject to resolute conditions enabling change to these rights, including outright cancellation. *Love v Amalgamated Society of Lithographic Printers of Great Britain and Ireland*<sup>4</sup> provides an excellent example in the existing case law, where the dependants' rights could have been altered or cancelled altogether.

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<sup>3</sup> See paras 3.3 and 3.5 above.

<sup>4</sup> 1912 SC 1078; discussed at para 2.72 above.

6.8 With this perspective, we think the approach in some of the comparator instruments by which the third party right becomes irrevocable or unmodifiable upon the occurrence of certain events involving the third party in some way, unless the contract otherwise provides, may put the cart before the horse. If the parties provide for variation or cancellation of the third party right, then we think that in general that should prevail except in two circumstances: (1) as in *Love*, where the suspensive conditions upon which a member of a class became entitled to support from the Society were fulfilled, while the resolutive conditions had not been; and (2) as in the provision found in the DCFR that protects the third party's reliance upon any statement of irrevocability emanating from the contracting parties. This latter seems perfectly consistent with Scots law principles of personal bar, under which a party's exercise of a right may be prevented because it is inconsistent with that party's previous conduct (whether by words, actions or inaction) despite knowledge of its right, and it would consequently be unfair to another party now to exercise that right.<sup>5</sup>

6.9 We therefore ask:

**20. Do consultees agree that it should be specifically provided that where a contract provides for a third party right while reserving the entitlement of the contracting parties to vary or cancel the right, that entitlement may only be defeated by (i) the fulfilment of any conditions for the third party's entitlement to enforce the right before any variation or cancellation is completed, or (ii) the operation of personal bar against the contracting parties' exercise of their entitlements?**

6.10 A further question is, so to speak, the converse of the one just asked: what if the parties specifically state in their contract that the third party right which it provides for 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.<sup>6</sup> It has been said of trusts that "*in dubio* a declaration that [a trust] is irrevocable will probably be decisive."<sup>7</sup> An express declaration that a third party right in a contract is irrevocable may seem to bring that contract close to being a trust; but the contract model applies if no property is being set aside for the third party's benefit – if, for example, the partners of a firm agree that provided the profits of the business achieve a given level in any year a certain share will be paid to Tertia, a daughter of one of the partners who is about to undertake doctoral research for three years in an expensive institute of higher education in the USA.

6.11 Given the emphasis of our suggested reform upon the intention of the contracting parties, it would be consistent to propose that an express statement of irrevocability or unmodifiability in the contract should be likewise decisive for third party rights, at least if delivered or intimated or otherwise communicated to the third party.<sup>8</sup> It would certainly be odd if this were not so while, as we suggest below,<sup>9</sup> a third party right could be made

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<sup>5</sup> See generally E C Reid and J W G Blackie, *Personal Bar* (2006); also the summary overview in Gloag & Henderson, paras 3.04-3.06.

<sup>6</sup> McBryde, *Contract*, paras 2.20-2.27 and 6.57.

<sup>7</sup> Gloag & Henderson, para 41.19, citing *Scott v Scott* 1930 SC 903 (where a trustor's declaration that "I declare these presents to be irrevocable; and I oblige myself that I shall do no act inconsistent therewith" was held to make the trust irrevocable and so deprive the trustor of the ownership of the property entrusted).

<sup>8</sup> There may be a question whether such a provision in a contract which binds the contracting parties even needs communication to the third party: see paras 2.4, 2.50 and 2.65 above.

<sup>9</sup> See paras 6.16-6.17 below.

irrevocable by post-contract representations to that effect emanating from the contracting parties and relied upon by the third party to its detriment. We accordingly ask:

- 21. Do consultees agree that an express contractual statement that a third party right conferred by the contract is irrevocable should be given effect, at least if delivered, intimated or otherwise communicated to the third party?**

*(2) When there is no contractual provision on cancellation or alteration*

6.12 We now turn to the situation where the contract does not provide for variation or cancellation of the third party right by the contracting parties. Various approaches may be possible in this situation. For example, a starting point could be found in the basic principle of contract law that contracting parties may unmake or vary their contract as much as they make it by agreement. It might be regarded as implicit that this freedom exists unless explicitly given up in some way. This could readily be coupled with the approach found in the comparator instruments so that only further acts of the contracting parties involving or affecting the third party, such as notification, acceptance or reliance, could be treated as preventing variation or cancellation of the latter's right without its consent.

6.13 Another possibility, however, is the approach mooted many years ago by the late Professor Neil MacCormick as the "crucial question which ought to occupy the mind of the law reformer":<sup>10</sup> choosing whether to presume a third party right either irrevocable or revocable in the absence of a proven intention to treat them as irrevocable. The attraction of such a statutory presumption is its serving a pedagogic purpose for contracting parties and their advisers, in that their minds might thus be focused on whether or not the presumption should be rebutted by an express term. As between Professor MacCormick's alternatives, a presumption of revocability might be more consistent with the needs of legal practice as identified in this Discussion Paper.<sup>11</sup> Irrevocability would no longer be a concern at the forefront of practitioners' minds if the law provided that a right in favour of a third party would be considered revocable unless expressly stated otherwise. But we also note that Professor McBryde is against any presumption on the basis that the meaning of a term in favour of a third party should always be a matter of interpretation.<sup>12</sup>

6.14 On the other hand, if there was no express term in the contract to be interpreted (which is the problem with which we are trying to deal at this point), an unfettered entitlement of the contracting parties to change or cancel the third party's right might have potential to inflict unfairness upon the third party. Revocability and variability would become a rule rather than a presumption. It would, therefore, have at least to be provided that the presumption could be rebutted by actions of the contracting parties and the third party subsequent to the formation of the contract justifying the right being irrevocable or unmodifiable. It thus might seem easier simply to consider what, if any, acts subsequent to the contract should have the effect of making the third party right irrevocable or unmodifiable, as in all the comparator instruments.

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<sup>10</sup> D N MacCormick, "*Jus Quaesitum Tertio: Stair v Dunedin*" 1970 JR 228, 236.

<sup>11</sup> See paras 3.3 and 3.5 above.

<sup>12</sup> McBryde, *Contract*, para 10.30.

6.15 If that is accepted, a good starting point may be the approach already applied to the case where the parties do provide for the revocability or variability of the contract. Bearing in mind that we are considering the case where the contract makes no provision one way or another on irrevocability or variability, if at the point the third party otherwise meets the conditions upon which the right becomes enforceable the contracting parties have not altered or cancelled the term, there seems to be no compelling reason why the third party should not be able to claim its benefit as apparently provided for by the contracting parties. Such a rule is at least implicit in the comparator instruments, and the California Civil Code provides explicitly 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.”<sup>13</sup> So, in our previous example of the business partners agreeing to support the cost of Tertia’s doctoral research, if 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.

6.16 Again, if after the contract has been formed the third party is led by the contracting parties into the belief that the term will not be altered or cancelled, there seems no reason against letting the principles of personal bar apply, so that the third party who has detrimentally relied on its right under the contract can prevent revocation or variation by the contracting parties. If Tertia embarks upon the second or third year of her research having previously sought and received financial reassurance from the partners, she will be able to claim her money, again provided that the condition about the profit levels is fulfilled.

6.17 An attraction of taking these approaches where the contract makes no express provision about revocability or variability is that they parallel the rules proposed above for where the contract does make express provision on the subject. Hence they avoid arguments about whether or not the contract impliedly provided for the contracting parties’ entitlement to change or revoke the term in the third party’s favour. The crucial questions over and above the interpretation of the contract would always be: (1) have the contracting parties altered or cancelled the contract? (2) have there been any representations of irrevocability or unmodifiability by the contracting parties to the third party, coupled with the latter’s detrimental reliance thereupon? We ask:

**22. Do consultees agree that, where a contract sets up a third party right without any provision for an entitlement of the contracting parties to vary or cancel the right, either:**

**(i) the fulfilment of any conditions for the third party’s entitlement to enforce the right will prevent any variation or cancellation by the contracting parties; or**

**(ii) representations of irrevocability or unmodifiability made to the third party by the contracting parties (or any one of them?) and detrimentally relied upon by the third party will lead to the operation of a personal bar against any attempt by the contracting parties to revoke or modify the third party’s right?**

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<sup>13</sup> Californian Civil Code §1559.

6.18 There is another case of express statement by the contracting parties to be considered, namely where post-contract one or more of them makes, not a representation, but a promise that the contract will not be revoked or varied. Where all the contracting parties have taken whatever steps may be needed to make the promissory statement effective and enforceable, there seems to be no difficulty in holding that the third party's right is indeed irrevocable or unmodifiable, as the case may be. The key point would be the lack of any need for reliance by the third party to make its right enforceable, in line with Scots law's general approach to the enforceability of promises. In our example, Tertia would need simply to show the making of the partners' promise and not the reliance expense she incurred by going to study in the USA institution.

**23. Do consultees agree that a post-contract promise to the third party by the contracting parties that a third party right conferred by the contract is irrevocable or unmodifiable should be given effect if the steps needed for the constitution of an enforceable promise have been met by the contracting parties?**

6.19 More complex issues might arise about what claims the third party could make where not all the contracting parties participated directly in the making of the promissory statement, and there were then attempts to cancel or change its right. We do not think it appropriate to make suggestions as to possible provisions for this case, since a wide variety of factual scenarios seems possible. It ought to be feasible for the courts to devise suitable solutions for particular cases should they arise, for example by awards of damages against the promisor(s), and possibly the deployment of personal bar against the non-promisors if their actions after the promise was made induced the third party to act to its detriment.

6.20 Are there any other factors that should make a third party right irrevocable or unmodifiable where the contract has made no provision on the matter? We do not think that the third party's 'acceptance' should be borrowed from the PICC or the 1999 Act as a relevant consideration. 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, and to be a recipe for confusion.

6.21 On the other hand, it would seem entirely consistent with the general principles of Scots law that both delivery and intimation of the contract (or the relevant terms thereof) to the third party (or its representative) should be a ground for thereafter regarding that right as irrevocable or unmodifiable, unless it was accompanied by a reservation of the contracting parties' entitlement to vary or cancel the right. With intimation, we think of the analogy between third party rights and assignation, the forms of intimation provided for by statute, and the law's recognition of "equivalents to intimation" where the notice to the debtor is as strong as those forms of intimation recognised at common law and by statute.<sup>14</sup> This delivery or intimation, it is important to stress, would not be necessary to constitute the right; it would merely make it irrevocable or unmodifiable unless made with a specific reservation.

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<sup>14</sup> 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.

24. **Do consultees agree that where a contract provides for a third party right without any provision about an entitlement of the contracting parties to vary or cancel the right, there will be no such entitlement if the term conferring the right upon the third party has been delivered or intimated to that party?**
25. **Do consultees further agree that the contracting parties may at the time of the delivery or intimation mentioned in the previous question reserve an entitlement to vary or cancel the third party's right?**
26. **Do consultees also agree that any purported acceptance of the right by the third party should not by itself have the effect of making the right irrevocable or unmodifiable?**

6.22 We have no strong *a priori* view on three further possibilities by which a third party right in a contract making no provision for revocability or modifiability might be made irrevocable. All of them are probably part of the existing law, and we are not aware of any particular practical difficulties that exist as a result.

6.23 The first of these is registration of the contract (or at least of the provisions in favour of the third party) in the Books of Council and Session or the sheriff court books. The registered document is in effect a public commitment by the contracting parties and if it contains the appropriate consent will also be a basis for enforcement by summary diligence. This seems a good basis for saying that the effect of such registration is that the contracting parties can no longer alter or cancel the third party's right. It would be necessary to add that if the registered contract also contained terms entitling the contracting parties to revoke then these would remain effective notwithstanding registration.

27. **Should registration of a contract conferring a third party right, whether for preservation only or also for execution, make that right irrevocable or unmodifiable unless the contract expressly provides the contracting parties with an entitlement to vary or cancel the right?**

6.24 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 irrevocable and unmodifiable under the 1999 Act. The right differs from the personal bar already mentioned 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, it would be enough to make her right irrevocable 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 revocability.

6.25 A further requirement for there to be reliance is that the third party previously knows about the existence of the right. It is necessary here to bear in mind the discussion above of the possibility that the third party right be made irrevocable by formal intimation from the contracting parties. With such intimation, if the suggestion is accepted, there would be no need for reliance to make the third party right irrevocable. This seems to be how the present

law should be understood. In *Carmichael*, Lord Dunedin expressed the possibility 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."<sup>15</sup> The co-feuar cases were his main example of this in the authorities, although as already discussed these are actually rather doubtful instances of the doctrine of *jus quaesitum tertio*. But it seems clear that if formal intimation is accepted as a ground for making a third party right irrevocable, then reliance need only be introduced as a further such ground on the footing that the third party had become aware of the provision in its favour in some fashion less formal than intimation.<sup>16</sup>

6.26 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 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 vary or cancel the right. There may be a model readily to hand in the statutory *rei interventus* formulation in the Requirements of Writing (Scotland) Act 1995 which, paraphrased to fit the context provided by the example of Tertia, 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 vary or cancel her right, provided that (1) her position 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' revocation or variation of the contract.<sup>17</sup> 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.

6.27 While a provision like this would not eliminate all uncertainty about third party reliance and detriment, 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 also that they must be further materially affected by the proposed revocation or modification. This would, however, not reach the 1999 Act's case of reliance that was reasonably foreseeable, but not at the time it took place actually known, to the contracting parties, and we would be interested to know whether consultees think that this situation should be included as well.

- 28. Should the third party's detrimental reliance (perhaps defined along the lines found in sections 1(3) and (4) of the Requirements of Writing (Scotland) Act 1995), based upon informal knowledge of its right and known to and acquiesced in by the contracting parties, make a third party right irrevocable or unmodifiable?**
- 29. In addition, should third party reliance that is reasonably foreseeable by the contracting parties (although they had no actual knowledge of it at the time it happened) have the same effect?**

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<sup>15</sup> *Carmichael v Carmichael's Ex* 1920 SC (HL) 195, 203.

<sup>16</sup> 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.

<sup>17</sup> See further on statutory *rei interventus* paras 2.5 and 2.53 above.

6.28 The *Carmichael* case accepts the possibility, and indeed the case was decided on the basis, that the third party's informally acquired knowledge of its right can make it irrevocable. This must be seen, however, as a decision very much based on its own particular facts, tied to the House of Lords' finding of law that a third party right had to be irrevocable before it could be enforced at all. We are, however, proposing that that initial requirement be removed.<sup>18</sup> We are now at the point where we are considering when, in the absence of any provision in the contract about revocation, the third party's right should be treated as being irrevocable. The possibilities of making the third party right irrevocable by way of formal intimation or reliance (and indeed delivery) become effectively redundant if the third party's mere knowledge of the right is enough to achieve that effect anyway. There is accordingly no such rule in any of the comparator instruments.

6.29 On balance, we think that the main focus in determining when irrevocability or unmodifiability arise, apart from the provisions of the contract itself and the fulfilment of any conditions it lays down, should be on what the contracting parties have done (or indeed, not done), since it is their ordinary entitlement to vary or cancel their contract which is to be lost. Thus the questions arising from our previous discussion are as follows:

- Have the conditions for the exercise of the third party right been met before any attempt to vary or cancel it by the contracting parties?
- Have the contracting parties made any representations or promises that the third party right is irrevocable or unmodifiable?
- Has there been delivery or formal intimation of the contract to the third party by the contracting parties?
- Have the contracting parties registered the contract?
- Has there been third party reliance of which the contracting parties knew and to which they acquiesced?

6.30 Third party knowledge by itself does not, we think, have the weight of these other circumstances against the contracting parties. We note that if the *Carmichael* case were to arise under the scheme of rules which we are proposing here, young *Carmichael*'s executrix would still win, on the basis that the insurance policy had not been revoked at the point in time when the third party right crystallised. Recognising that a negative answer would render some of the earlier questions in this Chapter redundant, we nonetheless ask:

**30. Do consultees agree that a third party right should not become irrevocable simply because the third party has informally acquired knowledge of the existence of the right?**

6.31 It appears 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.<sup>19</sup> We would be interested to know whether consultees think that the same result should follow in Scots law.

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<sup>18</sup> See para 6.6 above.

<sup>19</sup> Basler Kommentar OR I (5th edn, 2012) Gonzenbach/Zellweger-Gutknecht, Art 112, N 18 (a reference for which we are indebted to Dr Ross Anderson, Advocate).

31. **Should the third party's death prior to any cancellation or variation of the contract containing its right have the effect of making the right irrevocable or unmodifiable so that it becomes enforceable by the deceased's executors?**

### Assignment and irrevocability

6.32 A consequential and subsidiary issue arising from the previous discussion of when a third party right may be made irrevocable concerns assignment of the third party's right. As indicated in Chapter 2,<sup>20</sup> 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. 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 revocable or modifiable, as in the model being put forward for consideration in this Chapter, assignability may be a more complex question. If there is an assignment by the third party while the right remains unrevoked or unmodified, to what extent is the assignee's right subject to the contracting parties' power to revoke 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?

6.33 We think that in principle if the third party right has become irrevocable before the assignment takes place, then the third party's assignee receives the same irrevocable right, the assignment being completed by its formal intimation to the contracting parties (in which process, it must be remembered, they are entirely passive recipients of notification and which cannot therefore constitute any sort of personal bar against them).<sup>21</sup> It could, however, be suggested that the assignment is a form of reasonably foreseeable reliance by the third party, detrimental because as cedent it comes under contractual duties to the assignee,<sup>22</sup> which should therefore make a previously revocable right irrevocable. On this argument, assignment and irrevocability would be concurrent events.

6.34 If we suppose, however, that the right remains or continues to be revocable or modifiable by the contracting parties at and after the time the third party assigns, the question becomes first one of whether a revocable 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 assignment is competent.<sup>23</sup> The assignment will be completed by intimation to the contracting parties, and the assignee takes the risk that they will exercise the power to revoke or modify. Must subsequent acts by the contracting parties relate to the assignee rather than the third party, either to revoke or modify the right, or to make it irrevocable or unmodifiable against the assignee? Should the reliance of the assignee upon the right be relevant to prevent revocation or modification by the contracting parties?

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<sup>20</sup> See para 2.81 above.

<sup>21</sup> Anderson, *Assignment*, para 6.02.

<sup>22</sup> Implied warrandice that the claim assigned subsists and that the cedent has conferred on the assignee everything necessary to make the claim effectual (W A Wilson, *The Scottish Law of Debt* (2<sup>nd</sup> edn, 1991), para 27.8).

<sup>23</sup> See discussion in Wilson, *The Scottish Law of Debt* (fn 22 to para 6.33 above), para 1.1 (*inter alia* quoting G J 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 Assignment of Contingent Rights" 1993 JR 23, 26-37; McBryde, *Contract*, para 12.30.

6.35 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/modify or to make the contract irrevocable/unmodifiable would have to be by the contracting parties and/or by/to the assignee.<sup>24</sup> 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.

6.36 The 1999 Act contains no provision on the assignment of third party rights: the Law Commission of England & Wales saw no good reason why such assignment should not be possible but thought no legislation was needed to make the position clear. Clause 12 of the draft Hong Kong Bill 2013, 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".<sup>25</sup> But it does not deal with the issue identified by the Law Reform Commission of Hong Kong in its 2005 Report.

6.37 We do not think that there is any need in Scots law to make clear that in general a third party right can be assigned. We are uncertain, however, whether it is necessary to make some provision about the effects of assignation by the third party in relation to making its right irrevocable or unmodifiable; if such a provision is required, how should the provision be framed? We therefore ask as an open question:

**32. Should there be some provision about the effects of assignation in relation to making a third party right irrevocable or unmodifiable? If so, which direction should that provision take on the matter?**

6.38 In discussion with our Judicial Advisory Group the possibility of the third party putting its right into trust was raised. There are various different permutations: the third party (TP) might be sole trustee for the benefit of a fourth party,<sup>26</sup> 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. Only the first of these requires intimation, and then only to the beneficiary. Thus, unlike an assignation of a third party right, which to be effective requires to be intimated to the contracting parties as debtors in the right assigned, a declaration of trust may be effected without the contracting parties knowing about it. To gauge views on how this might affect those parties' ability to revoke or modify the third party's right, we ask:

**33. In relation to making a third party right irrevocable or unmodifiable, should there be some provision about the effect of the third party declaring a trust over its right? If so, which direction should that provision take, and, in particular, should it take account of the identity of the trust beneficiary?**

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<sup>24</sup> Law Reform Commission of Hong Kong, Report on Privity of Contract (2005), para 4.189.

<sup>25</sup> The draft Bill is accessible at: <http://www.doj.gov.hk/eng/public/pdf/2012/consulte.pdf>.

<sup>26</sup> Under the conditions set out in *Allan's Trs v Lord Advocate* 1971 SC (HL) 45.

## Two kinds of case?

6.39 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.<sup>27</sup> This is best seen in the judgment of Lord Dunedin in *Carmichael* (emphasis added):

“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.”<sup>28</sup>

6.40 Unfortunately, Lord Dunedin did not elaborate on the consequences of the distinction, although he did identify the facts of *Carmichael* as lending themselves to the latter category. The question 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.

6.41 In 1961 JT Cameron (later Lord Coulsfield), following Lord Dunedin, 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 (eg delivery of the deed to the third party) to constitute the right.<sup>29</sup> 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.<sup>30</sup>

6.42 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

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<sup>27</sup> See, eg, SLC Memo No 38, 1977; McBryde, *Contract*, para 10.04.

<sup>28</sup> *Carmichael v Carmichael's Ex* 1920 SC (HL) 195, 197-198.

<sup>29</sup> 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.

<sup>30</sup> See especially *Dickson v National Bank of Scotland plc* 1917 SC (HL) 50.

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 leave intact, not only these basic principles, but also the quite separate doctrine of *jus quaesitum tertio*.<sup>31</sup>

6.43 It may be, 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. We are not concerned with what other rights may be created 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 a practical exercise 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.

- 34. Do consultees agree that there is no need in the present exercise to deal with competing claims between the third party and the contracting parties, and that 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?**

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<sup>31</sup> MacQueen, "Third Party Rights in Contract", p 250; commented upon by Sutherland and Johnston, "Contracts for the Benefit of Third Parties", p 225.

# Chapter 7                      Renunciation or Rejection, Remedies and Defences

7.1     In this Chapter we consider a range of significant issues, most of which concern the interaction of third party rights with the general law. The overall question that arises is whether these matters may 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

DCFR	PICC	CESL	Contracts (Rights of Third Parties) Act 1999
<p>II. – 9:303: Rejection or revocation of benefit</p> <p>(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.</p>	<p>Article 5.2.6</p> <p><i>Renunciation</i></p> <p>The beneficiary may renounce a right conferred on it.</p>	<p>Article 78</p> <p>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.</p> <p>On such rejection, the right is treated as never having accrued to the third party.</p>	<p>No relevant provision.</p>

7.2     Aside from the 1999 Act, the comparator instruments agree with present Scots law 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.

7.3 Whilst all this does seem self-evident, and it is striking that despite the previous absence of third party rights in English law no provision was thought necessary in the 1999 Act, some statutory clarification might be helpful in the absence of any case authority on the matter in Scotland. It has been pointed out by Laura Macgregor that the DCFR's mechanism for rejection by the third party of the benefit made in his favour offers greater certainty on this point than Scots law.<sup>1</sup> The PICC and the proposed CESL contain provisions equivalent to that in the DCFR.

7.4 It is then necessary to decide how and when renunciation should be available. Professor Sutherland has stated that the objective in deciding this question must be protecting the third party who has received an unsolicited right, and that the risk of uncertainty should fall on the contracting parties rather than the third party.<sup>2</sup> Consequently, a possible approach is to deem third party rights to be valid unless they are renounced by the third party, allowing the third party to indicate dissent to the right at any time.

7.5 Professor Sutherland goes on to write, however, that third parties should lose their right to renounce once they have accepted the right or created the impression that they have done so.<sup>3</sup> This is a complex point. Acceptance is not required for the right's existence, and the third party should not generally come under any liability as a result of the right made in its favour. But it seems unreasonable to allow the third party to renounce the right if its conduct has previously caused the contracting parties to spend money and time upon the right's realisation.

7.6 While the point seems to be relatively minor, it may be helpful to offer statutory clarification that a third party may renounce its right. As the contracting parties may initially confer a right on the third party either expressly or impliedly, the third party's renunciation could likewise be express or implied. An implied renunciation could not, however, be assumed from a lack of acknowledgement of the right, 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 should be something more than mere passivity in response to the prospect of benefit. The third party must actively renounce the right in some way. An implied renunciation might take the form of, for example, returning delivered documents providing for the right to the contracting parties.

7.7 In relation to the third party's conduct giving the impression of willingness to receive the benefit to the prejudice of the contracting parties, one solution may be 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. This would leave open a further possibility that the third party's conduct was such as to give rise to a personal bar enforceable against it by the contracting parties. But this would be an extreme

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<sup>1</sup> Macgregor, *Report on the Draft Common Frame of Reference*, Appendix, 5.2.1.

<sup>2</sup> Sutherland, "Third Party Contracts", p 210.

<sup>3</sup> *Ibid*, p 211.

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.<sup>4</sup>

7.8 A final point may be whether a third party right is capable of being renounced only as a whole, or may be so in part. The latter possibility would seem to require that the right was divisible in some way.

- 35. Would a statutory mechanism allowing third parties to renounce rights conferred in their favour be useful?**
- 36. Should it be provided that such renunciation of a third party right may be express or implied from the third party's conduct?**
- 37. Is it necessary to make any provision to protect the contracting parties against unfair exercise of the third party's power to renounce the right, for example to require the return of any benefit already conferred and reimbursement of expenses incurred by the contracting parties?**
- 38. Should it be made possible to renounce a right in part if it is divisible?**

#### Remedies available to the third party

7.9 Professor McBryde states that there is little doubt that a third party can sue for payment due<sup>5</sup> or specific implement in enforcement of its right, while current thought is that third parties are also able to make claims for damages.<sup>6</sup> The third party's loss, according to Professor McBryde, would be the measure of the damages claim. The third party is further able to waive or discharge the claim.<sup>7</sup> Essentially, Professor McBryde thinks that there is no reason why a third party should not be allowed to call upon any judicial remedies which are permissible for the contracting parties.<sup>8</sup> It has also been observed by Professor Sutherland that gratuitous obligations are enforceable in the same way as other voluntary obligations in Scots law (principally, through actions for specific implement, payment and damages).<sup>9</sup>

DCFR 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; ...
PICC	No default provision.

<sup>4</sup> Cf 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).

<sup>5</sup> This is the case in the majority of claims: *SME* Vol 15, para 837.

<sup>6</sup> McBryde, *Contract*, para 10.24, *SME* Vol 15, para 837.

<sup>7</sup> McBryde, *Contract*, para 10.24.

<sup>8</sup> *Ibid*; SLC Memo No 38, 1977, pp 38-41; *SME* Vol 15, para 837.

<sup>9</sup> Sutherland, "Third Party Contracts", pp 221-225.

CESL Article 78	<p>3. When one of the contracting parties is bound to render a performance to the third party under the contract, then:</p> <p>(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; ...</p>
Contracts (Rights of Third Parties) Act 1999	<p>Section 1(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).”</p> <p>Section 3(6): “When the third party brings proceedings against the promisor in which the former seeks to enforce a term under section 1, “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.”</p>

7.10 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. We have already noted that, while the approach of the 1999 Act (and the proposed CESL) is to give the third party the remedies it would have if the obligation to be enforced was a contractual one, the DCFR instead draws an analogy with the remedies available to the creditor of a unilateral undertaking. This is because, unlike the other two instruments (but like Scots law), the DCFR recognises the legal enforceability of such undertakings. The remedies made available to the third party thus include cure, specific performance (including payment) and damages. The DCFR remedy of ‘withholding performance’, equivalent to the Scots law remedy of retention, will not be relevant to the third-party right-holder, since it has no obligatory performance to withhold. We will discuss in a little more detail below the question of a remedy of termination for the third party.

7.11 It might seem that the matter of which remedies should be available to third parties could likewise be left to be determined by the general principles of Scots law on remedies. This could either be for the courts to develop as they see fit, or a brief provision could be enacted stating that the third party should have available any generally appropriate remedy for the enforcement of a voluntary obligation. The approach taken 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, seems inapt to the form of third party right that will continue to exist in Scots law if our tentative proposals become law; but the wording of the DCFR may be a more useful model for a system recognising the unilateral promise.<sup>10</sup>

7.12 If such generalised provisions were to be enacted, however, at least two points might helpfully be made clear. The most significant uncertainty in the current Scots law of third party rights is the general availability to the third party of a damages claim.<sup>11</sup> A specific

<sup>10</sup> See para 2.4 above.

<sup>11</sup> See *Scott Lithgow Ltd v GEC Electrical Projects Ltd* 1989 SC 412, discussed at para 2.49 above.

provision making this clear beyond doubt could be valuable for the avoidance of any lingering uncertainty. Further, the right to a cure of a defective performance of a third party right, for example by repair or replacement of goods supplied, may also be an attractive option for the third party in at least some circumstances. If this is not already caught by the general availability of specific implement, then it might be mentioned in legislation as an aspect of that remedy.

7.13 It could also be provided that the remedies thus made available to the third party do include rescission of its right. Rescission of the obligations of the contracting parties between themselves clearly lies beyond the power of a third party to that contract. But there may be circumstances in which the third party wishes to break off its relationship with the contracting parties: for example, if repeatedly unsatisfactory attempts to perform the third party right are made, or even just one completely unsatisfactory one. This situation would be most likely to arise where the third party right consisted of the delivery of goods or services. Such rescission falls to be distinguished from the third party's entitlement to reject or renounce its own right, discussed in the previous Chapter, which cannot be used once the party has expressly or impliedly indicated its willingness to receive the performance of the right. A right to rescind for material breach, in addition to the claim for damages that might also arise, could be useful to save the third party from being subjected to repeated attempts to perform.<sup>12</sup>

39. **Should it be provided that third parties have at their disposal all remedies which are appropriate to the enforcement of their right? If not, how (if at all) should the issue of remedies be addressed in any legislation on third party rights?**
40. **Would it be useful to make clear in legislation the availability of (i) a damages claim; (ii) a right to a cure in appropriate cases, possibly as an aspect of specific implement; (iii) a right to rescind for material breach?**

#### *Rectification*

7.14 A final question is whether the remedy of rectification of the document embodying the contract, available under sections 8 and 9 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985, should also be available to the third party. Arguably it is already so available, since the 1985 Act does not expressly restrict the remedy to the parties to the document to be rectified. As has been pointed out, "[t]his could be of benefit ... to a third party claiming that a document failed to express the original parties' common intention to confer a *jus quaesitum tertio*."<sup>13</sup> It would of course be necessary for the third party to produce evidence in support of its claims about the contracting parties' common intention, and this, coupled with the ability of the original parties or their successors to lead counter-evidence, should for the most part provide quite adequate protection against fraud in

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<sup>12</sup> DCFR III.-3:501(1) allows termination only in contractual relationships and thus seems to deny the possibility of any such remedy for a third-party right-holder.

<sup>13</sup> MacQueen and Thomson, *Contract*, para 3.26.

general.<sup>14</sup> In pursuit as much of general current understandings and clarification of the existing position as of its reform, we ask:

**41. Should third parties be entitled to exercise the remedy of rectification in relation to the contract under which rights are claimed?**

**Defences**

7.15 In the absence of much authority on the matter, it is thought that in Scots law a defect in the contract's formation rendering it invalid (whether void or voidable) - ie error, misrepresentation, fraud, force and fear, facility and circumvention and undue influence - will also make the third party's right invalid (void or voidable, as the case may be).<sup>15</sup> It is not entirely clear whether, if part of a contract is illegal but the part containing the third party's right is legal, the latter is enforceable, although it is clear that the right is not enforceable if it is dependent upon the illegality.<sup>16</sup> There is almost no authority on the effect upon a third party right of the contract's frustration by supervening events.<sup>17</sup>

DCFR 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: ...  (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.
PICC Article 5.2.4 <i>Defences</i>	The promisor may assert against the beneficiary all defences which the promisor could assert against the promisee.
CESL Article 78	3. When one of the contracting parties is bound to render a performance to the third party under the contract, then: ...  (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.

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<sup>14</sup> It is worth noting here that the contracting parties might pursue rectification in order to remove an unintended third party right, in which case of course there are provisions in the 1985 Act (s 9) for the protection of the third party's interests against any adverse effects of the rectification.

<sup>15</sup> See paras 2.82-2.83 above.

<sup>16</sup> *Ibid.*

<sup>17</sup> See para 2.83 above.

<p>Contracts (Rights of Third Parties) Act 1999, Section 3: Defences etc. available to promisor</p>	<p>(2) The promisor shall have available to him by way of defence or set-off any matter that—</p> <p style="padding-left: 40px;">(a) arises from or in connection with the contract and is relevant to the term, and</p> <p style="padding-left: 40px;">(b) would have been available to him by way of defence or set-off if the proceedings had been brought by the promisee.</p> <p>(3) The promisor shall also have available to him by way of defence or set-off any matter if—</p> <p style="padding-left: 40px;">(a) an express term of the contract provides for it to be available to him in proceedings brought by the third party, and</p> <p style="padding-left: 40px;">(b) it would have been available to him by way of defence or set-off if the proceedings had been brought by the promisee.</p> <p>(4) The promisor shall also have available to him—</p> <p style="padding-left: 40px;">(a) by way of defence or set-off any matter, and</p> <p style="padding-left: 40px;">(b) by way of counterclaim any matter not arising from the contract,</p> <p>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.</p> <p>(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.</p>
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7.16 The 1999 Act, the DCFR, the PICC and the proposed CESL 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 we are to allow the third party to use any remedies which would in general be available to a contracting party, the logical counterpart rule on defences would be that which is expressed in the DCFR, the PICC and the proposed CESL. But it might be necessary to add specific protection for the third party's interest where the reason for the contract's failure does not directly affect the third party right.

7.17 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."<sup>18</sup>

7.18 That being the case, a reasonable approach might 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.

7.19 But it may well be that questions arising in connection with third party rights pertaining to invalidity, unenforceability and frustration can be left to be dealt with under the general principles of the law of obligations and remedies, making unnecessary specific statutory provision such as found in the DCFR, the proposed CESL and the 1999 Act.

**42. Are specific provisions required regarding the enforceability of third party rights arising from contracts which fail as a result of invalidity, illegality, or frustration?**

*“Set-off”*

7.20 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.

7.21 The Scots law analogue to set-off is compensation under the Compensation Act 1592. It is pleadable only between liquid debts, with an exception mainly in the discretion of the court where an illiquid debt may be rendered liquid without delay. 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 capacity. Compensation is not automatic but must be pleaded, so only arises in the context of court action. The effect of compensation is to extinguish the debts *pro tanto*.

7.22 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 in respect of an existing 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 see no need to make legislative provision on this point in Scotland.

7.23 It may, however, be for consideration whether compensation available between the contracting parties should 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. But it seems to us that the availability of compensation between the contracting parties should not extinguish the third party right unless the two debts are clearly relevant to the right. In other words,

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<sup>18</sup> SME Vol 15, para 839.

compensation is like illegality and frustration: the impact of the discharge or unenforceability must be felt specifically in relation to the third party right. 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.”<sup>19</sup>

7.24 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. We accordingly ask:

- 43. Would a specific provision, to the effect that compensation under the Compensation Act 1592 arising from or in connection with the contract and relevant to the third party’s right under the same contract could be used in extinction of the third party’s claim if liquid, be appropriate and useful?**

7.25 We note in parenthesis that the law of compensation is in many ways narrower in scope than the English law of set-off; but this is not the occasion upon which to tackle possible reforms in this area of the law.

### *Prescription*

7.26 We described in Chapter 2 the application of the Prescription and Limitation (Scotland) Act 1973 to the present law of *jus quaesitum tertio*.<sup>20</sup> While that discussion shows that there may be 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 think that there can be no doubt that it should do so. If consultees were to think 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, that could certainly be included in any reform package emerging from the present exercise. Such a provision would be 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).<sup>21</sup> We accordingly ask:

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<sup>19</sup> LC No 242, 1996, para 10.11.

<sup>20</sup> See paras 2.86-2.89 above.

<sup>21</sup> See para 2.87 above for these restrictions.

- 44. Should a specific provision be inserted into paragraph 1 of Schedule 1 to the Prescription and Limitation (Scotland) Act 1973 to make clear that the short negative prescription applies to third party rights arising from a contract?**

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

7.27 In principle, the obligation of a contracting party to perform to the third party is unaffected by the other contracting party's breach, even if that breach is such as to entitle the first party to withhold its performance to the second party (retention) or even to terminate its obligations of performance to that party (rescission). But in practice such a breach may make performance on the part of the first contracting party an impossibility, or the first party's obligation may be contingent upon the performance which the second contracting party was to render under the contract (eg putting the first party in funds that may then be released to the third party).<sup>22</sup> In such cases, it is thought likely that the third party's remedy is against the second contracting party. The *SME* states that this is so because the second contracting party has promised the third party that they will not default in rendering counterpart performance to the first party to the contract.<sup>23</sup> This aspect of the promissory analysis is useful, as it allows for security on the part of the third party and ensures that the first contracting party is not unfairly called upon to perform in favour of the third party when financially or otherwise unable to do so.

- 45. 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, should the third party have a remedy against the initially defaulting party?**

*Contracting out of liabilities to third parties*

7.28 One minor point concerns the contracting parties' ability to contract out of liability to third parties. The Law Society of England and Wales have described the drafting of the proposed CESL's provisions on third party rights as "perhaps over-concise," on the grounds that it is not clear whether it would be feasible under Article 78 to contract out of liabilities to third parties.<sup>24</sup>

7.29 There is no express provision in the 1999 Act allowing parties to contract out of liability to third parties, but it is apparently "easy and common" under English law to contract out of such liability. The Law Society 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."<sup>25</sup>

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<sup>22</sup> *SME* Vol 15, para 839.

<sup>23</sup> *SME* Vol 15, paras 837 and 839.

<sup>24</sup> Law Society of England and Wales, *Common European Sales Law: Response to the UK Government Call for Evidence*, May 2012, accessible at:

[http://international.lawsociety.org.uk/files/The%20Law%20Society\\_Response%20to%20CESL%20consultation\\_0512\\_Final.pdf](http://international.lawsociety.org.uk/files/The%20Law%20Society_Response%20to%20CESL%20consultation_0512_Final.pdf).

<sup>25</sup> *Ibid.*

7.30 We do not feel that express provision to this extent is necessary in any Scottish legislation on this subject, 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.<sup>26</sup>

**46. Do consultees agree that no express provision is needed to deal with the possibility that contracting parties may exclude or limit a liability to third parties (such as damages) that would otherwise arise?**

**Other points arising from the 1999 Act**

7.31 There are a number of issues related to enforcement which emerge from a study of the 1999 Act. Apart from the first, we think that they 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.

*Third party can enforce a term of the contract only*

7.32 A first point regarding the remedies available to third parties is that it should be made clear in any legislation pertaining to third party rights that the third party may enforce only the terms in the contract made in its favour, and not any other part of the contract. Clarification on this point is necessary because it will prevent third parties from exercising influence over terms which have little direct relevance to them. Indeed, the Contracts (Rights of Third Parties) Bill contained in the Law Commission's Privity of Contract: Contracts for the Benefit of Third Parties Report was altered so that section 1(1) no longer referred to the third party's right "to enforce the contract":<sup>27</sup> the 1999 Act now refers to the right to enforce "a term in the contract." This section was changed due to concerns voiced in the construction sector that third party rights could be exercised to the extent that the contracting parties could not vary any of their work, whereas the construction industry standard forms do indeed provide for variations and these are commonly used, indeed essential to the successful completion of construction projects.<sup>28</sup>

7.33 Professor Beale thinks that even the word "term" may be too ambiguous, as this can refer to a single obligation, or to a clause in a document which could impose one or more obligations, some of which may be irrelevant to the third party.<sup>29</sup> A potential solution may be to refer to the third party as entitled to require performance of any right available to it under the contract.<sup>30</sup> We therefore ask:

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<sup>26</sup> See para 2.85 above.

<sup>27</sup> LC No 242, 1996, p 173.

<sup>28</sup> Beale, "Review", p 226.

<sup>29</sup> *Ibid.*

<sup>30</sup> *Ibid.*

**47. Do consultees agree that it should be clear on the face of any legislation arising from this Discussion Paper that the third party can enforce only its own rights under the contract?**

*Concurrency between the third party and the contracting parties*

7.34 A notable aspect of the 1999 Act is a provision in section 4 that section 1 of the Act does not affect the promisee's right to enforce the contract. Such a rule consolidates the fact that the promisor's duty 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.<sup>31</sup> 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<sup>32</sup> – we do not see that it is necessary to enact an equivalent term for a reformed Scots third party right. In case we have missed anything, however, we ask:

**48. Would an equivalent to section 4(1) of the 1999 Act serve any useful purpose in Scotland?**

7.35 Section 4 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 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.<sup>33</sup> This is significantly more convenient and efficient than requiring that one or more of the contracting parties sue alongside the third party. But we see no need to elaborate on this point, which for Scots law seems self-evident. We ask:

**49. Do consultees agree that the third party need not involve any of the contracting parties in its action beyond the one from whom it seeks a remedy?**

*Double liability for contracting party bound to perform to the third party?*

7.36 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,

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<sup>31</sup> LC No 242, 1996, p 128.

<sup>32</sup> See *Mercedes-Benz Finance Ltd v Clydesdale Bank plc* 1997 SLT 905 (discussed at para 2.42 above).

<sup>33</sup> *SME* Vol 15, para 837.

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.”

7.37 This is an unusual provision which is not reflected in any of the other measures analysed in this Discussion Paper. Indeed, it was noted in the commentary to the DCFR that:

“In some cases there is a theoretical risk of double liability. A contracting party might be liable to the other contracting party for not performing in favour of the third party and also liable to the third party. This is only a theoretical possibility, however, because the parties would be most unlikely to provide expressly for this and it would not be reasonable or in accordance with the requirements of good faith and fair dealing to imply an agreement to this effect.”<sup>34</sup>

7.38 Of course, in Scots law, at present, we cannot be certain that the general duty of good faith would help resolve such issues.<sup>35</sup> It is nonetheless not immediately clear that a provision like section 5 of the 1999 Act would be useful in Scots law. If, as we suggested in the discussion of remedies, the third party has a right to performance from one of the contracting parties and a right against the other contracting party under which the third party can only oblige the latter to act under the contract to the extent that the first contracting party is able to perform, then a provision equivalent to section 5 (b) will not be necessary, as the second contracting party will not be obliged to ‘make good’ the first’s lack of or deficient performance. Likewise, section 5 (a) is also unnecessary in Scots law.

**50. Do consultees agree that there is no need in Scots law for a provision equivalent to section 5 of the 1999 Act?**

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<sup>34</sup> DCFR Vol 1, p 622.

<sup>35</sup> Although there is some recognition of a broad principle of good faith in Scots law (see, eg, Lord Clyde in *Smith v Bank of Scotland plc* 1997 SC (HL) 111, especially at 121), the point is not entirely settled. For further discussion, see H L MacQueen, “Good Faith in the Scots Law of Contract: an Undisclosed Principle?” in A D M Forte (ed), *Good Faith in Contract and Property Law* (1999), pp 5-37.

# Chapter 8 Relationship with Specific Rules

## Introduction

8.1 The proposals for a restated regime of third party rights set out earlier in this Paper – and which are summarised in Chapter 9 – are intended to be general in their application. Broadly speaking, they are not intended to be restricted to particular types of contract or party or situation (nor, to put the same point in a different way, to be inapplicable to particular types of contract, etc.). We recognise, though, that there are two qualifications to this. First, as we have already seen,<sup>1</sup> there are certain specific statutory or common law rules governing the rights of third parties in particular areas. Secondly, and leading on from this, the rights of third parties under the current law have, at a practical level, tended to be recognised in particular spheres of activity.<sup>2</sup> We see no reason why this might not be so under any statutory reform based on our proposals; much depends on the use which practitioners and others decide to make of the rules.

8.2 In this Chapter we are concerned with the ramifications of these qualifications. To that end we seek views on whether the proposed reform of the law should be expressly subject to such statutory or common law rules as already exist, and indeed to those which might be created in the future.

## Current law

8.3 We begin by setting out the main such rules in the current law of which we are aware.<sup>3</sup> Amongst the statutory ones are the following:

- The Married Women's Policies of Assurance (Scotland) Act 1880;<sup>4</sup>
- The Bills of Exchange Act 1882;<sup>5</sup>

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<sup>1</sup> Eg see paras 2.43-2.47.

<sup>2</sup> We note that, 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).

<sup>3</sup> See generally *SME* Vol 15, paras 841 onwards. In addition, see the Law Commission for England and Wales' Consultation Paper on Privity of Contract: Contracts for the Benefit of Third Parties (CP No 121, 1991) at Pt 3 and para 5.38, and Pt 12 of the corresponding Report (LC No 242, 1996). Section 6 of the draft Bill appended to the Report began: "Section 1 above [ie the general statutory rule of a third party to enforce a contract] is without prejudice to any right or remedy of a third party which exists or is available apart from this Act." Subsection (2) then made provision for some specific contracts and agreements, such as contracts for the carriage of goods and bills of exchange. Although the Law Commission's Bill and the 1999 Act are in broadly similar terms, they differ most markedly in respect of s 6 in each (see *Hansard*, HC, Second Reading Committee (29 June 1999)).

<sup>4</sup> Section 2 (as amended) provides that where a person takes out a policy of insurance on his or her own life to be for the benefit of his or her spouse and/or children, a trust is created in favour of those purported beneficiaries. The equivalent provision in English law is discussed at paras 12.22-12.27 of LC No 242, 1996; the suggestion of extending it to other insurance contracts was rejected for the time being.

- The Third Parties (Rights against Insurers) Acts 1930 and 2010;<sup>6</sup>
- The Package Travel, Package Holidays and Package Tours Regulations 1992 (SI 1992/3288) as amended (SI 1995/1648; SI 1998/1208);<sup>7</sup>
- The Carriage of Goods by Sea Act 1992;<sup>8</sup>
- Legislation implementing international conventions on Contracts for the International Carriage of Goods by Road, Rail or Air;<sup>9</sup>
- The Road Traffic Acts so far as they pertain to motor insurance;<sup>10</sup>
- The Title Conditions (Scotland) Act 2003.<sup>11</sup>

8.4 In relation to the common law, the employment contract is an area in which third party rights might be sought. Although we have not found a discussion of this in any of the leading Scottish textbooks on the subject,<sup>12</sup> we note that there was a concern at the time of the passage of the 1999 Act that the legislation should not be applicable to contracts of employment. This resulted in section 6(3) of the Act, which expressly disapplies the general third party rights rule in relation to contracts involving employees, workers and agency

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<sup>5</sup> The Act gives third party rights of enforceability only to those who are holders of bills of exchange, promissory notes and other negotiable instruments to which the Act applies. Unwelcome consequences might follow if other third parties were to acquire rights of enforcement (though the Law Commission's discussion of this issue notes that, as a matter of commercial practice, the 1882 Act is treated as applying to negotiable instruments which do not in fact fall within its scope (LC No 242, 1996, fn 23 to para 12.16); this, though, may be considered to be extending the third party rights regime by analogy rather than extending it to those who would otherwise be strangers).

<sup>6</sup> The 1930 Act will be replaced by the 2010 Act when the latter comes into force.

<sup>7</sup> These provide rights for consumers against the suppliers of the relevant services, with 'consumer' being defined to include "the principal contractor, any person on whose behalf the principal contractor agrees to purchase the package ('the other beneficiaries') or any person to whom the principal contractor or any of the other beneficiaries transfers the package" (Reg 2(2)). The "other party to the contract" is liable "to the consumer" for the proper performance of the contract, including a liability in damages (Reg 15).

<sup>8</sup> For a discussion of this topic, see E Clive, "*Jus Quaesitum Tertio* and Carriage of Goods by Sea" in D L C Miller and D W Meyers (eds), *Comparative and Historical Essays in Scots Law: A Tribute to Professor Sir Thomas Smith QC* (1992). Professor Clive was a Scottish Law Commissioner at the time of the preparation of the joint Report (Rights of Suit in Respect of Carriage of Goods by Sea: LC No 196, 1991; SLC No 130, 1991) on which the 1992 Act is based.

<sup>9</sup> International carriage of goods by road is governed by the Geneva Convention on the Contract for the International Carriage of Goods by Road 1956 (CMR), given statutory force by the Carriage of Goods by Road Act 1965, as amended by the Carriage by Air and Road Act 1979. International carriage of goods by rail is governed by Appendix B (CIM) of the Berne Convention concerning International Carriage by Rail 1980 (COTIF), given the force of law by the Railways (Convention on International Carriage by Rail) Regulations 2005 (SI 2005/2092). International carriage of cargo by air is governed by the Warsaw Convention 1929 (as amended by the Hague Protocol 1955, the Guadalajara Convention 1961, the Guatemala Protocol 1971, and a series of four Additional Protocols agreed at Montreal in 1975) and the Montreal Convention 1999, applied in UK law via the Carriage by Air Act 1961, the Carriage by Air (Supplementary Provisions) Act 1962, subordinate legislation made under those Acts, and European Union legislation on air carrier liability.

<sup>10</sup> The principal enactments relating to road traffic are the Road Traffic Act 1988, the Road Traffic Offenders Act 1988 and the Road Traffic (Consequential Provisions) Act 1988. These Acts have been amended and extended by the Road Traffic Act 1991, the Road Safety Act 2001 and the Local Transport Act 2008. Many detailed provisions are contained in subordinate legislation.

<sup>11</sup> See paras 2.46 and 3.47 above.

<sup>12</sup> See, eg, D Brodie, *The Contract of Employment* (2008). But note R L C Hunter, "Collective Agreements" (cited in fn 2 to para 8.1 above); see also the discussion of restrictive covenants in para 3.19 above. We have also noticed an online article by Brodies LLP which, in contrasting 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/scotland-home/10167-scottish-employment-law-small-but-significant-differences-can-be-a-trap-for-the-unwary>. It would therefore appear to be a relevant part of the law.

workers.<sup>13</sup> There appears to be no reason to doubt that such a concern, i.e. as to whether the third party rights rule in English law might upset employment law in unexpected and unwelcome ways, should not also be a concern for Scots law.<sup>14</sup>

## **A provisional view**

8.5 Our provisional view, on which we would welcome comment, is that the particular rules set out in the paragraphs above should remain in force. This is principally because what we are concerned with in the current Paper is the broad topic of third party rights rather than the ways in which they have been provided either by particular legislation or as a result of case law in specific fields. If there are ways in which the current regime can be improved we would welcome comments and suggestions, but we have not undertaken a detailed study of these areas. They each belong to different and discrete parts of the law, and parts with which we have no direct interest for our present purpose.

8.6 Accordingly, in order to canvass views, we ask:

**51. (a) Do consultees agree that, in principle, the general reforms proposed in this Discussion Paper should be without prejudice to the specific third party rights under the current law (for example, in the areas listed in paragraphs 8.3 and 8.4)?**

**(b) Do consultees consider that any of the specific third party rights should be amended in the light of the general reforms which are proposed? Would it be desirable to provide that those reforms should not extend to employment contracts relating to employees, workers and agency workers?**

## **Options for reform: a constraint**

8.7 It is premature to discuss reform options in any detail, as we would first wish to consider all responses to this consultation and formulate some preliminary recommendations. We recognise, however, that there is a constitutional constraint in this area as the legislative competence of the Scottish Parliament is limited.<sup>15</sup> Although the law of contract, and of Scots private law in general, is devolved,<sup>16</sup> many of the specific third party rights happen to be in areas of the law which are reserved to Westminster. This will be a particular factor which we will need to consider when formulating any recommendations in this regard, especially in deciding how to reflect them in draft legislation.

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<sup>13</sup> The Lord Chancellor (Lord Irvine of Lairg) stated at Second Reading: "Clause 6 now prevents a third party from suing an employee for a breach of his contract of employment. Without this exception it could be thought that there was a risk of the rights of workers to take lawful industrial action being restricted in unexpected ways. It is not intended by a by-wind to upset the present balance of our labour laws" (*Hansard*, HL, Vol 596, col 21 (11 Jan 1999)).

<sup>14</sup> Some areas of employment law might be amenable to the exercise of third party rights. We have already mentioned restrictive covenants; pension rights flowing from contracts of employment may be another such area: see *Fox v British Airways plc* [2013] EWCA Civ 972, discussed at fn 152 to para 2.76 above.

<sup>15</sup> See s 29 of the Scotland Act 1998. Such considerations did not, of course, determine or play any part in the way in which s 6 of the Law Commission for England and Wales' draft Bill and what became s 6 of the 1999 Act were drafted. For more detail of those provisions, see fn 3 to para 8.3 above.

<sup>16</sup> See para 1.30 above.

8.8 It is not necessary to say much at this stage of our work, but we note that one approach would be to echo a provision found in both the DCFR and CESL: “Where there is a general rule and a special rule applying to a particular situation within the scope of the general rule, the special rule prevails in any case of conflict.”<sup>17</sup> This is in line with one of the domestic linguistic canons of statutory interpretation, sometimes known by the Latin tag *generalibus specialia derogant*. This provides that, in a case covered by a general enactment but also falling within a specific provision, the latter is presumed to prevail.<sup>18</sup>

8.9 There are a number of other options which may also be available, depending on the recommendations which we may consider suitable to make.<sup>19</sup> We expect to return to this topic in greater detail in the Report which will follow on this Paper and to be in a better position to see how the constraints of the devolution settlement can be accommodated. We therefore do not ask a specific question at this point, but would nonetheless welcome any comments.

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<sup>17</sup> DCFR I.-1:102(5); CESL Art 4(3).

<sup>18</sup> See O Jones and F A R Bennion, *Bennion on Statutory Interpretation* (6<sup>th</sup> ed, 2013), p 1038.

<sup>19</sup> Amongst the options, though perhaps not a very attractive one in modern times, is to set out the general rule on third party rights and to say nothing about the inter-action between it and existing (or future) particular rules on such rights. The silence will then require to be interpreted where necessary, perhaps as meaning that the general rule is to yield to a specific one where applicable. For a discussion of possible interpretations (using examples from the distant past) see D Daube, “The Self-Understood in Legal History” 1973 JR 126-134.

## Chapter 9      Overview of Suggestions for Reform

9.1      In this concluding Chapter we offer a brief overview of the model of third party rights in contract which would be produced if the provisional proposals made in the preceding chapters were implemented. We also seek views on the best general approach to take.

9.2      As at present, it would be possible for contracting parties to create by way of their contract a right (but not a duty)<sup>1</sup> for a third party or parties. The third party would have to be identified in or identifiable from the express terms of the contract,<sup>2</sup> but need not be in existence at the time the contract is formed.<sup>3</sup> There is no requirement that the third party accept the right,<sup>4</sup> or that the contract be in writing.<sup>5</sup>

9.3      The intention of the contracting parties to confer a right, as distinct from the third party having an interest in or being benefited by the performance of the contract, may be expressed in or implied from the contract.<sup>6</sup> The third party right may co-exist with the rights of the contracting parties between themselves.<sup>7</sup> The contracting parties may make clear by express provision that they intend no third party right to arise from their contract,<sup>8</sup> or exclude or limit liabilities to the third party which might otherwise arise, the latter always being subject to the applicability of the unfair contract terms legislation.<sup>9</sup>

9.4      The third party's right may be to claim payment or other performance from one or more of the contracting parties, but can also take the form of an immunity against a claim by one or more of the contracting parties.<sup>10</sup> The right may be future in nature (that is, dependent upon the occurrence of an event that is certain to happen) or conditional (that is, dependent for its existence or enforceability upon an uncertain future event, which may also be one within the power of the parties to bring about).<sup>11</sup>

9.5      The third party can be a particular person, or a person meeting certain conditions laid down in the contract such as coming into existence, some other event in the person's life (e.g. attainment of majority, marriage, entry into university), membership of a class of persons, or later nomination or authorisation by one or more of the contracting parties.<sup>12</sup>

9.6      We leave open as a question for consultees the possibility that a third party may be identified or identifiable from sources other than the contract and that an intention to confer a

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<sup>1</sup> See para 2.23.

<sup>2</sup> See paras 2.26, 2.35-2.37, 3.11-3.18, 5.3-5.8.

<sup>3</sup> See paras 2.29-2.32, 3.9, 5.9-5.10.

<sup>4</sup> See paras 2.16, 2.50-2.52, 6.20.

<sup>5</sup> See paras 2.53-2.56, 4.14-4.15.

<sup>6</sup> See paras 2.38-2.49, 3.11-3.18, 3.37-3.47, 5.16-5.21.

<sup>7</sup> See paras 2.80, 7.34-7.35.

<sup>8</sup> See para 3.32, 7.28-7.30.

<sup>9</sup> See paras 2.85, 7.28-7.30.

<sup>10</sup> See paras 2.24-2.25, 4.6, 5.22-5.25.

<sup>11</sup> See paras 2.6-2.9, 4.19-4.20.

<sup>12</sup> See paras 2.26-2.32, 3.11-3.18, 5.3-5.15.

right upon the third party might be implied in all the circumstances;<sup>13</sup> but we suggest that this could take the law of third party rights in contract into the territory of delict, with possible uncertainty then resulting.<sup>14</sup>

9.7 Contrary to the standard view of the present law,<sup>15</sup> 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.<sup>16</sup> They would instead be free to make provision in their contract for the cancellation or variation of the third party's right, and to exercise those powers at any time prior to the crystallisation of the third party's right.<sup>17</sup>

9.8 Contracting parties are also free to make the third party right irrevocable or unmodifiable by provision in their contract should they so wish. They will be bound by that contractual provision at least where there has been delivery, intimation or other communication of the contract to the third party.<sup>18</sup>

9.9 If the third party's right is dependent upon the fulfilment of conditions,<sup>19</sup> and this happens before any cancellation or alteration is made to it by the contracting parties, then the latter lose their freedom to revoke or vary the right.<sup>20</sup> The same result follows if the contracting parties subsequently promise not to exercise their entitlements under the contract,<sup>21</sup> or if they make representations to the third party that they will not do so, upon which the third party then acts in detrimental reliance.<sup>22</sup>

9.10 An open question for consultees is whether the law should go further than this in protecting the third party from the contracting parties' power to revoke or alter its right when the contract makes no provision on the matter one way or another. The following specific possibilities on when the right might become unalterable are canvassed:

- delivery of the contract or its relevant terms to the third party (subject to an entitlement of the contracting parties to reserve the power to change or cancel the right);<sup>23</sup>
- intimation of the contract or its relevant terms to the third party (subject to an entitlement of the contracting parties to reserve the power to change or cancel the right);<sup>24</sup>
- registration of the contract, whether for preservation only or also for execution;<sup>25</sup>
- detrimental reliance of the third party based upon informally acquired knowledge of its right, the form of reliance required being perhaps modelled upon the statutory *rei interventus* familiar from section 1(3) and (4) of the Requirements of Writing (Scotland) Act 1995;<sup>26</sup>

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<sup>13</sup> See paras 2.35-2.36, 2.43-2.47, 3.37-3.47, 5.12-5.15.

<sup>14</sup> See paras 2.37.

<sup>15</sup> See paras 2.57-2.78, paras 3.1-3.5.

<sup>16</sup> See paras 6.1-6.6.

<sup>17</sup> See paras 6.6-6.9.

<sup>18</sup> See paras 6.10-6.11.

<sup>19</sup> See paras 2.6-2.9, 4.19-4.20.

<sup>20</sup> See paras 6.7-6.9.

<sup>21</sup> See para 6.18.

<sup>22</sup> See paras 6.16-6.17.

<sup>23</sup> See paras 2.61, 6.21.

<sup>24</sup> See paras 2.61, 6.21.

<sup>25</sup> See paras 2.61, 6.23.

<sup>26</sup> See paras 2.61, 6.24-6.27.

- death of the third party;<sup>27</sup>
- assignation of its right by the third party;<sup>28</sup>
- formation of a trust over its right by the third party.<sup>29</sup>

9.11 We do not think, however, that the third party's informally acquired knowledge of the existence of a contractual provision purporting to create a right for it should be enough to deprive the contracting parties of the power to change their minds on either the existence or the content of that right.<sup>30</sup>

9.12 The model here can be represented as on the following page, with a flow chart in which the possible issues are given as questions in boxes with the arrowed lines from each box being the answer Yes. The more open possibilities with regard to events that will lead to a third party right becoming irrevocable and unmodifiable are shown in *italic*. Contracting parties are shown as CPs, the third party as TP, and the latter's right as TPR.

9.13 Whether or not it has crystallised in one of the ways illustrated above, the third party right may be renounced or rejected by the third party expressly or impliedly. Since no acceptance by the third party is required in the constitution of the right,<sup>31</sup> mere passivity by the third party in response to the prospect or tender of a benefit from or by the contracting parties is not enough for such renunciation to be implied.<sup>32</sup>

9.14 The third party has available in principle all the usual remedies by means of which any personal right can be enforced,<sup>33</sup> and also the remedy of rectification of the contract.<sup>34</sup> Where one of the contracting parties has the primary duty of performance to the third party, but is disabled from fulfilling it through a default by the other contracting party, the third party might perhaps have an appropriate remedy against the defaulter;<sup>35</sup> this however is a question which we regard as an open one for consultees' advice. Otherwise there is no need for the third party to involve in the enforcement process any party other than those with the primary responsibility to perform under the right in question.

9.15 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 insofar as these may impact upon the third party right.<sup>36</sup> Compensation (or "set off") may be available to the contracting parties against the third party's claim.<sup>37</sup> The third party's right is in general subject to the short negative prescription of five years, although in some cases it may be subject to the long negative prescription.<sup>38</sup>

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<sup>27</sup> See para 6.31.

<sup>28</sup> See paras 2.81, 6.32-6.37.

<sup>29</sup> See para 6.38.

<sup>30</sup> See paras 2.61, 6.28-6.30.

<sup>31</sup> See paras 2.16, 2.50-2.52, 6.20.

<sup>32</sup> See paras 2.79, 7.2-7.8.

<sup>33</sup> See paras 2.84-2.85, 7.9-7.13.

<sup>34</sup> See para 7.14.

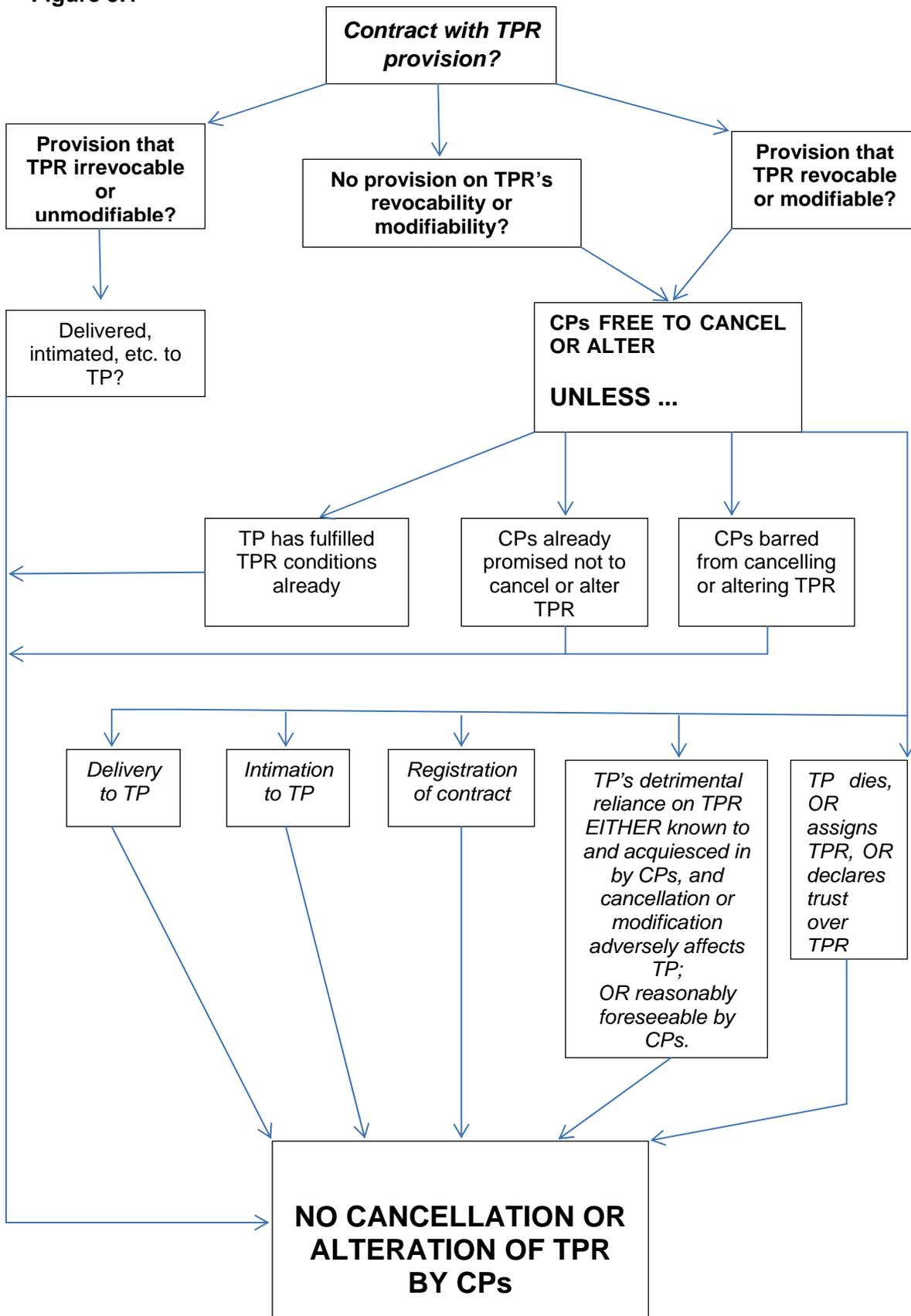
<sup>35</sup> See para 7.27.

<sup>36</sup> See paras 2.82-2.83, 7.15-7.19.

<sup>37</sup> See paras 7.20-7.24.

<sup>38</sup> See paras 2.86-2.89, 7.26.

Figure 9.1



9.16 We think that this scheme of reform would produce a law of third party rights in contract very much in line with the international standards described in the quotation from Professor Vogenauer given in the first chapter.<sup>39</sup> It would meet what we have identified as the needs of business in this area, while also providing a means by which private individuals may choose to do good and confer legally enforceable benefits upon others, especially those in need of the support of others such as minors or adults with incapacity. Moreover, it might provide a means by which the courts could find just solutions in complex situations.

9.17 As a final issue, we would be grateful for views on what we see as two alternative methods of enacting whatever policy goals are recommended after consultation. In broad terms, the legislation could either set out a comprehensive statement of the new law on third party rights, which would entirely replace the common law, or alternatively it could leave the common law in place except for certain specific reforms, such as the removal of the requirement of irrevocability.<sup>40</sup> The first approach is, in essence, that adopted by the 1999 Act.<sup>41</sup> It is at present our favoured option in this exercise, on the grounds that it is better to set out a reasonably clear overall statement of the law rather than wait for it to be filled in by decisions of the courts. This should provide the sort of certainty which practitioners in particular look for from the law in preparing transactions and drafting their documentation. We think however that it might not be necessary to go into full detail on every point, especially those referred to in Chapter 7, and in particular those dealing with the topics of remedies and defences. Accordingly we ask:

- 52. (a) Are there advantages in having a comprehensive statutory statement of the law on third party rights?**
- (b) Alternatively, should any legislation seek only to amend the common law so far as is necessary to achieve the desired reforms?**

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<sup>39</sup> See para 1.17 above.

<sup>40</sup> See paras 2.57-2.78 and ch 6 above.

<sup>41</sup> Though the comparison cannot be pushed too far, as it was enacted against the background of common law rules on privity of contract, which differs fundamentally from the current Scots common law of JQT.

# Chapter 10 List of Questions and Proposals

Respondents who wish to address only some of the questions and proposals below may do so.

## Impact assessment

1. Do consultees know of any information or statistical data, or have any comments on any potential economic impacts of either the current law relating to the third party rights or any proposed reform of that law?

(Paragraph 1.29)

## Company groups

2. Are there other situations involving company groups beyond those identified in paragraphs 3.4-3.19 in which third party rights might be of use to contracting parties?

(Paragraph 3.19)

## Construction projects and collateral warranties

3. Do consultees agree that collateral warranties are currently relied on rather than third party rights in Scots law? If so, is this problematic in practical terms? Would a modern set of rules on third party rights be utilised in place of collateral warranties should such rules be introduced?

(Paragraph 3.28)

## Community of interest cases

4. Do consultees agree that, while parties to “community of interest” transactions should continue to be free to make use of third party rights law, there is no need to make special provision for such cases in any reform of the law?

(Paragraph 3.47)

## Concepts and terminology

5. Should any legislation on third party rights that may follow from this Discussion Paper and any subsequent Report be expressed in terms of rights or benefits or both?

(Paragraph 4.6)

6. Do consultees agree with the suggested terminology for the parties and for the right, and that these might be suitable for use in any legislation on third party rights in Scots law? Would these terms be easily understood in practice? Are there better alternatives?

(Paragraph 4.13)

7. Do consultees agree it is preferable for any legislation dealing with third party rights to avoid as far as possible any explicit juristic characterisation of the right?

(Paragraph 4.14)

8. Is it a correct perception that a requirement that third party rights be constituted in formal writing (ie subscribed by the grantor(s)) is undesirable in the interests of maintaining flexibility?

(Paragraph 4.15)

9. Should any legislation on third party rights make clear that formal writing is not required for their constitution?

(Paragraph 4.15)

10. Is it useful in the interests of legislative economy to draw analogies as may be appropriate with other legal institutions such as the unilateral promise (eg to define without elaborating the remedies available to the third party)?

(Paragraph 4.18)

11. Should there be any general or more specific provision to the effect that a third party right may be conditional upon some performance by the third party or some other uncertain future event?

(Paragraph 4.20)

### **Identification and intention**

12. Do consultees agree that the third party must be identified by or identifiable from the contract, in particular as a member of a particular class of persons or as a person fulfilling or meeting conditions laid down in the contract?

(Paragraph 5.11)

13. Do consultees agree that a right in favour of a third party who is not in existence at the time that the right is set up should continue to be valid and enforceable by any such third party which subsequently comes into existence?

(Paragraph 5.11)

14. Should it be provided for the avoidance of doubt that 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 then a member of the intended class, may become so upon joining the class if the contracting parties so intended?  
(Paragraph 5.11)
15. Subject to the over-arching requirement that the existence of any third party's right must depend upon the contracting parties' intention, should the identification or identifiability of the third party come from the contract only, or should it be possible to refer to extra-contractual evidence by which a third party can be identified?  
(Paragraph 5.15)
16. If so, what kinds of evidence might be allowed?  
(Paragraph 5.15)
17. Do consultees agree that 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 be continued?  
(Paragraph 5.21)
18. Do consultees agree that it should be expressly provided that an exclusion or limitation of the third party's liability to one or more of the contracting parties can be an example of a third party right?  
(Paragraph 5.25)

### **Irrevocability**

*NB Respondents may wish to note the discussion in paragraph 6.3 of some of the terms which are used in the questions in this section*

19. Do consultees agree that 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?  
(Paragraph 6.6)
20. Do consultees agree that it should be specifically provided that where a contract provides for a third party right while reserving the entitlement of the contracting parties to vary or cancel the right, that entitlement may only be defeated by (i) the fulfilment of any conditions for the third party's entitlement to enforce the right before any variation or cancellation is completed, or (ii) the operation of personal bar against the contracting parties' exercise of their entitlements?  
(Paragraph 6.9)

21. Do consultees agree that an express contractual statement that a third party right conferred by the contract is irrevocable should be given effect, at least if delivered, intimated or otherwise communicated to the third party?

(Paragraph 6.11)

22. Do consultees agree that, where a contract sets up a third party right without any provision for an entitlement of the contracting parties to vary or cancel the right, either:

(i) the fulfilment of any conditions for the third party's entitlement to enforce the right will prevent any variation or cancellation by the contracting parties; or

(ii) representations of irrevocability or unmodifiability made to the third party by the contracting parties (or any one of them?) and detrimentally relied upon by the third party will lead to the operation of a personal bar against any attempt by the contracting parties to revoke or modify the third party's right?

(Paragraph 6.17)

23. Do consultees agree that a post-contract promise to the third party by the contracting parties that a third party right conferred by the contract is irrevocable or unmodifiable should be given effect if the steps needed for the constitution of an enforceable promise have been met by the contracting parties?

(Paragraph 6.18)

24. Do consultees agree that where a contract provides for a third party right without any provision about an entitlement of the contracting parties to vary or cancel the right, there will be no such entitlement if the term conferring the right upon the third party has been delivered or intimated to that party?

(Paragraph 6.21)

25. Do consultees further agree that the contracting parties may at the time of the delivery or intimation mentioned in the previous question reserve an entitlement to vary or cancel the third party's right?

(Paragraph 6.21)

26. Do consultees also agree that any purported acceptance of the right by the third party should not by itself have the effect of making the right irrevocable or unmodifiable?

(Paragraph 6.21)

27. Should registration of a contract conferring a third party right, whether for preservation only or also for execution, make that right irrevocable or unmodifiable unless the contract expressly provides the contracting parties with an entitlement to vary or cancel the right?
- (Paragraph 6.23)
28. Should the third party's detrimental reliance (perhaps defined along the lines found in sections 1(3) and (4) of the Requirements of Writing (Scotland) Act 1995), based upon informal knowledge of its right and known to and acquiesced in by the contracting parties, make a third party right irrevocable or unmodifiable?
- (Paragraph 6.27)
29. In addition, should third party reliance that is reasonably foreseeable by the contracting parties (although they had no actual knowledge of it at the time it happened) have the same effect?
- (Paragraph 6.27)
30. Do consultees agree that a third party right should not become irrevocable simply because the third party has informally acquired knowledge of the existence of the right?
- (Paragraph 6.30)
31. Should the third party's death prior to any cancellation or variation of the contract containing its right have the effect of making the right irrevocable or unmodifiable so that it becomes enforceable by the deceased's executors?
- (Paragraph 6.31)
32. Should there be some provision about the effects of assignation in relation to making a third party right irrevocable or unmodifiable? If so, which direction should that provision take on the matter?
- (Paragraph 6.37)
33. In relation to making a third party right irrevocable or unmodifiable, should there be some provision about the effect of the third party declaring a trust over its right? If so, which direction should that provision take, and, in particular, should it take account of the identity of the trust beneficiary?
- (Paragraph 6.38)

34. Do consultees agree that there is no need in the present exercise to deal with competing claims between the third party and the contracting parties, and that 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 6.43)

### **Renunciation or rejection of its right by the third party**

35. Would a statutory mechanism allowing third parties to renounce rights conferred in their favour be useful?

(Paragraph 7.8)

36. Should it be provided that such renunciation of a third party right may be express or implied from the third party's conduct?

(Paragraph 7.8)

37. Is it necessary to make any provision to protect the contracting parties against unfair exercise of the third party's power to renounce the right, for example to require the return of any benefit already conferred and reimbursement of expenses incurred by the contracting parties?

(Paragraph 7.8)

38. Should it be made possible to renounce a right in part if it is divisible?

(Paragraph 7.8)

### **Remedies available to the third party**

39. Should it be provided that third parties have at their disposal all remedies which are appropriate to the enforcement of their right? If not, how (if at all) should the issue of remedies be addressed in any legislation on third party rights?

(Paragraph 7.13)

40. Would it be useful to make clear in legislation the availability of (i) a damages claim; (ii) a right to a cure in appropriate cases, possibly as an aspect of specific implement; (iii) a right to rescind for material breach?

(Paragraph 7.13)

41. Should third parties be entitled to exercise the remedy of rectification in relation to the contract under which rights are claimed?

(Paragraph 7.14)

## **Defences**

42. Are specific provisions required regarding the enforceability of third party rights arising from contracts which fail as a result of invalidity, illegality, or frustration?

(Paragraph 7.19)

43. Would a specific provision, to the effect that compensation under the Compensation Act 1592 arising from or in connection with the contract and relevant to the third party's right under the same contract could be used in extinction of the third party's claim if liquid, be appropriate and useful?

(Paragraph 7.24)

## **Prescription**

44. Should a specific provision be inserted into paragraph 1 of Schedule 1 to the Prescription and Limitation (Scotland) Act 1973 to make clear that the short negative prescription applies to third party rights arising from a contract?

(Paragraph 7.26)

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

45. 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, should the third party have a remedy against the initially defaulting party?

(Paragraph 7.27)

## **Contracting out of liabilities to third parties**

46. Do consultees agree that no express provision is needed to deal with the possibility that contracting parties may exclude or limit a liability to third parties (such as damages) that would otherwise arise?

(Paragraph 7.30)

## **Other points arising from the 1999 Act**

47. Do consultees agree that it should be clear on the face of any legislation arising from this Discussion Paper that the third party can enforce only its own rights under the contract?

(Paragraph 7.33)

48. Would an equivalent to section 4(1) of the 1999 Act serve any useful purpose in Scotland?

(Paragraph 7.34)

49. Do consultees agree that the third party need not involve any of the contracting parties in its action beyond the one from whom it seeks a remedy?

(Paragraph 7.35)

50. Do consultees agree that there is no need in Scots law for a provision equivalent to section 5 of the 1999 Act?

(Paragraph 7.38)

### **Relationship with specific rules**

51. (a) Do consultees agree that, in principle, the general reforms proposed in this Discussion Paper should be without prejudice to the specific third party rights under the current law (for example, in the areas listed in paragraphs 8.3 and 8.4)?

(b) Do consultees consider that any of the specific third party rights should be amended in the light of the general reforms which are proposed? Would it be desirable to provide that those reforms should not extend to employment contracts relating to employees, workers and agency workers?

(Paragraph 8.6)

### **Methods of reform**

52. (a) Are there advantages in having a comprehensive statutory statement of the law on third party rights?

(b) Alternatively, should any legislation seek only to amend the common law so far as is necessary to achieve the desired reforms?

(Paragraph 9.17)

# APPENDIX A

## 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 B**

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