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CASE COMMENT

Lorna Richardson*

What do we know about retention now?

In *J H&W Lamont of Heathfield Farm v Chattisham Ltd*¹ the Inner House considered the scope and limitations of the right to retain contractual performance.

A THE FACTS

The pursuers, a partnership, owned land, over which they had granted an option to the defenders, who were developers. The pursuers had granted a standard security over the land in favour of the defenders in security of their obligations under the option. The pursuers terminated the option agreement. There was no dispute that the option had come to an end.

The pursuers raised an action seeking implement by the defenders of their obligation under the option to deliver a discharge of the standard security. The defenders were not prepared to grant a discharge, arguing that the pursuers had been in breach of their obligations under the option, which were the subject of the defenders' counterclaim for damages. The defenders asserted a right of retention in respect of the obligation to provide a discharge.

B DECISION

At first instance the pursuers were successful.² The Inner House unanimously refused the defenders' appeal, however, very different reasons were given by each of the judges.

Lord Carloway noted that the remedy of withholding performance is available to a party in an ongoing contract where the other party has failed, refused or delayed to perform a reciprocal obligation in that contract.³ Retention was not normally available when a contract had come to an end. It was intended to compel performance in a subsisting contract. It was not normally available to a party who was not seeking performance by the other party, but who was seeking damages for a past breach that was unlikely to be repeated.⁴

He noted that withholding performance was available where the obligation, in respect of which performance is being withheld, is the counterpart of the obligation breached. Whether there was such interdependence was a matter of contractual interpretation, although, generally, all obligations on one side of the contract would normally be seen as reciprocal to those on the other in the absence of a clear indication to the contrary.⁵ The scheme of the parties' contract was plain. The

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¹ [2018] CSIH 33

² [2017] CSOH 119.

³ [2018] CSIH 33, para 18.

⁴ *Ibid.*

⁵ Para 20.

defenders had a right to oblige the pursuers to sell land to third parties and to share in the proceeds of sale. That was the primary obligation to be secured under the option.⁶ Although there were ancillary obligations on the pursuers to assist the sales process, those obligations were not enforceable after the option was terminated. Withholding performance could not be used to compel performance, even of a reciprocal obligation, when it was no longer extant.⁷ It was clear that “all obligations” secured by the standard security related only to obligations which remained prestable.⁸ Lord Carloway noted that, even if it were competent to withhold performance, it was inequitable in the circumstances. If the defenders wished security for their damages claim they could apply for diligence on the dependence.⁹

Lord Drummond Young had two reasons for refusing the appeal: firstly, that the pursuers’ obligation under the option to grant the security was not the counterpart of the other provisions in the option; secondly, that even if the obligation to grant the security was the counterpart of other obligations, it was inequitable to permit the defenders to retain performance.¹⁰ Lord Drummond Young then made a number of general observations about retention.

He noted that contractual retention served as a form of security for contractual performance.¹¹ It was a “very flexible form of security, applicable to a great range of obligations in a wide range of circumstances.”¹² It permitted the withholding or temporary non-performance of the substantive obligations under a contract, such as obligations to supply goods, provide services or pay the price.¹³ It was important that the right should be confined to substantive obligations. There were dangers of extending it more widely to incidental and ancillary obligations.¹⁴

He stated that contractual retention was based on the principle of mutuality of contract, which is fundamental to the notion of a bi- or multilateral contract in Scots law. The underlying principle was thus that the provisions of the contract are normally taken to be interdependent.¹⁵ Lord Drummond Young noted that *Turnbull v McLean*¹⁶ made clear that the normal rule of Scots law is that “the whole of the obligations on one side of the contract are regarded as counterparts of the whole obligations on the other side of the contract.”¹⁷ There were obvious practical reasons for that; “a contract is negotiated and concluded as a unity, and if it is not implemented and enforced as a unity a central and vital part of the parties’ bargain will be lost.”¹⁸ He noted that the mutuality of contract had been extended beyond the provisions of a single contract, to cover obligations under a related

⁶ Para 21.

⁷ *Ibid.*

⁸ Para 22.

⁹ Para 24. Lord Drummond Young is of the same opinion: para [46].

¹⁰ Para 26.

¹¹ Para 27.

¹² Para 28.

¹³ Para 30.

¹⁴ These dangers could be seen on the facts of *McNeill* 2014 SC 335, discussed in D Cabrelli, “The Mutuality of Obligations Doctrine and Termination of the Employment Contract: *McNeill v Aberdeen City Council (No 2)*” 2014, Edin LR 259.

¹⁵ Para 34.

¹⁶ 1874 1 R 730.

¹⁷ Para 36.

¹⁸ *Ibid.*

contract.¹⁹ The law relating to contracts performed in stages was quite clear from cases such as *Turnbull v McLean*. Lord Drummond Young considered that the speech of Lord Jauncey in *Bank of East Asia v Scottish Enterprise*²⁰ had to be read subject to the well-established existing law and should not be construed as suggesting that in instalment contracts the presumption of interdependence was in some way reduced.²¹ If the principle of mutuality were applied in that way to contracts to be performed in stages the result would be “nonsensical”.²² Problems would arise in contracts to be performed in stages, such as building contracts²³ and leases. The practical importance of such contracts “hardly required stating” and it would “be most regrettable if the doctrine of retention were not to be applied to them, or only to be applied in the restricted manner that appears to be contemplated by Lord Jauncey”.²⁴ He went on to note that although the norm was that contractual obligations were mutually interdependent, parties could frame their contract in such a way that one or more obligations were independent of the others; in that case one party could demand performance without tendering performance himself.²⁵ Lord Drummond Young found that the defenders’ obligation in the option to discharge the security fell into that category.²⁶ He also opined that when an express security is granted, such as a standard security, it could be reasonably inferred that the express security was intended to supersede the implied security conferred by contractual retention.²⁷

Lord Drummond Young considered the equitable nature of retention to be important.²⁸ As retention could be invoked in a wide range of circumstances it was essential that it should not be abused.²⁹ He considered an important policy consideration in restricting the doctrine of compensation to liquid debts only was the risk that payment of a debt, clearly due and payable, could be resisted because the debtor had a claim for damages that was uncertain as to liability or amount. Similar considerations applied to retention. Equity would not deny the defence of retention in every case; it would depend on the circumstances. The “fundamental point” was that when a damages claim was used to support a defence of retention it had to be looked at critically and the court had to determine whether it was fair and just that it should be allowed as a defence to a counterpart obligation that was clearly defined and clearly due.³⁰

Lord Malcolm considered that the matter could be determined on the basis of construction of the parties’ contract. He considered that the terms of the option demonstrated that the parties did not

¹⁹ *Ibid.*

²⁰ 1997 SLT 1213. Interestingly, Lord Drummond Young appeared in that case as senior counsel for the disappointed appellants.

²¹ Para 37.

²² *Ibid.*

²³ *Bank of East Asia* concerned a building contract.

²⁴ Para 37.

²⁵ *Ibid.*

²⁶ Para 38.

²⁷ Para 39.

²⁸ Para 43. Contractual retention, based on mutuality, is a right that can be exercised unless the court determines that its use is inequitable. This is in contrast to a different right of retention, “special retention”, where there is no right to retain and the defender must ask the court to exercise its discretion to allow it to retain: see L Richardson, “Examining ‘Equitable’ Retention” 2016, Edin LR 18.

²⁹ Para 44.

³⁰ *Ibid.*

intend the standard security to cover ongoing and outstanding damages claims.³¹ He then went on to consider, *obiter*, aspects of retention: noting that where stipulations were imposed on parties in a bilateral agreement which were conditional on each other, performance of one of them could not be demanded by the other party unless that party had performed or was able and willing to perform his counterpart obligations. This kind of retention was sometimes called “mutuality retention” and that absent the necessary mutuality retention of that type did not arise.³² He noted that in *Bank of East Asia* Lord Jauncey had quoted with approval the comments of Lord Shand in *Pegler v Northern Agricultural Implement and Foundry Co Ltd* that:

I venture to think the sound principle is rather this, that if the defence be founded on an obligation fairly arising out of the contract, and the performance of which is reciprocal to and contemporaneous (*viz.* exigible or prestable at the same time) with the obligation which is the foundation of the action, then the defence is good.³³

Lord Jauncey had commented that Lord Shand “was clearly envisaging not the totality of the obligations due under a contract but rather specific obligations which were the direct counterpart of the other obligations thereunder”.³⁴ Lord Jauncey had also noted that it was not the case that each and every obligation by one party was necessarily the counterpart of every obligation by the other and that it was a matter of circumstance.³⁵ It was thus clear that Lord Jauncey had rejected the proposition that any claim under a mutual contract could be set against any other claim howsoever and whensoever such claim might arise.³⁶ Counter obligations were “corresponding and contemporaneous claims” which had to be “exigible or prestable at the same time.”³⁷ Taking this into account, the defenders could not rely on mutuality retention because they were not attempting to force the pursuers to perform a contractual duty, let alone one that was the counterpart of the defenders’ obligation to discharge the standard security.³⁸ That obligation came into existence only on termination of the option and could not therefore be characterised as reciprocal upon any of the pursuer’s duties under the contract.³⁹

C CONCLUSIONS

There are a number of problems with this case. A major difficulty is that while the members of the bench come to the same decision they analysis retention in very different ways, and, at times, contradict each other. The most obvious example is in relation to Lord Jauncey’s comments in *Bank of East Asia*. Lord Drummond Young is highly critical of them, suggesting that they should not be construed as suggesting that in instalment contracts the presumption of interdependence is in some way reduced; and that applying the principle of mutuality in such a restricted way would be “nonsensical”. Yet Lord Malcolm relies on Lord Jauncey’s comments in finding that the parties’

³¹ Para 50.

³² Para 52.

³³ (1877) 4 R 435 at 442.

³⁴ 1997 SLT 1213 at 1217.

³⁵ Para 53.

³⁶ *Ibid.*

³⁷ *Ibid.*

³⁸ Para 54.

³⁹ *Ibid.*

obligations are not counterparts. It is difficult to reconcile the decisions in *Turnbull v McLean* and *Bank of East Asia*, but it may be noted that the latter was approved by Lord President Rodger in *Macari v Celtic Football and Athletic Club Ltd*⁴⁰ and, more recently, by Lord Hope in *Inveresk*.⁴¹

The Lord President notes that the right to retain is generally only available to secure future performance, not for past breaches that are unlikely to be repeated. Yet, as has been argued elsewhere, there is no conceptual reason for this limitation on the right to retain⁴² and it conflicts with the use of mutuality retention in *Inveresk*, where the defenders were seeking damages for breach on an obligation in the past, which obligation could not now be performed.

It is clear that mutuality retention is subject to equitable control by the courts, however, the scope of this control has been described as “undeveloped”.⁴³ Both the Lord President and Lord Drummond Young consider the fact that the defenders could seek diligence on the dependence as indicating it would be inequitable to allow mutuality retention. This seems misplaced. Any creditor raising proceedings has the ability to seek diligence on the dependence. It should not therefore be a reason militating against a right of retention. It must be borne in mind that mutuality retention, in contrast to special retention, is available as of right unless the court considers its use inequitable.

In this case, as in *McNeill*, Lord Drummond Young argues that the right to retain only applies in respect of substantive obligations, and not incidental contractual obligations. Having to determine what is a substantive obligation and what is not, in order to decide whether or not retention is available, brings yet further complexity to an already complex area. In some contracts it may be difficult for solicitors to determine whether an obligation is substantive or not. This is highly undesirable where parties may have to decide this for themselves without the benefit of legal advice. This is particularly problematic as retention, as well as being a defence, is a self-help remedy.⁴⁴

In determining that mutuality retention was not available to the defenders, Lord Drummond Young noted that the express grant of the standard security reasonably inferred that the implied security provided by retention was superseded. There is no reason to suppose that in obtaining an additional right by way of an express security, a party gives up his common law rights. This is especially so as excluding the common law right to retain is done either by agreement between the parties or where exclusion is the necessary implication of the parties’ agreement.⁴⁵ Lord Drummond Young also draws on the narrow ambit of compensation: that it is only available in respect of liquid debts given the risk that payment of a debt, clearly due and payable, could be resisted because the debtor had a claim for damages. He believed that similar considerations should apply to mutuality retention. Yet there are significant differences between compensation and retention, not least of which is that for compensation to operate there need be no link between the claims at all beyond the fact that they

⁴⁰ 1999 SC 628.

⁴¹ *Inveresk v Tullis Russell* 2010 SC (UKSC) 106 at para [43].

⁴² See L Richardson, “Set-off: A Concept Divided by a Common Language?” 2017 LMCLQ 238.

⁴³ Scottish Law Commission, *Discussion Paper on Remedies for Breach*, (SLC DP No 163), 2017 para 2.32.

⁴⁴ Scottish Law Commission, *Report on Formation, Interpretation, Remedies for Breach of Contract and Penalties* (SLC Report No 252), 2018, para 11.8.

⁴⁵ Gloag and Henderson, *The Law of Scotland*, 14th edn (2017) para 10.17.

are both due and payable by the same parties in the same right, so called *concursum debiti et crediti*. There needs to be a close link between obligations for mutuality retention to operate: the claims need to be counterparts, and will most often be found within the same contract.

Lord Drummond Young notes that a claim of damages as a basis for retention needs to be considered critically to determine whether it is fair and just that it be allowed. It is suggested that this puts the test the wrong way round. Mutuality retention is available as of right *unless it is inequitable* to allow it. The question therefore is not whether it is equitable to allow it⁴⁶ but whether there is anything that demonstrates it would be inequitable to allow it.⁴⁷

Lord Malcolm considers the fact that the defenders' obligation to grant a discharge only arose on termination of the option as a basis for the obligations not being counterparts. He notes that there must be contemporaneous claims which are "exigible or prestable" at the same time. This appears to conflate two issues: one, whether the obligations are counterparts; and secondly whether the claims are contemporaneous. For instance, paying the price is reciprocal to the obligation to deliver goods in a contract of sale⁴⁸ yet the buyer may be granted a period of credit such that he obtains delivery of the goods prior to the price being due. The obligations would not, until, payment was due be contemporaneous. The requirement that claims be contemporaneous means that B is only able to withhold her contractual performance if A has breached a contractual obligation before the date on which B would have to perform her obligation under the contract.⁴⁹ If so, B can then retain. In this case the defenders' counterclaim was based on alleged breaches of the option by the pursuers before the option was terminated, which meant that the obligations, while perhaps not counterparts, were contemporaneous.

It is perhaps arguable that the terms of the option were enough to demonstrate that all of the pursuers' obligations were not the counterparts of all of the defenders' obligations such that mutuality retention was unavailable. The major difficulty with this case is the diverging comments regarding the way in which retention operates and how it ought to be controlled. The case poses more questions than it answers about this misunderstood area of law.

⁴⁶ The test for special retention.

⁴⁷ Such as retention being pled simply to delay performance: see Gloag p627; *Earl of Galloway v M'Connell* 1911 SC 846.

⁴⁸ S28 of the Sale of Goods Act 1979.

⁴⁹ *Redpath Dorman Long Ltd v Cummins Engine Co Ltd* 1981 SC 370.