

CLIENT GUIDE

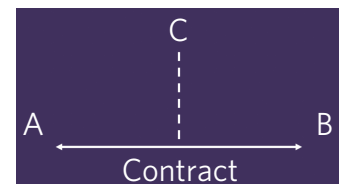
The new third-party rights law in Scotland

The Contract (Third Party Rights) (Scotland) Act 2017 (the “2017 Act”) came into force on 26 February 2018. This briefing looks at the impact of the 2017 Act on third-party rights in Scotland, in particular from the perspective of our investment funds practice.

Prior to the 2017 Act coming into force, third-party rights were recognised in Scotland under the common law of *jus quaesitum tertio*. However, this law was uncertain, inflexible and lacked clarity. The new rules on third-party rights under the 2017 Act are intended to be a comprehensive, commercially attractive, statutory statement of the law on third-party rights, replacing the old common law. The 2017 Act is distinct from the English law on third-party rights as set out in the Contracts (Rights of Third Parties) Act 1999 (the “1999 Act”).

WHAT IS A THIRD-PARTY RIGHT?

There may be circumstances where parties to a contract (A and B) wish to grant rights to a third party (C). Although C is not a party to the contract, C is given an undertaking in the contract and has the right to enforce that undertaking.



HOW DO YOU CREATE A THIRD-PARTY RIGHT?

The 2017 Act requires that a third-party right must be created by including an undertaking in a contract that one or more of the contracting parties will do, or not do, something for the third party's benefit. In addition, the contracting parties must have intended to create that right at the time the contract was made.

Third-party rights under the 2017 Act may include an indemnity or a provision to limit or exclude a person's liability. The undertaking can be dependent on something happening or not happening, ie. the right may be future or conditional. The right can exist without the third party having been told about it.

In a funds context, third-party rights are commonly used in limited partnership agreements, where the parties to the agreement wish to indemnify certain third parties such as directors and employees of the general partner and fund manager for losses incurred as a result of actions taken by those persons. The 2017 Act could be used to give those third parties the rights required to enforce the indemnity.

WHAT PROTECTIONS DO THIRD PARTIES HAVE?

Under the 2017 Act, there are statutory protections for third parties which provide that, in certain circumstances, their third-party rights crystallise and cannot then be modified or cancelled by the contracting parties. However, the contracting parties can modify or cancel these rights if this is expressly set out in the contract. Preserving the ability of the contracting parties to change or remove third-party rights requires careful drafting in order to override a third party's statutory protections.

THE 2017 ACT IN PRACTICE

Prior to the 2017 Act coming into force, third-party rights in fund documentation governed by Scots law were rarely labelled as such or set out all in one place. The 2017 Act has changed this and we have seen more Scots law agreements including an express statement of the contracting parties' intention with regard to granting third-party rights. The 2017 Act states that the contracting parties' intention to create the right may be express or implied, which creates the possibility that rights may arise unintentionally. Third-party rights clauses are therefore being routinely included in Scots law agreements so that it is clear which rights the contracting parties intend to grant and to avoid third-party rights arising by implication.

Such third-party rights clauses have long been used in the English agreements; however, these Scottish clauses cannot simply mirror the English wording. One of the stated intentions of the 2017 Act is to improve upon the perceived issues that hampered the use of the 1999 Act in England and Wales. The 2017 Act therefore adopts a difference in approach than that taken in the 1999 Act, in particular around the contracting parties' ability to change or cancel the third-party rights. Although there are many similarities in the principles behind the 1999 Act and the 2017 Act, the differences in detail could prove significant in any future disputes.

This client guide is intended as general guidance on current issues in the law. It is not a substitute for legal advice and it may not be relied upon as such.

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