Response to Scottish Law Commission relative to Discussion Paper 157, Discussion Paper on Third Party Rights in Contract

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Preliminary

May I firstly apologise for the fact that, due to pressure of work, this response comes so late. In am grateful to the Commission for being willing to receive it.

General

The Discussion Paper is an excellent piece of work which sets out both the current law and the case and options for reform with admirable clarity. In my view, the case for reform is compelling. This is an important area of law. In my experience[1], contractual provisions which bear on the rights of third parties are much more commonplace than is often thought. I acknowledge that my experience may be somewhat atypical in that my contractual work has primarily been undertaken in the context of one specific industry, the oil and gas industry, where the need for complex risk allocation provisions leads to the giving and receiving of indemnities on a grouped basis which inevitably causes third party issues to arise.[2] But even if this is so, (a) the petroleum industry is a highly significant sector, and (b) it is not alone among industries in using contractual provisions to delimit or re-allocate risk.

Third party rights is an area where (relative to English law, at least) Scots law traditionally enjoyed considerable advantage in recognising the doctrine of *jus quaesitum tertio* (JQT). However, any "first mover advantage" has long since been lost. While English law has come to recognise the deficiencies inherent in its previously strict approach to privity of contract and to enact, in the shape of the Contracts (Rights of Third Parties) Act 1999, a sophisticated response to the problem, JQT has remained an obscure and under-developed area of Scots law. The point is well-made in the Discussion Paper that the uncertainty created by the law's

[1] I had eight years in practice before entering academia 11 years ago. For around half my time in practice I spent a significant portion of my working life being involved in drafting and litigating commercial contracts, particularly in the oil and gas sector. I was dual qualified in Scots law and the law of England and Wales for much of that time and so have at least some experience of the operation of the English law. Since entering academia, I have spent a significant proportion of my time examining aspects of oil and gas contracts, most notably, their risk-allocation provisions.

[2] Other third party issues can also arise; see further the section on "Oil Industry Contracts", below.

lack of development has had the effect of deterring practitioners from using it (which of course serves to perpetuate the lack of development). One could of course say that if practitioners were bolder the courts would be compelled to develop the law and reform might not be necessary, but this is to miss the point. Clients are not pawns in a game played by lawyers and clients' desire for a dependable outcome without the necessity of having recourse to litigation is entirely understandable. The example of practitioners going so far as to use the private international law principle of dépeçage to make use of the English law of third party rights while writing the majority of the contract under Scots law is a striking one. The fact that such ingenuity is necessary in order to achieve legal certainty goes a long way towards establishing that the Scots law of third party rights is in need of reform.

The Discussion Paper identifies the irrevocability requirement as the major barrier to the more general use of JQT. At paras 2.70-2.78 and para 3.2, the Discussion Paper raises the possibility that the requirement of irrevocability might be less absolute than might appear from *Carmichael v Carmichael's Executrix* 1920 SC (HL) 195. However, I do not think that this undercuts the case for reform. As is noted in the Discussion Paper, any reconsideration of *Carmichael* would have to come from the Supreme Court. Very few clients will be willing to incur the uncertainty and expense of adopting a solution which will require that where there is any viable alternative, and a viable alternative will often exist, such as making all persons who are intended to receive rights under the contract parties thereto or (as we have seen above) utilising dépeçage, or perhaps just writing the entire contract under English law, as commonly happens in the oil and gas industry.[3],[4] However, just because an alternative is viable does not mean that it is optimal. The practical difficulties, delays and costs associated with having multiple parties execute agreements are considerable, the use of dépeçage is not without risk, and Scots law is arguably impoverished if contracts that could readily be written under Scots law routinely are not because of technical deficiencies in the rules.

Finally in this regard, I would suggest that if solicitors with sufficient knowledge and imagination to use dépeçage perceive there to be a problem with JQT, then there is – in

[3] The ability, in many, commercial contexts, to write contracts under the law of other jurisdictions could therefore be said to hinder the development of contractual doctrine in Scotland. The lex situs rule insulates land law from this problem.

[4] I do not think that this practice evolved as a result of problems in Scots law with the enforcement of third party rights. Indeed, at the time that the practice evolved, it was probably true to say that the Scots law in this area was superior to that of England and Wales. However, now that the practice has developed, one of the barriers which stands in the way of persuading clients to utilise Scots law is the absence of a clear and fit-for-purpose power to confer third party rights.

practical terms – a problem with JQT. That being so, and having regard both to the range and complexities of the issues identified by the Commission throughout the Discussion Paper and the perceived success of the Contract (Rights of Third Parties) Act 1999, there is a very strong case for a legislative solution to the problem.

Specific Points

I am in general agreement with the approach outlined in the Discussion Paper. I have specific comments to make only in relation to the issue of rights/benefits (paras 4.1-4.6 and Q5) and assignation (6.32-6.38; Qs 32 and 33)

Rights and/or benefits?

In this regard, I would note that there might be some confusion in the Discussion Paper about the effect of the relevant provisions in the 1999 Act. In the table entitled "Rights and benefits" to be found at the foot of para 4.1, in the expression "(a third party) may in his own right enforce a term...", the word "right" is italicised while the word "benefit", which occurs later on in the extract, is not. In later discussion, it is said that some of the other instruments referred to as comparators may have muddied the waters by introducing the idea of benefit, rather than right, but the 1999 Act is not subjected to the same criticism. However, as noted above, the Act does refer to benefit, and in practice commercial drafting tends to reflect this (see the discussion of the IMHH 2012, below). I therefore don't consider the expression "in his own right" to be an indication that the 1999 Act is concerned solely with rights to the exclusion of benefits. Instead I suspect that the reference to "in his own right" means only that the beneficiary can enforce the benefit himself, without having to go act through another (presumably, the person who conferred the benefit upon him).

Assignation

I can see no reason in principle why rights which are of a nature that they could ordinarily be assigned should not be assigned merely because they are of a third party nature. I think the statute should include express provision on this point as without it unnecessary doubts could arise on the point. I think that the assignee should receive precisely the same right as was held by the assignor immediately prior to assignation: an absolute and irrevocable right, if that is what the assignor held, but a revocable or modifiable right, if that is what the assignor was entitled to. Clearly this will have implications for e.g. the value of the right, but as a matter of principle I cannot see why the contracting parties obligations should be affected by the unilateral act of the third party.

Oil Industry Examples

The Discussion Paper makes reference to the oil industry's indemnification practices at 3.16 to 3.19. There is a reference, in para 3.16, to drilling contracts. That is too specific: the practice is endemic throughout all of the industry's service-sector (operator-contractor)

contracts,[5] and also exists, in a somewhat modified form, in oilco-oilco contracts such as Joint Operating Agreements. That caveat aside, the Discussion Paper captures the essence of the practice well.

As noted above, oil and gas contracts are almost invariably written under English law and they provide good examples of how the 1999 Act is used in practice. Generally, the practice is to specifically list the provisions where a third party right/benefit is intended to be conferred, and to state that no third party rights/benefits are otherwise intended to be conferred. In this connection, see the Third Party provisions in e.g. LOGIC's standard Supply of Major Items of Plant and Equipment contract, available at the weblink referred to at n.5.

Two other interesting examples of the 1999 Act in operation can also be drawn from the oil industry. The Industry Mutual Hold Harmless Deed[6] is an example of kind of highly ambitious and complex contractual solution to the economically-efficient allocation of accident risk on an offshore platform that would be simply impracticable without a clearly enforceable and trusted system for conferring third party benefits or rights. This Deed addresses the

> "contractual gap that traditionally exists between contractors working on the UKCS with regard to the allocation of liability. On an offshore installation an operator will award contracts to a contractor who may sub-contract to its sub-contractors. This provides a vertical relationship between some of the parties but no relationship across contractors and sub-contractors. The IMHH is designed to sit as a background agreement where there is no direct contract between the contractors."[7]

Each party to the Deed (at the present time, the number of signatories runs into the hundreds) contracts grants and receives indemnities relative to personal injury, property damage and consequential loss on a grouped basis. Third Party benefits are dealt with in Clause 6, which provides,

> "The Signatories intend that, in accordance with the 1999 Act, a member of the signatories group shall be entitled to enforce the benefit of the indemnities , but parties intend that no provision of the deed shall confer any benefit on or by enforceable by any person not a signatory. "

Finally, the OPOL agreement relative to oil pollution emanating from offshore installations may be referred to. By contract, the OPOL companies have agreed among themselves to operate a system of strict liability, subject to a financial cap, relative to losses caused by offshore pollution. However, third party benefits under the 1999 Act are expressly excluded by the Agreement. This would seem to mean that third parties have no legally enforceable right to access OPOL's dispute resolution mechanisms and thereby enforce a claim, despite

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[5] For an illustration of the breadth of range of such contracts, see the various standard terms and conditions available at http://www.logic-oil.com/standard-contracts.

[6] Available to download from http://www.logic-oil.com/imhh.

[7] http://www.logic-oil.com/imhh, first paragraph under the heading "Introduction"

the fact that the principal purpose of OPOL would seem to be the provision of such a remedy. This could be seen to be an unfortunate but logical consequence of the essentially permissive approach adopted by the 1999 Act.[8] One way of addressing the matter would be to have a more assertive piece of legislation, which states that, where the principal or a major purpose of a contractual arrangement is to provide rights or benefits to a third party, the effect of the Act cannot be excluded, but perhaps this example is too unusual or esoteric to require to be written into general legislation. Perhaps the OPOL example also helps to shine a light on the distinction between rights and benefits. A third party under a voluntary industry compensation scheme might not have a legal right to claim compensation, but a benefit under the arrangement.

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[8] For a fuller account of OPOL, see G Gordon, Oil, Water and Law Don't Mix, Part 2, 2013 25 ELM 121.