

CONTRACT (FORMATION) (SCOTLAND) BILL

INFORMAL CONSULTATION ON WORKING DRAFT – 1 SEPTEMBER TO 3 NOVEMBER 2017

Introduction

1.1 The Scottish Law Commission's project on reform of contract law is approaching its final stages. The project is comprised of four main areas, penalty clauses, interpretation, remedies for breach of contract (the latter of which is the subject of a Discussion Paper which is out to consultation until 6 October 2017) and formation. It is currently proposed that we will be publishing a Report on all four areas of contract law in Spring 2018.¹

1.2 This note relates to our review of the law of formation. We have developed and decided on policy in light of responses to the Discussion Paper on Formation of Contract (No 154) which was published in March 2012 and our own further work on the subject. We are currently preparing a draft Bill to give effect to our policy and a working draft of that Bill has been published for consultation on our website, along with draft Explanatory Notes. The purpose of this consultation, is to seek views on the drafting of the provisions, before the draft Bill is finalised and published with the Report referred to above. We would particularly welcome views on the aspects of the Bill highlighted below. We have tried to explain our policy in relation to these aspects, where the policy may not be immediately clear from the Bill itself and would be interested in hearing whether you think the draft Bill gives effect to that policy. We would be grateful for any views by **3 November 2017**. Comments would be welcomed by email, in whichever format you would wish to submit them. They should be sent to info@scotlawcom.gsi.gov.uk

1.3 Please note that information about the current consultation, including copies of responses, may be made available in terms of the Freedom of Information (Scotland) Act 2002. Any confidential response will be dealt with in accordance with the 2002 Act. We may also (i) publish responses on our website (either in full or in some other way such as reformatted or summarised); and (ii) attribute comments and publish a list of respondents' names. For further details on the project please see our project page.

Background to the current project

1.4 The Eighth Programme of Law Reform was published in February 2010 and proposed to review the law of contract following the publication in 2009 of the Draft Common Frame of Reference: Principles, Definitions and Model Rules of European Private Law ("the DCFR"). The DCFR was prepared by an academic group from the European Commission and provides a contemporary statement of contract law based on comparative research from across the European Union. It was intended to aid better, more consistent and coherent contract law legislation in the European Union, as well as being available for parties to use in contracting in the European Union, instead of national law. For this reason therefore, it was considered necessary for Scots law to at least compare favourably or keep pace with the DCFR.

¹ Two further areas related to Third Party Rights and Execution in Counterpart. The Third Party Rights (Scotland) Bill was introduced in the Scottish Parliament on 31st January 2017, with stage 3 taking place in September 2017 and on 1 July 2015, the Legal Writings (Counterparts and Delivery) (Scotland) Act 2015 came into force introducing signing in counterpart into Scots law.

1.5 As noted in the Discussion Paper on Formation of Contract (“the Discussion Paper”) the Commission published a series of Reports on aspects of contract law in the 1990s, only one of which was implemented, the Report on the Three Bad Rules in Contract Law). One of the unimplemented Reports considered the law on Formation of Contract (Report on Formation of Contract: Scottish Law and the United Nations Convention on Contracts for the International Sale of Goods, no 144, (“the 1993 Report”). Again as noted in the Discussion Paper, there was no real opposition to the substance of the unimplemented Reports at the time, but the then priorities for law reform were the abolition of feudalism and associated property law reforms. We therefore thought that there was a case for reconsidering the topics of the unimplemented Reports, and taking into consideration developments in the law since the 1990s, both in Scotland and Europe and internationally.

1.6 The Discussion Paper proposed reform of the law on execution in counterpart (which was ultimately addressed in the Legal Writings (Counterparts and Delivery) (Scotland) Act 2015), battle of the forms², reform of the postal acceptance rule and a statutory statement of the law on formation of contract (the latter two of which are being taken forward in the draft Bill). The proposal for statutory statement was driven primarily by two considerations, the difficulty in reforming the postal acceptance rule without giving it a clear setting in an overall scheme and the fact that there is no direct Scottish authority in point in a number of areas in the law of formation.

Areas of particular note in the draft Bill

1.7 As stated above, there are a number of elements of the Bill which are particularly of note and which we give a little more context to here. We would also be particularly interested in obtaining views in relation to the drafting of certain of the Bill provisions and these are set out in the paragraphs below. In addition we would be interested in hearing any views on the ordering of the provisions in the draft Bill. There are a number of different ways in which the provisions could be ordered, but we would be interested in hearing whether the proposed ordering causes any difficulties.

When notification takes effect

1.8 We think it is important for the Bill to include a provision specifying when a communication from one party reaches the other as well as to make it clear what sort of communications this should apply to. This is perhaps of particular importance in the context of electronic communication, given some of the technological difficulties that may arise from the nature of the infrastructure through which online communication makes its way to the addressee. Section 3(1) of the draft Bill provides that in relation to the formation of a contract, a notification to a person of an offer, acceptance, counter-offer, withdrawal, rejection, revocation or declaration takes effect on reaching a person and sets out various instances of this.

1.9 Section 3(3) gives instances of when reaching occurs in the most commonly-encountered situations and section 3(3)(d) gives the instance of a when a notification transmitted by electronic means reaches a person (when it becomes available to be accessed by the person). Section 3(2) makes it clear that a notification has to be made available to a person “in such circumstances as make it reasonable to expect the person to

² We are not recommending specific reform in relation to the battle of the forms, at this stage, and the reasons for this will be set out in the Report referred to in paragraph 1.

be able to obtain access to it without undue delay”. We would be interested to hear any views on whether it is considered that the wording of section 3(3)(d) when read with section 3(2) provides sufficient protection to the recipient who, for example, is absent from the office and has set an out of office reply which specifies dates for absence or possibly times for absences during a working day.

1.10 We have used the general concept of a notification transmitted “by electronic means” in section 3(3)(d), as we thought that being any more specific in terms of our reference to technology would risk the provision becoming out of date.

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

1.11 The Discussion Paper proposed the abolition of the exception to the general principle in Scots law that acceptance, like other statements intended to have some legal effect, must be communicated to the person to be affected by it. Received from English law in the mid-nineteenth century, the postal acceptance rule provides that an unqualified acceptance takes effect when the acceptance is posted, rather than when it reaches the offeror. As the Discussion Paper points out, the rationale for the rule is that the offeror, having initiated the transaction and in doing so having use of the postal service in its contemplation, should bear the risks inherent in the period of time between the posting of the acceptance and its arrival with the offeror, while the offeree may rely on having a contract after doing all in their power to conclude one.

1.12 The postal acceptance rule can give rise to some well-known difficulties if taken to its logical conclusions. For example, in the English decision of *Household Fire Insurance Co v Grant* (1878-79) LR 4 Ex D 216 (CA), it was held that even if a posted acceptance never reaches the intended party a contract will be concluded despite the offeror's ignorance of its obligations. However there are several other judicial dicta against this judgement from the nineteenth century down to the present. A further example is the Scottish case of *Jacobsen, Sons & Co v Underwood & Son Ltd* (1894) 21 R 654, where it was held that an acceptance posted within a time limit set by an offer but arriving with the offeror after the limit's expiry nonetheless concluded a contract between the parties. In the light of this state of the law, we understand that it is conventional for formal offers of a contract to stipulate that to be effective, acceptances must reach the offeror and the courts will give effect to such provisions. The validity of this practice of exclusion is supported by the authority of Bell, Commentaries, I, 344, so it is not anything new (as might be thought from the reference conventionally given in the books to the English case of *Holwell Securities Ltd v Hughes* [1974] 1 WLR 155). We also understand that the Scottish Standard Clauses for residential conveyancing, allows parties to contract out of the postal acceptance rule.

1.13 The postal acceptance rule took shape in a world where the relatively newly developed postal system provided the only means of communication between distant parties. However the position in the twenty-first century is completely different, with a wide range of alternative means of communication available. In this context, the idea that one or other of distant negotiating parties needs protection from the risks inherent in the gap of time between the sending and receiving of a letter from a special rule of law is less persuasive than may have seemed to be the case in the mid-nineteenth century and before. Given the above therefore and given also that there was unanimous support from consultees in relation to this proposal in the Discussion Paper, section 4 provides for the abolition of the postal acceptance rule.

Section 6 – revocation of offer

1.14 Section 6 of the draft Bill relates to revocation of offers and provides that they may be revoked unless any notification of acceptance of the offer by the offeree or notification of statements or conduct of the offeree, by virtue of which it may be determined that agreement has been reached.

1.15 The Discussion Paper considered whether the rule should also specify in particular, that fixing a time limit for the offer's acceptance is a declaration of irrevocability for these purposes. It drew attention to two Scottish cases on this point. In *Heys v Kimball and Morton* (1890) 17 R 381 at 384-385, it was held that an offer "made on condition of acceptance within three days" was one which could not be accepted after three days rather than one which was irrevocable within the same period. Likewise in *Effold Properties Ltd v Sprot* 1979 SLT (Notes) 85 (OH), an offer in which it was stated that the contract must be concluded by a particular date and time was held not to be irrevocable.

1.16 The Discussion Paper therefore asked whether a statutory statement on formation of contract should include a rule like those in the comparator instruments making the fixing of a time limit for acceptance a declaration of irrevocability. Some consultees offered doubts on making time-limited offers automatically irrevocable ones, raising concerns about the potential impact on small businesses, because the practical result of such a rule would be offerors simply stipulating shorter time limits for acceptance.

1.17 As a result, we have concluded that there should be no specific rule on time limits. It will therefore be a question of construction whether a time-limited offer is or is not also irrevocable.

Section 7 – lapsing of offer on material change of circumstances

1.18 It is not firmly settled in Scots law what happens, after an offer is made, if the offeror or offeree dies or becomes incapable of making any decision as to whether to conclude the contract. The 1993 Report argued that there can be no valid contract if, at the moment of conclusion there is only one party and that "death is the ultimate incapacity" (para 4.10). The Discussion Paper proposed making this clear and most consultees agreed. Therefore 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, 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.

1.19 Section 7(2)(b) refers to a person becoming "incapable of making a decision" which is broad enough to cover the issue of fluctuating capacity or a person's capacity to enter into particular transactions. The language used is also general enough to allow for the further development of the law of capacity to contract in the future, whether by further legislation or by judicial decision.

1.20 While there is some doubt as to what the current Scots law is in relation to the effect of insolvency on the formation of contract, it is considered that the general position is that insolvency does not itself prevent a person entering into contracts (McBryde, *Contract*, paragraph 26.21) Paragraph 3.40 of the Discussion Paper notes that businesses may

continue to trade after insolvency, and may even manage to trade their way out of insolvency. Therefore section 7(3) makes it clear that insolvency of the offeror or offeree after a contract is made but before it is concluded, does not result in the offer lapsing. Most consultees to the Discussion Paper supported this proposal.

Section 9 – Conclusion of contract by unnotified acts

1.21 While the general rule is 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 provides for an exception to this. Section 9(2) provides that a contract is concluded on the offeree beginning to perform certain acts, without the offeror necessarily being aware. 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 necessarily known to the offeror at the time they take place. The most famous example of this, is *Carlill v Carbolic Smoke Ball Co Ltd* [1893] 1 QB 256 (CA). The Carbolic Smoke Ball Company made a general offer of a reward to anyone catching influenza despite using its product. Mrs Carlill's acceptance was held to be complete from the time she began to use the produce in accordance with the company's directions.

1.22 The exception is consistent with the over-arching principle of party autonomy in that it would also allow parties who so wished, to reinstate a postal acceptance rule between themselves. It is considered that an explicit legislative statement would, however, avoid arguments about the extent to which the principle of party autonomy allowed implicit departures from the default rule about acceptance having to reach the offeror through the general nature of the preceding offer, course of dealing between the parties, or customs of a trade or geographical area. While there was considerable support for this proposal from consultees, one consultee was of the view that a provision making the conclusion of the contract occur when the offeree begins to perform the required act was unnecessary because the question will be answered, either expressly or impliedly, by the offer, usage or practice. It is our view however, that making express provision would be helpful where there is no express statement or the usage or practice is unclear on such detailed matters.

Counter-offer

1.23 Section 14 deals with the scenario where a purported acceptance is not a simple outright assent to the offer. It is currently not clear in Scots law how far there is a requirement that the difference between the offer and acceptance must be material for the purported acceptance to amount to a rejection of the offer and a counter offer. There is some caselaw which suggests that there can be a contract in at least some situations. For example, in *Wight v Newton* 1911 SC 762 (IH) a contract was found to exist as there was agreement between parties on the essentials of a lease, despite the fact there were discrepancies between the parties on other non-essential matters.

1.24 The Discussion Paper pointed out that if there is anything in Scots law about non-material alterations and additions in a purported acceptance not blocking the formation of a contract, it is very limited and probably only related to the situation where the extra condition would have been part of the contract regardless, either as an implied term or as a necessary

action to give effect to the contract. In order to address this lack of clarity, the Discussion Paper proposed a rule which provided that a notification by the offeree which provides terms additional to those of the original offer, terms different from those of the original offer, or the omission of terms of the original offer, amount to a rejection of the original offer and a notification of a counter-offer (whether or not the terms of the original offer are expressly or impliedly included in the terms of the counter-offer).

1.25 The approach which we have taken in section 14, was favoured by most consultees to the Discussion Paper, and does not require any alternations or additions to the offer to have to be material in order for it to amount to a rejection of the offer and a counter-offer. This is because it is considered that doing so, would have created too much room for confusion and uncertainty in trying to establish what was material.

Topics covered in the Discussion Paper but not being taken forward in the draft Bill

1.26 A number of further proposals for reform of the law on formation of contract were made in the Discussion Paper, which we have not proceeded with in the draft Bill, either due to a lack of support from consultees or for other considerations referred to in the Discussion Paper. These are listed below for information, with references to the relevant paragraphs in the Discussion Paper and the particular question posed to the consultees.

Battle of the forms

1.27 The Battle of the forms issue was discussed in paragraphs 5.1 to 5.25, with the following questions posed (proposals 39 and 40) Is there a need for a specific solution to the problem of the battle of the forms? If so, should that solution be along the lines suggested by the PICC, the DCFR and the proposed CESL? If uncertainty is a concern with that solution, how might that best be ameliorated? If the answer to question 39 above is no, might there still be merit in making provision that, in respect of long-term commercial relationships only, an approach other than a strict offer-and-acceptance one is to apply in battle of the forms situations? If so, are the schemes in the PICC, the DCFR and the proposed CESL of any assistance in this context? To what sort of long-term commercial relationships might such an approach be applied?

1.28 However we think that a possible approach to this problem may be by way of the general provision in section 2(1) of the draft Bill.

Rule preventing revocation of an offer if postal acceptance posted before revocation communicated

1.29 This proposal was discussed in paragraph 4.14 of the Discussion Paper, with the following question posed (proposal 29): Were there to be a statutory restatement of the law on formation of contract it should be provided that the sending of an acceptance by the offeree will prevent a subsequently arriving revocation of the offer taking effect.

Definition of "writing"

1.30 Paragraph 2.30 and 2.31 of the Discussion Paper discussed whether a definition of "writing" was required and proposed as follows (proposal 7): Any general legislative

restatement of the law relating to formation of contract should not include any definition of 'writing'.

Usages and practices

1.31 Paragraphs 2.32 to 2.35 discussed usages and practices, with the following question posed (proposal 8): Should a provision on usages and practices be included in any statutory restatement of the law on formation of contract?

Supply goods from stock, or supply services, at a stated price

1.32 This issue was discussed in paragraphs 3.9 to 3.13 of the Discussion Paper, with the following questions posed (proposals 11 and 12): In any statutory restatement of the law on formation of contract, should a proposal to supply goods from stock at a stated price made by a business in a public advertisement or a catalogue, or by a display of goods, be treated, unless the circumstances indicate otherwise, as an offer to supply at that price until the stock of goods is exhausted? If so, should a similar rule apply in the case of supply of services?

Offers stating a fixed time for acceptance are irrevocable

1.33 This proposal was discussed in paragraphs 3.24 and 3.25 of the Discussion Paper, with the following question posed (proposal 18): The rule that an offer may indicate that it is irrevocable, or state a fixed time for its acceptance, in which case it is irrevocable should be added to the list of those for adoption in any statutory restatement of the rules on formation of contract.

Reliance on irrevocability of an offer makes subsequent revocation of the offeror ineffective

1.34 This proposal was discussed in paragraphs 3.26 and 3.27, with the following question posed (proposal 19): Should an offeree's reasonable reliance on the irrevocability of an offer make any subsequent revocation of the offer by the offeror ineffective?

Delayed offers

1.35 Delayed offers were discussed in paragraphs 3.43 to 3.45 of the Discussion Paper with the following question posed (proposal 25): a) Should any statutory restatement of the rules on formation of contract include rules on the application of time limits contained in offers which have been delayed in their transmission to the intended recipients? b) To what extent are the rules in Section 49 of the US Restatement (2d) Contracts a model to be followed in this regard?

Late acceptances

1.36 Late acceptances were discussed in paragraph 4.34, with the following question posed (proposal 36): If there was to be a rule under which a late acceptance could nonetheless conclude a contract, should there be a further rule that this effect would not arise where there had been a material change of circumstances since (a) the acceptance was first sent; or (b) the expiry of the time limit contained in the offer?