

Client Update

Changes to Third-Party Rights Under Scots Law Contracts: What You Need to Know

A long overdue update to the law governing third-party rights in Scotland went live on 26 February 2018. Scots law has finally been updated to provide a clear framework for third-party rights – essentially the rights of those who are not themselves party to a contract, but who are intended to be able to rely upon it – which largely aligns with that in the rest of the United Kingdom.

In this update, we examine the new regime, and in particular its impact on Scottish fund structures.

WHAT IS A THIRD-PARTY RIGHT?

A third-party right arises when a person receives the benefit of a contractual right despite not being party to the contract creating the right. That person can then rely upon and enforce that contractual right, despite not having signed the document in which it is contained.

THIRD-PARTY RIGHTS IN FUND STRUCTURES: A BRIEF OVERVIEW

Third-party rights are useful in the context of private fund structures in order to give rights to (for example) fund managers and their employees even if they are not a party to the fund's limited partnership agreement.

The new Scots law regime will therefore affect any funds using a Scottish limited partnership in its structure.

OUT WITH THE OLD, IN WITH THE NEW

Prior to the new regime, third-party rights in Scotland were governed by a historic legal principle. The old rules were particularly prescriptive; third parties had to be specifically identified, and there had to be an express intention to create a right with no option for irrevocability or modification.

The new regime takes a more commercial approach and brings third-party rights law into the 21st century, allowing for more flexibility in creating, modifying and extinguishing these rights.

CREATING THIRD-PARTY RIGHTS UNDER THE NEW REGIME

In order for a contract to give rise to rights in favour of a third party, there are two simple requirements:

- **There must be an undertaking from at least one of the parties that it will or will not do something for the benefit of a third party.** The third party can be specific, or a group (i.e., a particular class of persons – for example, employees of the fund manager). It may be the case that the parties who will seek to rely on the contract don't yet exist.
- **The parties should have the intention that the right created be enforceable by the third party.** This intention can be either express or implicit.

It's important to note that, under the regime, although there is provision for irrevocability, once a third-party is given a right in a contract, this cannot later be modified or cancelled unless the ability to do so has been provided for in the contract itself.

CONSIDERATIONS IN A FUND CONTEXT

Any document governed by Scots law can take advantage of the new regime by including appropriate wording. This is most likely to affect the fund's Limited Partnership Agreement.

Since typical provisions in a limited partnership agreement such as indemnities, limits or exclusions on liability can be treated as third-party rights, it's important to consider whether, going forward, these agreements should explicitly give the contracting parties flexibility to create and modify rights. The new regime isn't, however, retrospective, so contracts entered into before 26 February 2018 which relate to any Scots law vehicles don't need to be amended.

Because of the inflexibility of the old regime, previously there was no need to include a third-party rights clause if there was no intention to create any such rights. Now that, as under English law, third-party rights can be implied, agreements should include language to ensure that the regime does not apply if there is no intention to create any third-party rights, or to specify the clauses in which any intended third-party rights are given and to exclude the creation of any others.

BUSINESS AS USUAL?

Despite the changes, the use of Scots law vehicles should, subject to making sure the provisions are up to date, be business as usual, with the benefit of the new flexibility that the regime has introduced.

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Please do not hesitate to contact us with any questions.

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