

Third party rights in Scotland - all change?

March 29, 2018

A new third party rights Act came into force in Scotland in February. Kirsty Olson asks whether it spells the end for collateral warranties, and can third parties adjudicate?

Key Points

- The *Contract (Third Party Rights) (Scotland) Act 2017* comes into force on 26 February 2018
- Third parties will be able to enforce contract undertakings made for their benefit
- The parties can choose to exclude third party rights from their contract
- It is not clear whether third parties will be able to adjudicate
- It is expected that collateral warranties will still be used in Scottish building projects

Third party rights are a significant issue in construction projects. Numerous different parties may suffer loss if a building is found to be defective (for example, purchasers, tenants and funders). However, at the end of the day, there is only one construction contract to rely upon. If each of these parties is to recover its loss, another solution must be found.

The existing law

Before the *Contracts (Rights of Third Parties) Act 1999* (the *CRTPA 1999*) came into force in England and Wales, the doctrine of privity meant that only the parties to the contract could have rights arising out of it.

By contrast, Scots law has always recognised that a contract can create an enforceable right in favour of a third party: this is known as a *jus quaesitum tertio* (JQT).

For a JQT to arise in Scotland, two or more parties must contract to confer a right on a third. The third party must be identified, either individually or as a member of a class. So far, so good.

However, case law on the subject has also created a number of other rather onerous requirements, which have to be satisfied. Crucially, the right created in the contract in favour of the third party must be irrevocable; the contracting parties must have intended that they would not be able to change their minds later. This has proved to be a very significant hurdle.

Because of the restricted circumstances in which third party rights might arise, the JQT has actually proven not to be very useful in the context of a Scottish building project. It is an argument of last resort, used only by third parties when nothing else is available. In practice, collateral warranties are always insisted upon.

The CTPRSA 2017

The law on third party rights in Scotland is about to change. The *Contract (Third Party Rights) (Scotland) Act 2017* (the *CTPRSA 2017*) will come into force on 26 February 2018. The Act follows the recommendations made in July 2016 by the Scottish Law Commission in its Report on Third Party Rights (Report No 245).

Collateral warranties no longer needed

The main benefit for Scottish construction projects is envisaged to be that collateral warranties will no longer be needed. Tenants, funders and subsequent purchasers of a building will instead be able to rely upon statutory third party rights.

It is true that collateral warranties have their drawbacks. They can be difficult, expensive and time-consuming to collect in. If the bulk of the work on the project has been done and paid for by the time the warranty is requested, professionals and sub-contractors have little incentive to sign up.

The problem is even more acute if, by the time the warranty is requested, there is already an issue with the building. Contractors are reluctant to sign up to warranties that they know will be used straight away to make a claim against them. In addition, an obligation upon the main contractor to procure warranties from its sub-contractors is only useful so long as the main contractor remains solvent.

A simpler solution to third party rights in the context of a construction project would therefore be welcome. The question is whether, in Scotland, the *CTPRSA 2017* will provide that solution.

Key features of the new law

The first thing to notice about the *CTPRSA 2017* is its length. The *CTPRSA 2017* is much shorter than the *CRTPA 1999*. The Scottish Law Commission made a positive decision in its Report that the drafting of the new Act should be concise and precise and avoid the use of archaic legal language.

Third party rights

How will third party rights come to exist under the *CTPRSA 2017*? For a third party to acquire a right there must be an undertaking by one of the parties to a contract to do something for the third party's benefit.

Note the subtle difference in the language here. The *CTPRSA 2017* allows an undertaking to be enforced. The *CRTPA 1999* allows a contract term to be enforced. The Scottish Law Commission was concerned that the word 'term' in the English Act was too restrictive; the third party right to be enforced might be found in more than one term of the contract.

Under the *CTPRSA 2017*, it must also be the intention of the contracting parties (express or implied) that the third party should be entitled to enforce the undertaking. So, the position in both jurisdictions will be that third party rights can be excluded, if that is what the parties want to do.

Intention

Again though, note the difference in approach between the two Acts on the question of intention.

Under the *CTPRSA 2017*, the parties must intend that the third party should be entitled to enforce the undertaking.

Under the *CRTPA 1999*, the third party will not be able to enforce the contract term if it appears that the parties did not intend the term to be enforceable. A minor nuance perhaps, but potentially important when it comes to deciding who

bears the burden of proof when a dispute arises over whether intention existed or not.

Under the *CTPRSA 2017*, the third party must be identifiable from the contract either by being named or described in it. It does not matter if the third party exists when the contract is entered into. It is also not necessary for the third party to fall within the description of persons at the time of contracting. This will mean that a sub-contractor, who is not engaged at the outset but is brought into the project later, can still acquire third party rights when it becomes a member of the group.

Crucially, there is no requirement in the *CTPRSA 2017* that the rights granted to the third party must be irrevocable. The requirement for irrevocability has been abolished. The undertaking in favour of the third party can be cancelled or modified by the parties to the contract later. In certain circumstances, the *CRTPA 1999* requires the third party's consent for cancellation of the right to be effective. Under the *CTPRSA 2017*, the right to cancel or modify the undertaking is also qualified in some respects.

Under the *CTPRSA 2017*, third parties will be entitled to the same remedies for breach of the undertaking that the contracting parties are entitled to (although the parties to the contract are free to specify what remedies are available). This is broadly similar to the position in England, although the wording in the *CTPRSA 2017* is slightly wider to cater for the fact that the Scots law of contract recognises the concept of unilateral promise.

In response, under the *CTPRSA 2017* the contracting party will have available to him those defences that he would normally have available against the other contracting party, provided that they are relevant to the undertaking. Again, the parties to the contract can specify otherwise, if they want to.

No provisions on double liability or concurrency of rights

The Scottish Law Commission considered, but decided against, replicating certain provisions of the *CRTPA 1999* in the *CTPRSA 2017* on the grounds that it was unnecessary. So, there are no provisions in the *CTPRSA 2017* relating to double liability or concurrency of rights. There is also no long list of exceptions to the scope of the Act, such as those listed in s 6 of the *CRTPA 1999*. That is not because the *CTPRSA 2017* is intended to override other existing regimes. Rather, it is because existing rules of interpretation in Scotland would have the effect of preserving those regimes anyway.

Dispute resolution

Both the *CRTPA 1999* and the *CTPRSA 2017* allow third parties to engage in arbitration (by becoming a party to the arbitration agreement between the contracting parties), provided that various requirements set out in the legislation are satisfied.

Can a third party adjudicate under a construction contract between two other parties?

Neither Act makes any mention of adjudication. This has been the subject of some discussion in England. Can a person with third party rights adjudicate under a construction contract between two other parties?

In England, this issue was discussed in *Hurley Palmer Flatt Ltd v Barclays Bank plc* [2015] Bus LR 106. In that case, an engineer's appointment allowed any affiliate of the client with a direct interest in the project to enforce the terms of the contract as if it were the client. Barclays (an affiliate) served a notice of adjudication on the contractor relating to defects. This was challenged. Ramsay J held that the wording of the contract indicated that the parties only intended the affiliate to have the benefit of rights giving rise to liability by the engineer to the client. It was not intended that the affiliate would be also able to exercise procedural rights.

Given that the outcome in the *Hurley Palmer Flatt* case turned on the wording of the contract, in England the issue as

to whether a third party can adjudicate remains open. However, there is some doubt that adjudication would be possible, unless the contract specifically says so. Although the *CRTPA 1999* states that the third party will have the same remedies that the contracting parties have, s 108(1) of the *Housing Grants, Construction and Regeneration Act 1996* (the *HGCRA 1996*) provides that only 'a party to a construction contract has the right to refer a dispute arising under the contract for adjudication' and s 7(4) of the *CRTPA 1999* specifically says 'a third party shall not ... be treated as a party to the contract for the purposes of any other Act'.

There is no equivalent provision in the *CTPRSA 2017* to s 7(4) of the *HGCRA 1996*. It seems likely that, in Scotland, the wording of s 108(1) of the *CRTPA 1999* would still carry the day but the issue will no doubt be litigated in Scotland at some point.

Will *CTPRSA 2017* make a difference?

We do, of course, already have some experience of this type of legislation. When the *CRTPA 1999* came into force in England and Wales, it was expected that the use of collateral warranties would decrease. Interestingly, this did not happen. The JCT, in its 2005 suite of standard forms, expressly excluded the operation of the *CRTPA 1999*. There was uncertainty generally as to what the scope would be of any rights that might flow from the *CRTPA 1999*. Collateral warranties remained the norm.

More recently, the position appears to be altering in England. Third party rights under the *CRTPA 1999* are becoming a more acceptable solution in a construction project. Will the position be the same in Scotland when the new Act comes into force?

The general consensus is that the *CTPRSA 2017* is unlikely to make a difference to the Scottish construction project. Contracting parties will still want collateral warranties. It is what they are used to and comfortable with. Banks, in particular, do not like third party rights and insist on warranties if they are available.

There is also a practical problem. It is not uncommon for funders, tenants and purchasers to require individual changes to be made to their warranties before signing. That can easily be accommodated on a warranty by warranty basis. It will be much more difficult to accommodate, however, in a third party rights scenario where the contract itself will have to be amended each time.

Conclusion

The *CTPRSA 2017* comes into force on 26 February 2018. Time will tell whether it will make a difference to Scottish construction projects. In the meantime, there will be transitional arrangements in place. The JQT will continue to apply to contracts entered into before the *CTPRSA 2017* comes into force, unless the parties specifically amend their contract to bring in the new regime. For contracts entered into on or after 26 February 2018, only the new regime will apply. The JQT will therefore gradually fall out of use in Scotland. It will not be missed.

This article first appeared in the Construction Law Journal on 1 March 2018. You subscribe to the journal here.

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