

Draft explanatory material to accompany draft Contract (Formation) (Scotland) Bill – for consultation purposes

DRAFT EXPLANATORY NOTES

INTRODUCTION

These Explanatory Notes have been prepared by the Scottish Law Commission (“the Commission”) in order to assist the reader of the Bill, and to help inform debate on the recommendations made by the Commission in Part 3, Formation of Contract, of their Report on Review of Contract Law (“the Report”), publication pending. They do not form part of the Bill and have not been endorsed by the Scottish Government or the Scottish Parliament.

The Notes should be read in conjunction with the Report. The Notes are not, and are not meant to be, a comprehensive description of the Bill. So, where a section or a part of a section does not seem to require any explanation or comment, none is given.

THE BILL – OVERVIEW

The Bill provides for a statutory statement of the law of formation of contract, replacing many elements of the common law on formation (but preserving others which are not inconsistent with the Bill) and abolishes the postal acceptance rule exception which provides that an acceptance has legal effect when it is posted, as opposed to when it reaches the person making the offer (“the offeror”).

Discussion Paper

The law of formation has been subject to substantive review by the Commission, which published a Discussion Paper on formation of contract in March 2012 (DP 154) (“Discussion Paper”). This has been followed up by the Report on Review of Contract Law, publication pending, Part 3 of which makes the recommendations given effect by the Bill.

Structure of Bill

The Bill has 18 sections. Section 1 provides for the principle of party autonomy. Section 2 specifies what the requirements are for the conclusion of a contract. Section 3 sets out when a notification of an offer, acceptance, counter-offer, withdrawal, rejection, revocation or declaration takes effect and identifies examples of this. Section 4 provides for the abolition of the rule of law as to when notification of a postal acceptance takes effect. Section 5 provides for what constitutes an offer and section 6 provides for when an offer can be revoked (including when a revocation of an offer is ineffective). Section 7 specifies that an offer lapses and can no longer be accepted on a material change of circumstances (it also identifies examples of a material change of circumstances). Section 8 sets out what is meant by an acceptance of an offer and section 9 provides for conclusion of a contract by unnotified acts. Section 10 specifies when an offer may be withdrawn. Section 11 provides for time limits for the acceptance of an offer and section 12 provides for when such a time period begins. Section 13 sets out when an offer is rejected and the effect of rejection of an offer. Section 14 specifies what a counter-offer is and the effect of a counter-offer on the original offer. Section 15 is the interpretation provision for the Bill. Section 16 is a savings provision making it clear that the Bill is without prejudice to any enactment or rule of law which for example, provides protection against unfair contract terms. Section 17 deals with commencement of the provisions and section 18 is the short title of the Bill provision.

THE BILL – COMMENTARY ON SECTIONS

Section 1 – Application of provisions of this Act

Background

One of the general principles underpinning the statutory statement for formation is that contracts are agreements between two or more parties which they intend to take legal effect between them. Recognising the importance of the general principle that contracts are formed by parties' agreement leads naturally to another principle, that of party autonomy in contracting.

Section 1 recognises and provides for this principle of party autonomy in contracting and has the effect that most of the other provisions or rules in the Bill are default rules. It therefore leaves it open to parties to provide their own, different, rules on how and when a contract is concluded between them.

Section 1(1) provides that sections 2, 3, 5 to 7, 8(3) and 9 to 14 of the Bill apply in relation to the formation of contract except in so far as the offer, or any counter-offer provides otherwise or except in so far as the parties have, before the offer is made, come to an agreement which (whether in regard to the formation of that contract or to the formation of contracts which include that contract) provide otherwise. This therefore allows the person making the offer or making the counter-offer to provide for alternative rules to govern the formation of the contract or for parties to have come to an agreement as to the rules governing formation of contract, prior to an offer being made. Section 1(2) provides that any such alternative provision may be express or implied and may either provide that the contract will be concluded in a way other than in accordance with those provisions of the Bill or in accordance with them, subject to such modifications as they may agree.

Section 2 – Formation of contract: general

Section 2(1) recognises and provides for the above mentioned general principle underpinning the statutory statement for formation, that contracts are concluded on parties coming to an agreement which they intend to have legal effect and which, after taking any relevant enactment or rule of law into consideration, can be given legal effect. It also recognises the doctrine of agreement between parties on the “essentials” of the contract, and the requirement for certainty of contract terms, in order for the agreement to be given legal effect.

Section 2(2) provides that if parties agree on all but one matter or all but some matters, a contract may still be concluded, provided the agreement is one which they intend to have legal effect and which can be given legal effect (after taking any relevant enactment or rule of law into consideration). However section 2(3) makes it clear that if a party requires there to be an agreement on a specific matter before a contract is concluded, there can be no contract until this matter is agreed between parties.

Section 2(4) provides that for the purposes of subsections (1) to (3), the question as to whether there is agreement or not may be determined from the statements and conduct of the parties.

Section 3 – When notification takes effect

Section 3 recognises and provides for a third general principle, that relating to when a notification has legal effect. Section 3(1) provides that any notification in relation to formation of contract takes effect when it reaches the person (the addressee). Notification is given a broad definition, including offers, acceptances, counter-offers, withdrawals, rejections and revocations. It also includes declarations, as well as a person's conduct. Section 3(4) provides that subsection (1) is subject to section 11(1)(a) which provides that notification of an acceptance of an offer is only effective if it reaches the offeror before the expiry of any time limit for acceptance specified in the offer (or if no such time period is specified, within a reasonable time after the offer reaches the offeree).

Section 3(2) goes on to provide that a notification reaches a person (the addressee) when the notification is made available to the person in such circumstances as make it reasonable to expect the person to be able to access it without undue delay. This is a broad and flexible test which enables contracting parties to deliver notifications to each other in the way which suits their needs best.

Section 3(3) gives instances of when reaching occurs in the most commonly-encountered situations: on personal delivery to the addressee, on delivery to that person's place of business or to that person's habitual residence if the person does not have a place of business or if the notification does not relate to a business matter, and when it is delivered by electronic means. These are illustrative rather than mandatory, therefore it is open to parties to use other means to deliver a notification if those means satisfy the general test.

Section 4 – Abolition of rule of law as to when notification of postal acceptance takes effect

In Scots law, the exception from the general rule that an acceptance must reach the offeror to conclude a contract, is the postal acceptance rule. Under the exception, an unqualified acceptance takes effect when the acceptance is posted, rather than when it reaches the offeror. The rule only applies to acceptances: postal offers, withdrawals and revocations of offers, and qualified acceptances do not benefit from it, and qualified acceptances in particular only become counter-offers when actually communicated.

Section 4 of the Bill however provides that in relation to the formation of a contract, any rule of law whereby an acceptance sent by means of a postal service takes effect when posted is abolished.

Section 5 – What constitutes an offer

Section 5(1) specifies what constitutes an offer. For a proposal to constitute an "offer" in relation to the formation of contract, the proposal must intend that it will result in a contract if accepted and the proposal must be one which, after taking any relevant enactment or rule of law into account, could be given legal effect as a contract if accepted. In order for the proposal, if accepted, to be given legal effect, its content would have to be sufficiently definite. The formulation of section 5(1) mirrors the formulation of section 2(1) of the Bill (the latter providing that a contract is only concluded on parties coming to an agreement which they intend to have legal effect and which, after taking any relevant enactment or rule of law into consideration, can be given legal effect), in other words, an offer is a proposal for a contract.

Section 5(2) makes it clear that any such offer may be addressed to a specific person or to the public at large and section 5(3) makes it clear that subsections (1) and (2) are without

prejudice to the possible application to the proposal of any enactment or rule of law in relation to the constitution of a unilateral promise.

Section 6 – Revocation of offer

Section 6(1) provides that in relation to the formation of a contract, an offer may be revoked by the offeror but only if notification of the revocation takes effect before any notification referred to in subsection (2) takes effect. Subsection (2) specifies that such notification is of acceptance of the offer by the offeree, or of statements or conduct of the offeree by virtue of which it may be determined that agreement has been reached. An offer may therefore be revoked if the revocation reaches the offeree before notification of acceptance of the offer by the offeree takes effect, or, in cases of acceptance by statements or conduct, before any notification of such statements or conduct by which it may be determined that agreement has been reached, takes effect.

Subsections (4) to (6) of section 6 relate to offers to the general public (where there is no specific offeree). Subsection (4) provides that offers to the general public may be revoked by the offeror but, in relation to any individual member of the public, only if notification of the revocation takes effect before such notification as is referred to in subsection (5) takes effect (subsection (5) relates to notifications of acceptance of the offer by an individual or of statements or conduct of an individual from which it may be determined that agreement is reached).

Subsection (6) provides that a notification of revocation of an offer to the general public has to be given by the same means as used in the offer (unless the means of notification of revocation is specified in the offer, in which case the means specified must be used).

Section 6(7) deals with irrevocable offers. An irrevocable offer arises if the offeror declares that the offer is irrevocable and this reaches the offeree. In Scots law any attempt to revoke such an offer is ineffective. Section 6(7) provides that a revocation of an offer either to one person/individual or to the general public, is ineffective if it is clear from the terms of the offer in question that it is intended to be irrevocable or if the offeror has stated that it is irrevocable in a declaration that has taken effect.

Section 7 – Lapsing of offer on material change of circumstances

Section 7(1) recognises and provides for the present rule on material change of circumstances as set out by Lord President Inglis in *Macrae v Edinburgh Street Tramways Co* (1885) 13 R 265 at 269, that an offer lapses on a material change of circumstances. Section 7(1) also makes it clear that having lapsed, the offer can no longer be accepted.

Section 7(2) provides that if after an offer is made, the offeror or offeree dies or becomes incapable of making any decision to conclude the contract, that this is a material change of circumstance and therefore section 7(1) applies, and the offer lapses and can no longer be accepted. This provision does not however change the rule that contracts and other obligations, as distinct from offers, generally continue to bind the estates of parties to such obligations who happen to die during their currency.

Section 7(3) provides that an offer in relation to the formation of a contract does not lapse where, after it is made, but before a contract is concluded, the offeror or offeree becomes insolvent and section 7(4) sets out when an offeror or offeree becomes insolvent (both where the offeror or offeree is an individual and where they are not an individual).

Section 7(5) makes it clear that section 7(1) to (4) are without prejudice to the application of any enactment, or rule of law, in relation to the transaction with regard to which the offer is made. Section 7(6) provides that “incapable” has the same meaning as used in section 1(6) of the Adults with Incapacity (Scotland) Act 2000 (which defines incapable as meaning incapable of acting, making decisions, communicating decisions, understanding decisions, or retaining the memory of decisions, by reason of mental disorder or of inability to communicate because of physical disability; but a person does not fall within this definition by reason only of a lack or deficiency in a faculty of communication if that lack or deficiency can be made good by human or mechanical aid (whether of an interpretative nature or otherwise)).

Section 8 – Acceptance of offer

Section 8(1) provides that in the Bill, any reference to acceptance of an offer is to a statement, in any form, or conduct, of whatever kind, of the offeree showing unqualified assent and section 8(2) makes it clear that any such conduct, must be conduct of which the offeror is or ought to be aware.

Section 8(3) makes it clear that silence or inactivity, in itself is not to be taken to show assent. This is not however an absolute prohibition, and it will be possible for silence or inactivity to be sufficient in exceptional cases.

Section 9 – Conclusion of contract by unnotified acts

Section 9 provides for an exception to the general rule that an acceptance must reach the offeror in order to form a contract between the parties (as provided for in section 3(1) of the Bill). Section 9(2) provides that a contract is concluded on the offeree beginning to perform certain acts. The exception applies where an offer expressly or impliedly provides, where the parties to the prospective contract have established a practice between or among themselves to the effect, or where there is a usage common to those parties to the effect, that the performance of certain acts by the offeree will conclude the contract. On the offeree beginning to perform the acts in question, a contract is formed even though these acts are not notified or known to the offeror at the time they take place.

Section 9(3) provides that section 9(1) and (2) are subject to section 11(1)(b) which provides that performance of any acts by the offeree is effective in concluding a contract, only if it begins before the expiry of any time limit for acceptance specified in the offer (and if none is specified, within a reasonable time after the notification of the offer takes effect).

Section 10 – Withdrawal

Section 10 provides that in relation to the formation of contract, an offer (whether or not irrevocable), may be withdrawn by the offeror if notification of the withdrawal takes effect before, or at the same time as, the offer takes effect. It also provides that an acceptance may be withdrawn by the offeree, if notification of the withdrawal take effect before, or at the same time as, notification of the acceptance takes effect.

Section 11 – Time limits

Section 11 makes provision for time limits for acceptances of offers. Section 11(1) provides that notification of an acceptance of an offer is only effective if it reaches the offeror before any time limit specified and if none is specified, it must reach the offeror within a reasonable time after the offer is made.

It also provides that, in relation to the acceptance of offers by an uncommunicated act, the act must be performed within any time limit specified, and again, if none is specified, it must be performed within a reasonable time after the offer is made.

Section 11(2) provides that section 3(2) and (3) which specify when a notification is made available to a person and provides examples, applies to time limits in relation to notifications of acceptances.

Section 12 – Commencement of a period of time within which a response to an offer is required

Section 12 specifies that where any period of time for acceptance is stated in an offer but it is not made clear when the period begins, the period begins to run from the moment that the offer reaches the offeree.

Section 13 – Rejection of an offer

Section 13 makes it clear that an offer lapses on the taking effect of a notification of the rejection of an offer (whether or not the offer is irrevocable).

Section 14 – Counter-offer

Section 14 deals with the scenario where a purported acceptance is not a simple outright assent to the offer. It provides that if a notification by the offeree provides for any additional or different terms or for any terms to be omitted from the original offer, then the notification is both a rejection of the offer and a counter-offer. It also provides that it is a counter-offer whether or not the terms of the original offer are expressly or impliedly included in the terms of the counter-offer.

Section 15 – Interpretation

Section 15 sets out definitions of terms that are of recurring significance in the Bill. Section 15(2) provides that any reference in the Bill to the taking effect of a notification, is to be interpreted in accordance with section 3 (which sets out when a notification takes effect and provides instances of this).

Section 16 – Saving

Section 16 regulates the scope of the Bill, and contains a number of savings for other matters that affect formation of contract (including preserving the common law on formation to deal with matters that have not been envisaged and included in the draft Bill).

Therefore section 16 provides that the provisions of the Bill are without prejudice to any enactment or rule of law which provides protection against unfair contract terms or for a particular category of contracting person, which requires writing for the constitution of a contract, which prescribes a form for a contract, or which regulates any question which relates to the formation of a contract but is not provided for by the provisions of this Act.

Section 17 – Commencement

In accordance with section 17, commencement of the Bill provisions will predominantly be in accordance with dates appointed by the Scottish Ministers in regulations. This is subject to a limited number of exceptions, for sections 15, 16 and 18 (the Interpretation, Savings and

Short title provisions). These provisions will come into force on the date after the Bill receives Royal Assent (the day after the Bill becomes law).

Section 18 – Short title

Section 18 sets out the short title of the draft Bill.