**Easter Term**
**[2010] UKSC 19**
*On appeal from: 2009 CSIH 56*

# JUDGMENT

# Inveresk plc (Respondent) *v* Tullis Russell Papermakers Limited (Appellant) (Scotland)

**before**

**Lord Hope, Deputy President**
**Lord Saville**
**Lord Rodger**
**Lord Collins**
**Lord Clarke**

## JUDGMENT GIVEN ON

## 5 May 2010

**Heard on 1 and 2 March 2010**

| *Appellant* | *Respondent* |
| --- | --- |
| Richard Keen QC, Dean of Faculty<br>Almira Delibegovic-Broome<br>(Instructed by Dundas & Wilson CS LLP) | Heriot Currie QC<br><br>Jonathan Lake QC<br><br>(Instructed by McGrigors LLP) |

**LORD HOPE**

1. This is an appeal against an interlocutor of an Extra Division of the Inner House of the Court of Session (Lords Kingarth, Wheatley and Clarke) dated 30 June 2009 ([2009] CSIH 56; 2009 SC 663) refusing a reclaiming motion by the defenders, Tullis Russell Papermakers Ltd ("Tullis Russell"), against an interlocutor of Lord Glennie sitting in the commercial court dated 11 September 2008 ([2008] CSOH 124). By that interlocutor he granted decree in favour of the pursuers, Inveresk plc ("Inveresk"), in terms of the first conclusion of the summons, as amended, for payment by Tullis Russell of the sum of £909,395. Prior to the raising of these proceedings Tullis Russell had raised a separate action in the commercial court against Inveresk (CA31/07) in which, among other things, they claimed damages for breach of contract arising out of the same transaction as that which had given rise to Inveresk's claim for payment. Those proceedings are the subject of a lengthy proof before answer which is in the course of being heard in the commercial court by Lord Drummond Young.

2. The transaction to which these two sets of proceedings relate was the sale by Inveresk to Tullis Russell of property rights in the Gemini brand of paper, customer information and related assets and the maintenance of the value of the brand by the effective transfer of customer connections. It was recorded in two documents, following a style which is commonly used for transactions for the sale and purchase of intellectual property. They were both executed at the same time on 9 June 2005. They were (i) an agreement for the acquisition on 9 June 2005 by Tullis Russell of the Gemini brand, customer information and related assets ("the Asset Purchase Agreement") and (ii) an agreement ("the Services Agreement") by which Inveresk undertook to continue to manufacture, sell and distribute specified products for the period from 9 June 2005 until 8 November 2005 or until the agreement was terminated. In recital (C) of the Services Agreement it was stated that Tullis Russell had requested that Inveresk enter into that agreement to ensure continuity in the manufacture and distribution of those products, facilitate the integration of their manufacture and distribution into Tullis Russell's operations and enable Tullis Russell to obtain the full benefit and value of the assets being acquired under the Asset Purchase Agreement.

3. The transaction provided for various payments to be made to Inveresk for the assets and services that were being purchased by Tullis Russell. The consideration for the assets that Tullis Russell were to acquire under the Asset Purchase Agreement consisted of an Initial Consideration amounting to £5 million and a further sum as Additional Consideration. The amount of the Additional Consideration was dependent on the volume of certain products sold and invoiced

by Tullis Russell during the period from 8 November 2005 to 8 November 2006. It was payable in terms of clause 5 and Part 3 of the Schedule up to a maximum of £2 million. Further sums were payable under the Services Agreement in consideration of Inveresk continuing to manufacture and distribute products pursuant to that agreement.

4. In implement of the transaction Tullis Russell have paid £13 million to Inveresk, consisting of £5 million under the Asset Purchase Agreement and £8 million under the Services Agreement. In this action Inveresk seek a further payment of £909,395 as Additional Consideration under the Asset Purchase Agreement. In the other action Tullis Russell seek payment by Inveresk of £5,358,032.90. They aver that Inveresk failed to manufacture paper products during the currency of the Services Agreement that complied with the relevant quality standards and dealt with the customers in a way which diminished the value of the assets sold by them to Tullis Russell.

5. The proceedings in this action have been protracted. By an interlocutor dated 15 February 2008, following a debate in the commercial court, Lord Drummond Young repelled the defences and granted decree in Inveresk's favour for the sum of £909,395: [2008] CSOH 26. Tullis Russell reclaimed against that decision to the Inner House. They also sought leave to amend their pleadings by including a plea that they were entitled to retain any sums that might be due to Inveresk pending the resolution of their own claim against them for damages. On 20 June 2008 an Extra Division of the Inner House, without hearing full argument or issuing an opinion, allowed the summons and defences to be amended, recalled the Lord Ordinary's interlocutor of 15 February 2008 and remitted the whole matter back to the commercial court for a fresh debate on the amended pleadings. It was in the light of that debate that Lord Glennie pronounced the interlocutor of 11 September 2008 to which the Extra Division adhered in its interlocutor of 30 June 2009 which is the subject of this appeal.

6. Two distinct issues are raised in the appeal. The first relates to Inveresk's claim for £909,395 as Additional Consideration, which is the sum sued for in the first conclusion of their summons. The question is whether the amount that is due to Inveresk as Additional Consideration has been determined in terms of clause 5 and Part 3 of the Schedule to the Asset Purchase Agreement. Tullis Russell maintain that no sum is payable as Additional Consideration until the procedures provided for in the Schedule have been carried through and that this has not yet happened. The second issue relates to Tullis Russell's plea of retention. The question is whether Tullis Russell are entitled to retain performance of their obligation to pay the Additional Consideration due under the Asset Purchase Agreement pending payment of sums due in respect of their claims against Inveresk in the other action, in which sums are sought as damages for breaches of the Services Agreement and of certain post-sale obligations of the Inveresk under

the Asset Purchase Agreement. Inveresk maintain that the obligations for breach of which Tullis Russell claim damages are not the counterparts of their obligation to make payment of the Additional Consideration, so the plea of retention is not available.

7. Having examined the provisions of Part 3 of the Schedule and the actings of the parties with regard to them, the Lord Ordinary held that Tullis Russell were obliged to pay as Additional Consideration an amount based on the Tonnage shown in the draft Consideration Accounts and that their defence that the action had to be sisted for a Tonnage Audit to take place was irrelevant: para 23. He also held that Tullis Russell's plea of retention was irrelevant. He said that, although the two agreements had to be viewed together, the plea must fail for want of mutuality or reciprocity between the obligations to perform the services in the manner required on the one hand and the obligation to pay any part of the price under the Asset Purchase Agreement on the other: para 45. The Extra Division agreed with the Lord Ordinary that the situation that had arisen as a result of the parties' actings could be accommodated within the provisions for payment in Part 3 of the Schedule and that a Tonnage Audit was not required. They also agreed with him, for the reasons set out in paras 51-53 of Lord Clarke's opinion, that the plea of retention was irrelevant.

*The Additional Consideration*

*(a)The Facts*

8. The way which the amount due as Additional Consideration is to be calculated is set out in Part 3 of the Schedule. Put very simply, the calculation of the amount due depends on the amount in tonnes of the relevant paper products for which Tullis Russell received orders during the period from 8 November 2005 to 8 November 2006 and issued invoices during the period from 8 November 2005 to 22 November 2006. The first step is the preparation in draft by Tullis Russell of accounts, referred to in Part 3 as the draft Consideration Accounts, specifying the Tonnage and a calculation of the Additional Consideration according to an agreed arithmetical formula. Inveresk are then given an opportunity according to a prescribed timetable to examine the draft Consideration Accounts, to decide whether or not to accept them or to elect that a Tonnage Audit be carried out by Tullis Russell's accountants to confirm and verify the Tonnage to be included in the calculation. Agreement as to the Tonnage, or its verification by means of a Tonnage Audit, provides the key to the amount of the Additional Consideration. The date when payment is due varies according to the decisions that Inveresk takes with regard to the various options that are available. The carefully defined procedures that Part 3 of the Schedule sets out appear to have been designed on the

assumption that the Tonnage could be ascertained simply by examining the entries in the books and records kept by Tullis Russell during the relevant period.

9. Unfortunately that was not how things turned out when the procedures were put into practice. Tullis Russell did prepare draft Consideration Accounts as required by Part 3 of the Schedule. They were served on Inveresk by Tullis Russell on 8 November 2006, which was within the prescribed timetable. This draft gave a figure for Tonnage which would have produced Additional Consideration amounting to £910,080. Following a meeting at Tullis Russell's premises on 10 and 11 January 2007 at which their books and records were available for inspection, Inveresk proposed adjustments to the Tonnage which would have produced an Additional Consideration of £1,030,494.40. The prescribed timetable gave the parties five business days to attempt to agree Inveresk's proposed adjustments, which by now had long passed. This period was extended by agreement to 30 January 2007, but on that date Tullis Russell's solicitors informed Inveresk's solicitors that they were unable to agree Inveresk's proposed adjustments. They also told them that Tullis Russell had ascertained that the Tonnage figures used in the draft Consideration Accounts incorrectly included tonnage that related to non-branded paper which, it was said, did not fall within the relevant definitions in the two agreements. On the following day Inveresk's solicitors wrote to Tullis Russell's solicitors stating that, as it was their clients' belief that agreement could not be reached, they had been instructed to invoke paragraph 4.4(b) of Part 3 of the Schedule and require that a Tonnage Audit be undertaken. The parties then entered into correspondence about the carrying out of the audit and the accountants' terms of engagement.

10. So far, apart from an agreed adjustment of the prescribed time limits, the procedures set out in Part 3 of the Schedule were being followed. But events then happened which those procedures had not provided for. It had become apparent that a more fundamental issue had arisen between the parties than could be resolved simply by examining the books and records kept during the relevant period. This was an issue about the definition of the paper products that were to be included in the Tonnage calculation. The word "Product" is defined in Part 3 of the Schedule as meaning "Products (as defined in the Services Agreement) incorporating the Trade Marks". The Services Agreement defines "Products" as meaning the products specified in Part 1 of the Schedule to that Agreement, which says that they are paper products which have been coated with Solid Bleached Sulphate. Part 2 of the Schedule to the Services Agreement sets out a list of registered and unregistered trade marks that had been attached to various grades of Gemini and inverX brand products by Inveresk. The expression "Trade Marks" is defined in the Asset Purchase Agreement as meaning all trade marks of Inveresk relating to the Gemini brand and the inverX brands. Attempts to agree the figure for Tonnage broke down when Tullis Russell sought to exclude from that figure brands of coated paper which had been ordered by, and manufactured and

packaged for, paper merchants under their own labels. They maintained that Inveresk's goodwill attached only to products which bore the trade marks which had been sold to them under the Asset Purchase Agreement.

11. The dispute as to whether own label brands fall to be excluded from the figure for Tonnage in the Consideration Accounts remains unresolved. In their second conclusion Inveresk seek declarator that quantities of paper under the three own label brand names for which orders were received and invoices issued during the relevant period, which Tullis Russell maintain should be excluded, are included in the Tonnage for the purposes of calculating the Additional Consideration. The Inner House did not hear any argument on this matter, and it does not form part of the subject matter of this appeal. But it forms part of the background, as there is a dispute between the parties as to whether the issue as to what falls within the definition of "Product" is for determination by Tullis Russells' accountants as part of their Tonnage Audit in paragraph 5 of Part 3 of the Schedule.

12. The accountants, Pricewaterhouse Coopers, were instructed to carry out the Tonnage Audit by Tullis Russell on 5 February 2007. But on 20 February 2007 they wrote to the parties' solicitors saying that they were unable to proceed with the Tonnage Audit. They had provided the parties with their draft terms of reference, but by their letter dated 16 February 2007 Inveresk's solicitors had made it clear that Inveresk did not agree with them. They said that, as matters stood, they were unable to meet the timetable in paragraph 5.1 because they had not been provided by the parties with an agreed terms of reference which they considered necessary for conducting the audit. The solicitors for Inveresk then offered to engage the accountants for the purpose of conducting an audit on a restricted basis, but this was not acceptable to Tullis Russell. On 14 March 2007 Inveresk's solicitors wrote to Tullis Russell's solicitors stating that no adjustment needed to be made to the draft Consideration Accounts, withdrawing Inveresk's request that a Tonnage Audit be undertaken and demanding payment of the sum of £909,395.

*(b) Part 3 of the Schedule*

13. Paragraph 2 lies at the heart of the scheme which Part 3 sets out. It provides that Tullis Russell shall pay to Inveresk the Additional Consideration on the Payment Date in accordance with paragraph 7. Paragraph 7.2 provides that the Tullis Russell shall pay to the Inveresk the Additional Consideration within 10 Business Days of the Payment Date. The question is whether, in the events that have happened, Inveresk are able to show that the Payment Date, as defined in Part 3, has arrived. Unless they are able to do that their claim for payment of the sum sued for in the first conclusion must be dismissed as irrelevant. In the quotations

that follow Inveresk are referred to in Part 3 as "the Vendor" and Tullis Russell as "the Purchaser".

14. Paragraphs 4 and 5 of Part 3 of the Schedule provide as follows:

> "4 Finalisation of draft Consideration Accounts
>
> 4.1 The Purchaser shall prepare and serve on the Vendor within 5 Business Days of 1 November 2006 a draft of the Consideration Accounts (draft Consideration Accounts).
>
> 4.2 The Vendor may, within the period of 10 Business Days after service of draft Consideration Accounts on the Vendor in accordance with paragraph 4.1 (Review Period):
>
> (a) notify the Purchaser in writing of any adjustments they consider need to be made to the draft Consideration Accounts (together with the reasons for such adjustments); or
>
> (b) elect that the Purchaser's Accountants carry out a Tonnage Audit in accordance with paragraph 5 of this Schedule.
>
> 4.3 If:
>
> (a) the Vendor notifies the Purchaser during the Review Period that no adjustment needs to be made to the draft Consideration Accounts; or
>
> (b) the Vendor notified (sic) the Purchaser during the Review Period that it does not wish to elect that a Tonnage audit be undertaken;
>
> (c) the Vendor does not notify the Purchaser during the Review Period of any proposed adjustment to the draft Consideration Accounts,
>
> the draft Consideration Accounts, Tonnage and Additional Consideration specified in it shall be the Consideration Accounts, Tonnage and Additional Consideration for all the purposes of this Agreement.
>
> 4.4 If the Vendor notifies the Purchaser during the Review period that certain adjustments need to be made and:
>
> (a) the Purchaser and the Vendor agree, in writing, on the adjustments to be made to the draft Consideration Accounts and/or Tonnage, and/or Additional Consideration they shall jointly incorporate such adjustments into the draft Consideration Accounts and the draft Consideration Accounts as so adjusted and the Tonnage

and Additional Consideration Accounts specified in it shall be the Consideration Accounts and the Tonnage for all purposes of this Agreement; or

(b) if the Vendor and the Purchaser are unable to so agree within 5 Business Days then paragraph 5 of this part 3 of the Schedule shall apply.

4.5 The Payment Date shall be:

(a) in the case of paragraph 4.3(a) above, the date the Vendor notifies the purchaser that no adjustments need to be made; or

(b) in the case of paragraph 4.3(b) above, the date the Vendor notifies the Purchaser that it does not require that a Tonnage Audit be undertaken; or

(c) in the case in the case (sic) of paragraph 4.3(c), the last day of the Review Period;

(d) and, in the case of paragraph 4.4(a) above, the date of the written agreement, of the adjusted Consideration Accounts and/or Tonnage and or Additional Consideration.

5 Tonnage Audit

5.1 Within 14 Business Days from the date that the Vendor notifies the Purchaser that it requires a Tonnage Audit, the Purchaser shall procure;

(a) that the Purchaser's Accountants carry out the Tonnage Audit to confirm and verify the Tonnage;

(b) deliver to the Vendor the Tonnage Audit Statement.

5.2 In undertaking the Tonnage Audit, the Purchaser's Accountants shall act as experts and not as arbitrators, and their decision as to any matter referred to them for determination shall, in the absence of manifest error or fraud, be final and biding in all respects on the parties and shall not be subject to question on any ground whatsoever.

5.3 The fees and expenses of the Purchaser's Accountants, and any other professional fees incurred by them shall be borne and paid as they direct or, failing such direction, shall be shared equally between the Vendor and the Purchaser.

5.4 Within 5 Business Days of receipt by the Vendor of the Tonnage Audit Statement, the Vendor and the Purchaser shall jointly

> incorporate in the draft Consideration Accounts the Tonnage as determined by the Tonnage Audit Statement and shall date the Consideration Accounts and calculation of Tonnage with the date on which such adjustments are made (which date shall be the Payment Date). The draft Consideration Accounts as amended, and the Tonnage stated in it, shall be the Consideration Accounts and the Tonnage for all the purposes of this Agreement."

*(c) Discussion*

15. As I mentioned when I was narrating the facts, apart from an agreed adjustment of the prescribed time limits, the procedures set out in Part 3 of the Schedule were being followed up to 31 January 2010 when Inveresk's solicitors wrote to Tullis Russell's solicitors stating that, as it was their clients' belief that agreement could not be reached, they had been instructed to invoke paragraph 4.4(b) of Part 3 of the Schedule and require that a Tonnage Audit be undertaken. None of the events referred to in paragraph 4.3 had occurred. Inveresk had notified Tullis Russell that certain adjustments needed to be made to the draft Consideration Accounts, and meetings had taken place in an attempt to reach agreement as provided for in paragraph 4.4(a). But the parties were unable to agree. This had two consequences for the working out of the agreed procedures. First, paragraph 4.4(b), which provides that paragraph 5 shall apply, came into effect. Secondly, as none of the events referred to in paragraph 4.5 had occurred, the only event listed in Part 3 that remained to identify the Payment Date was the incorporation in the draft Consideration Accounts of the Tonnage as determined by the Tonnage Audit Statement.

16. Part 3 of the Schedule does not in terms oblige Inveresk to require a Tonnage Audit. But Tullis Russell's case is that the effect of its provisions is that, in the events that have happened and in the absence of agreement as to some other procedure, a Tonnage Audit has to be undertaken before Inveresk are entitled to demand payment. In their second plea in law they state that, as the parties have agreed to expert determination in terms of the Asset Purchase Agreement, the Court of Session has no jurisdiction and the action should be dismissed. In their third plea in law they state that, as the parties have agreed to refer the subject matter of the action to expert determination, the action should be sisted pending the outcome of that determination. The Dean of Faculty said however that he was not insisting in either plea at this stage. He invited this Court to hold that a Tonnage Audit was required to determine the amount of the Additional Consideration and to remit the case to the commercial judge for further procedure.

17. Inveresk acknowledge that, as they are seeking payment of the Additional Consideration under and in terms of the Asset Purchase Agreement, they must follow the procedure for determining its amount that is set out in Part 3 of the Schedule. But they submit that the procedure for a Tonnage Audit is only engaged if the Vendor does not agree with the draft Consideration Accounts. They also submit that the Purchaser has no right to submit new or revised draft Consideration Accounts in substitution for those served on the Vendor under paragraph 4.1. Their position is that they are now in agreement with the figures in the draft Consideration Accounts. That being so, they say, a Tonnage Audit is not necessary and they are entitled to payment of the sum sued for. What they are seeking to do, in other words, is to resile from their notification under paragraph 5.1 that a Tonnage Audit was required and to rely instead on the option provided by paragraph 4.3(a). This would mean that 14 March 2007, which was the date when they notified Tullis Russell that no adjustments needed to be made, was to be the Payment Date. The date as from which interest is claimed in the first conclusion appears to have been chosen on that assumption.

18. Developing these submissions, Mr Currie QC said that the rationale for a Tonnage Audit disappeared if Inveresk did not dispute the draft Consideration Accounts. He rejected any suggestion that Inveresk was seeking to take advantage of an obvious error in their favour in that document. There was no such mistake in the original draft which had been served on them under paragraph 4.2. But it had been prepared on a different view from that which Tullis Russell were now taking as to whether the figure for Tonnage should include non-branded paper. As this was not agreed Tullis Russell had failed to procure the carrying out of a Tonnage Audit within 14 days of Inveresk's notification as required by paragraph 5.1. Inveresk were entitled in this situation to withdraw their notification and to call for payment of the amount shown in the draft Consideration Accounts which was no longer disputed. He submitted that the scope of the Tonnage Audit that was provided for in paragraph 5 was limited to a consideration of the figures in the draft Consideration Accounts. Those were the figures that the Purchaser's Accountants were required to confirm and verify. That was the extent of their remit. No provision was made for the consideration of any other figures that the Purchaser might produce.

19. I think that there would have been much to be said for Inveresk's position if they had not exercised their right to require a Tonnage Audit under paragraph 5.1. The earlier paragraphs proceed on the basis that the only question, following service of the draft Consideration Accounts on the Vendor, is whether the Vendor thinks that they are in need of adjustment. There is no provision that entitles the Purchaser to withdraw the draft Consolidation Accounts once they have been served on the Vendor or to propose its own adjustments. That is so even at the stage which is envisaged by the opening lines of paragraph 4.4, when the Vendor notifies the Purchaser during the Review Period that adjustments need to be made.

The question is whether the Purchaser is locked into that position once the stage has been reached that the parties are unable to agree on the adjustments and a Tonnage Audit is necessary to determine the amount that is to be paid and the Payment Date.

20. This in turn raises the question as to whether, as Mr Currie maintains, the scope of the Tonnage Audit is limited to a consideration of the figures in the draft Consideration Accounts. This was an important part of Lord Glennie's reasoning. He said that the words "as to any matter referred to them for determination" in paragraph 5.2 pointed very strongly to an understanding that the Tonnage Audit was not a general assessment of tonnage in the round but was constrained by the positions adopted by the parties in the draft Consideration Accounts and the proposed adjustments (if any): para 22. As it was not open to the Purchaser to revise its draft Consideration Accounts, it must have been open to the Vendor to drop its objections and indicate that it was content to accept the position put forward in the draft Consideration Accounts served under paragraph 4.1: para 23. In the Inner House Lord Clarke too said that the agreement showed that the experts' role was limited to confirming and verifying the figure in the draft Consideration Accounts, not to adjudicate in general between contesting figure proferred by either side: 2009 SC 663, 678, para 22.

21. The crucial question then is whether, on a proper construction of paragraph 5 of part 3 of the Schedule, the Purchaser's Accountants' role in conducting the Tonnage Audit is so limited. Paragraph 5.1(a) provides that the Purchaser shall procure that its Accountants "carry out the Tonnage Audit to confirm and verify the Tonnage". The definition of "Tonnage" in paragraph 1.1 of Part 3 states that this word means "the amount in tonnes of the Product for which the Purchaser receives orders during the Earnout period and thereafter issues invoices in relation to such tonnage in the Invoice Period as provided for in the Consideration Accounts." The definition of "Tonnage Audit" in the same paragraph states that this expression means "the external verification of the Tonnage by the Purchaser's Accountants" in accordance with paragraph 5 of the Schedule. It seems to me that, read together with these definitions, paragraph 5.1(a) indicates that the experts' task is to verify the amount in tonnes of the Product for which orders were received and invoices issued during the relevant periods. The product of this exercise is the Tonnage Audit statement referred to in paragraph 5.1(b), which then falls to be incorporated as the Tonnage in the draft Consideration Accounts under paragraph 5.4. I cannot find anything in wording of paragraph 5.1(a) to indicate that the experts are tied to the figures stated in the draft Consideration Accounts which the Vendor considers need to be adjusted. Their attention is directed instead to a consideration of the relevant orders and invoices. It is the product of that exercise that will produce the figure which they are required to confirm and verify as the Tonnage for the purposes of paragraph 5.4.

22. The words “confirm and verify” in paragraph 5.1(a) and “as to any matter referred to them for determination” in paragraph 5.2 were said to indicate that it was not open to the experts to consider any adjustments that the Purchaser might propose while they were undertaking the Tonnage Audit. Pressed to its logical conclusion, however, this submission indicates that it would not have been open to the experts to correct an obvious mistake in computing the relevant figures which produced a greater figure for Tonnage in the draft Consideration Accounts than the Vendor was entitled to having regard to the definition of Tonnage in paragraph 1.1. That produces a very strange result. It would mean the experts were being required to confirm and verify a figure which was obviously not right. It is hard to believe that this is what the parties intended when they entered into the agreement.

23. Commercial contracts are, of course, construed in the light of all the background which could reasonably have been expected to be available to the parties in order to ascertain what would objectively have been understood to have been their intention: *Prenn v Simmonds* [1971] 1 WLR 1381, 1383, per Lord Wilberforce; *Mannai Investmment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749, 779, per Lord Hoffmann. But this is not a case where a clause appears to have been badly drafted. On the contrary, the wording of paragraph 5.1(a) read together with the definitions, is perfectly intelligible. It favours the wider approach to what was intended that is contended for by Tullis Russell. This accords with business sense, as the agreed procedure must be taken to have been designed to ensure that the figure for Tonnage in the Consideration Accounts was an accurate statement of the amount in tonnes which in turn would produce the amount which Inveresk were entitled to be paid as Additional Consideration under the agreement. That being the purpose of the procedure, it falls to be read and applied in a way that will give effect to it.

24. It is true that the Vendor can tie the Purchaser to the figure in the draft Consideration Accounts during the Review Period referred to in paragraph 4.2 even if they are not accurate. During this stage the agreed procedures operate exclusively in the interests of the Vendor. But that advantage comes to an end when it notifies the Purchaser that it requires a Tonnage Audit. The focus now is on obtaining an accurate figure for Tonnage as defined in paragraph 1.1. Both parties have an interest in seeing that the Tonnage that the experts confirm and verify is the figure that the parties intended to be used in the draft Consideration Accounts as so defined. This is because a sensible commercial approach to the procedure indicates that the amount paid as Additional Consideration should be based on a correct assessment by the experts of the Tonnage as defined in paragraph 1.1, no more and no less. An error either way would defeat that objective.

25. Once this position is reached, Inveresk’s position seems to me to be untenable. The argument that it was entitled to resile from its election to require a

Tonnage Audit rested on two foundations. These were (a) the restricted nature of the material that the experts were entitled to consider when conducting that exercise, and (b) the proposition that the provision for the carrying out of a Tonnage Audit was conceived solely in the Vendor's interests: *Manheath Ltd v H J Banks & Co Ltd* 1996 SC 42, 48-49. For the reasons that I have given I would reject both of those arguments. Tullis Russell are entitled to insist that, as Inveresk have notified them that they require a Tonnage Audit, the figure for Tonnage that is to be entered in the draft is accurate. The definition of that expression in paragraph 1.1 shows that this figure must be based on an assessment of the amount in tonnes for which orders were received and invoices issued during the relevant periods. That is the measure of the amount that Inveresk are entitled to be paid under the agreement. All the information that is relevant to that assessment must be taken into account. The dispute as to whether there should be excluded from Tonnage brands of paper ordered by, and manufactured and packaged for, paper merchants under their own labels will, of course, need to be resolved before that assessment is undertaken. How this should be done will be for determination by the commercial judge, to whom I would remit the case for further procedure.

*Retention*

*(a) Introduction*

26. On one view, Tullis Russell's plea of retention will not need to be considered if the action is sisted pending the outcome of the reference of the Tonnage to the experts for determination. Until that happens Inveresk's claim for Additional Consideration will be illiquid and, as such, unenforceable. But the timetable for a resolution of the damages action, for perfectly understandable reasons, remains uncertain. It is possible that the damages claims will still be illiquid when the sist is recalled. In that event retention will once again become a live issue. So, as the question was fully debated before us, I think that we should reach a decision as to whether the Extra Division were right to refuse the reclaiming motion against the Lord Ordinary's decision that the plea should be repelled because the averments in support of it were irrelevant.

27. Tullis Russell base their claim of retention pending resolution of their claim of damages on the rule that a party has the right to withhold performance where both claims arise under a mutual contract. They aver that Inveresk failed, to a material extent, to perform properly obligations in both the Asset Purchase Agreement and the Service Agreement which they say are the counterparts of Tullis Russell's obligation to pay Additional Consideration. In their seventh plea-in-law they claim to be entitled to retain the sum sued for pending the resolution of their claim for damages. For Inveresk Mr Currie did not dispute the rule on which

Tullis Russell base their claim. But he submitted that retention can only operate under Scots law where the respective claims arise out of one contract. In this case there were two contracts, albeit both arising from a single transaction. So the plea was not available in this case. In any event fulfilment by Inveresk of the obligations in the Service Agreement was not a counterpart of Tullis Russell's obligation to pay the Additional Consideration, and there were no relevant averments of a right to retain based on breaches of the Asset Purchase Agreement.

28. The Lord Ordinary found in favour of Tullis Russell on the first point. He did not think that it was fatal to their plea that the relevant claims in the other action arose out of obligations under a different contract. He saw no reason in principle why the concept of mutuality should not apply to the transaction as a whole: para 44. But he held that the plea must fail for want of mutuality or reciprocity, because the Services Agreement was a wholly separate stage of the overall transaction from the initial acquisition of the assets that were being purchased: para 45. The counterpart of the sale of the assets under the Asset Purchase Agreement was the payment of the Consideration, in the two instalments. The counterpart of the provision of services under the Services Agreement was the payment of the fee for such services. The Extra Division took as its starting point the fact that the parties had deliberately chosen to enter into separate agreements with two separate legal descriptions: one a contract of sale, the other a contract of services. They had different consequences and no case had been referred to in which retention had been held to operate in such circumstances: para 49. The enforcement of the respective obligations was not made dependent one upon the other, and it was not sufficient that some form of inter-connectedness could be identified: para 51.

*The nature of the plea*

29. It may be helpful if I were to say something about the use of the word "retention". It is a word to be used with care: McBryde, *The Law of Contract in Scotland* 3rd ed, (2007), para 20-62. This is because it tends to be used to describe a variety of remedies, each with different rules attached to them. This has given rise to a good deal of confusion, with the result that it is not always easy to find clear guidance for the application of each remedy in the authorities. In a footnote to a paragraph which precedes the passage which I have just referred to, McBryde states that confusion is endemic in this area of the law: para 20-61, fn 21.

30. In simple terms, what Tullis Russell seek to do is to withhold, or "retain", payment of the sum sued for by Inveresk when the amount due to them has been ascertained, pending the ascertainment of their claim of damages so that, when it has become liquid, they may set off the amount of that claim against the sum payable to Inveresk. As a general rule payment of a debt which has been found to

be due and payable cannot be withheld on a plea of retention in respect of a claim which is still illiquid. But Tullis Russell seek to rely on an exception to that rule which applies where the illiquid claim arises directly out of the same contract. The obligation to pay the sum found to be due and payable to Inveresk will not be extinguished, but postponed. It may ultimately be extinguished, however, on the principle known as compensation should it be found that the amount due as damages equals or exceeds the amount due as Additional Consideration to Inveresk. Retention and compensation are sometimes confused with each other, but they are different remedies. As McBryde, *The Law of Contract in Scotland*, para 20-64 explains, retention does not operate to extinguish claims, whereas compensation when pled and sustained does have this effect. As matters stand in this case, compensation lies in the future. The issue at this stage is whether Tullis Russell are entitled to exercise the remedy of retention. Their case for its exercise rests on the mutuality of contractual obligations.

31. The principle that in mutual contracts "neither party should obtain implement of the obligements to him, till he fulfil the obligements by him" was recognised by Stair, *The Institutions of the Law of Scotland* (2nd ed, 1693), I, x, 17. He does not use the word "retention" in his discussion of the principle. But the examples which he gives in the previous paragraph show that he had in mind withholding performance of obligations which included the payment of money, such as the price in sale or the hire in location, so long as they were "properly mutual causes of each other": I, x, 16. As Erskine, *An Institute of the Law of Scotland* (Nicolson's edition, 1871), iii, 4, 20 points out, retention resembles compensation, "though it has not the effect of extinguishing obligations, but barely of suspending them, till he who pleads it obtains payment or satisfaction for his counterclaim." In para 21 he explains that the "right" of retention is more frequently pleaded by those who have bestowed either their money or their labour upon the subject sought to be retained; and that it commonly arises in that case "from the mutual obligations which naturally lie upon the contractor."

32. Gloag and Irvine, *Law of Rights in Security* (1897), p 303, provide this definition based on Erskine's treatment of the subject:

> "Retention may be defined as a right to resist a demand for payment or performance till some counter obligation be paid or performed… The law on the subject is complicated by the fact that the word retention is used to denote various rights, widely different in their origin and extent. Thus the right of a party to withhold performance of his obligation under a mutual contract, if the counter obligation is not performed, is often spoken of as a right of retention, and may result in a right to retain money or goods."

This use of the word is contrasted with the right of a creditor in bankruptcy to set off the debt owed to him against a debt which he himself owes to the bankrupt, which is said to be in origin a right of retention. As the authors explain at p 304, the law of retention of debts is an equitable extension of the statutory right of compensation under the Compensation Act 1592, c 143. They then provide this summary of the law of retention at p 305:

> "The cases where retention of debts is permissible form the exceptions to the general rule that an illiquid cannot be set off against a liquid claim. These cases may be grouped under four heads: (1) Where the illiquid claim admits of instant verification. (2) Where both the liquid and the illiquid claim arise out of a mutual contract. (3) Where one or other of the parties is bankrupt or *vergens ad inopiam*. (4) Where, in exceptional circumstances, retention has been allowed to meet the justice or convenience of the particular case."

As their seventh plea-in-law makes clear, Tullis Russell's claim for retention falls under the second of these four heads, it being assumed that Inveresk's claim will become liquid when the amount due as Additional Consideration has been ascertained. They do not seek an exercise of the court's equitable jurisdiction under the fourth head. That is the second kind of retention to which Lord Rodger helpfully draws attention in his judgment. I agree with him (see para 106) that Tullis Russell's seventh plea-in-law would not be appropriate if their case was that they should be allowed, in the exercise of the equitable power, to retain any sum due to Inveresk pending the resolution of their claim of damages.

33. The fact that these remedies differ in their origin and content is also noted in Gloag and Henderson's *Law of Scotland* 12th ed, (2007), of which the general editors were Lord Coulsfield and Professor Hector MacQueen. This edition, like all its recent predecessors, is the product of careful revision by its editors. Its treatment of the subject is to be found in paras 3.31-3.32 where the right of compensation referable to the statute of 1592 is dealt with:

> "Compensation is pleadable only between liquid debts, with an exception, largely in the discretion of the court, in cases where an illiquid debt may be rendered liquid without delay….The right of retention when debts arise out of the same contract, or where bankruptcy has supervened, is considered further in a later chapter."

A footnote to the last sentence in this passage refers to paras 10.14-10.17. In para 10.14 it is stated that the right, when it takes the form of refusal to pay a debt, is always known as a right of retention. In para 10.16 the rule that applies where debts arise from the same contract is set out:

> "When two claims, one liquid, the other in the nature of a claim for damages, arise from the same contract the creditor in the claim for damages may withhold payment of his debt until the amount due to him as damages is established."

The chapters in which the sentences which I have quoted appear have been re-organised by the editors of the latest edition, but the sentences themselves can be traced at least as far back as the 6th edition of Gloag and Henderson's *Introduction to the Law of Scotland* (1964). In my opinion they correctly state the law on this subject, which has been settled since at least 1693: see also Gloag on *Contract*, pp 626-628; *Stair Memorial Encyclopaedia*, vol 13, *Judicial and Other Remedies*, para 94; *British Motor Body Co Ltd v Thomas Shaw (Dundee) Ltd* 1914 SC 922, 926, per Lord President Strathclyde. It follows, of course, that Tullis Russell's case for retention stands or falls on the issue of mutuality. As McBryde explains, it must be appreciated that the mutuality principle applies only where the obligations are counterparts of each other: *The Law of Contract in Scotland*, para 20-70. So I do not think that either the Lord Ordinary or the Extra Division can be said to have fallen into error by dealing with the case on this basis, although I agree with Lord Rodger that the way the Extra Division dealt with the matter might be taken as suggesting, incorrectly, that retention was governed entirely by fixed rules and that there was no room for the equitable remedy.

34. I turn then to the question whether Inveresk's argument that retention is not available because the respective obligations do not arise under a single contract is well founded. This raises an important issue of principle. In most cases where the plea of retention has been argued it has not been necessary to examine the point, as there was only one contract. The many cases where a tenant has been held to be entitled to retain rent on the ground of the landlord's failure to fulfil his obligations under the lease provide the most obvious example: eg *Earl of Galloway v McConnell* 1911 SC 846; *John Haig & Co v Boswell-Preston* 1915 SC 339. For this reason I would not regard references to a single contract in the discussion of the principle by Erskine, *An Institute of the Law of Scotland* III, iii, 86 and by Gloag on *Contract*, pp 626-627 as determinative. On the contrary, Gloag's observation at p 627 that "even in cases where both debts arise out of the same contract" a claim of retention is not the assertion of an absolute right suggests that he was willing to accept that it is not essential that the debts (or obligations) should arise under the same contract, so long as they arise from the same transaction and are dependent or conditional on each other. As for the right of retention not being

the assertion of an absolute right, this is a reference to the Court's power to prevent its abuse by, for example, compelling the party who seeks to invoke it to consign the sum sued for: *Garscadden v Ardrossan Dry Dock Co* 1910 SC 178, 180, per Lord Ardwall; *Earl of Galloway v McConnell* 1911 SC 846, 852, per Lord Salvesen. Inveresk do not seek the exercise of that power in this case.

35. In *Claddagh Steamship Co Ltd v Steven & Co* 1919 SC (HL) 132 there were two contracts for the sale of two ships. The question was whether, when one of them was requisitioned by the Government, the purchasers were obliged to accept and pay for the other. Their case was that they were not obliged to do so, as the vendors were not able to perform their side of the bargain. I think that this is a good example of the right of retention of the kind explained by Erskine, *An Institute of the Law of Scotland*, III, iii, 86:

> "No party in a mutual contract, where the obligations on the parties are the causes of one another, can demand performance from the other, if he himself either cannot or will not perform the counter-part, for the mutual obligations are regarded as conditional."

It was held that, as the evidence showed that the object of the two contracts was to give effect to an agreement for the sale of the two ships together, the purchasers were entitled to refuse to accept delivery of one ship without the other. Viscount Finlay said at p 135 that it is always open to inquiry whether the existence of two separate documents represented the real bargain between the parties. That was a case of a refusal to perform a contractual obligation on the ground that it was impliedly conditional on performance of his obligation by the other party. In this case retention is relied on to delay performance until a claim of damages is satisfied. The distinction between these two forms of retention is noted by Gloag on *Contract*, p 623. But Viscount Finlay's observation supports the view that it would be wrong in either case to insist that retention can only be relied on where the obligations are both to be found in the same contractual document. That would be to give preference to form over substance, and the nature of the plea indicates that it cannot be the right approach. I think that the position is accurately stated by McBryde, *The Law of Contract in Scotland*, para 20-67 as follows:

> "The principle of mutuality of obligations applies to *all* contracts, and so in *any* type of contract a claim for the sums due under the contract may be met by the defence that the defender has claims arising from the pursuer's failure to perform that contract." [emphasis added]

36. The law does not compel the parties to a contract to set out the obligations that each owes to the other in a single document. For fiscal or other reasons it may be more helpful to use two or more contractual documents to record their overall agreement. The question in each case of retention will be whether the obligations that are founded on, wherever they are to be found, are truly counterparts of each other. It goes without saying that they must both be part of the same transaction, as there can be no mutuality between two or more transactions each of which has a life of its own. But, as Lord Drummond Young said in *Hoult v Turpie* 2004 SLT 308, para 10, the principle of mutuality has generally been given a wide scope in Scots law. It is derived from the *exceptio non adimpleti contractus*. The principle, as explained by Corbett J in *ESE Financial Services (Pty) Ltd v Cramer* 1973(2) SA 805, 809, concentrates on the obligations that each party owes to the other rather than the way in which the contract is made up:

> "Where a plaintiff sues to enforce performance of an obligation which is conditional upon performance by himself of a reciprocal obligation owed to the defendant, then the performance by him of this latter obligation (or, in cases where they are not consecutive, the tender of such performance) is a necessary pre-requisite of his right to sue and should be pleaded by him. Conversely in such a case the defendant may raise as a defence, known as the *exceptio non adimpleti contractus*, the fact that the plaintiff has failed to perform, or in the appropriate case, tender performance of, his own reciprocal obligation."

37. In the present case there are ample grounds for regarding the two agreements as depending upon one another and as each forming part of the same transaction. Clause 16 of the Asset Purchase Agreement is an entire agreement clause. It states that that Agreement (together with the documents referred to in it or executed at Completion) constitutes the entire agreement and understanding between the parties with respect to its subject matter. The Services Agreement is referred to in clauses 1.1 and 7.1 of the Asset Purchase Agreement, and the parties are agreed that both agreements were executed at the same time. Recital (C) of the Services Agreement, as has been already noted, makes it clear that that agreement was being entered into in order to facilitate the integration of the manufacture and distribution of the Products into existing Tullis Russell operations and to enable Tullis Russell to obtain the full benefit and value of the assets being acquired under the Asset Purchase Agreement. Clause 22, the entire agreement clause, states that the Services Agreement and the Asset Purchase Agreement of even date contain the whole agreement between the parties in respect of the subject matter of that Agreement.

38. The conclusion that these two agreements were part of the same transaction to which, as a whole, the principle of mutuality can apply, is inescapable. The

Extra Division's conclusion to the contrary seems to me, with respect, to be based on a misconception. The fact that each was a nominate contract with different legal effects is no more significant than the fact that the parties decided to give effect to their transaction by entering into two agreements. The true significance of these agreements is to be found in the respects in which they were each linked expressly with each other.

*The basis for retention*

39. For the principle to operate, therefore, the obligations in question must be the counterparts of each other. So the next question is whether that requirement is satisfied in this case. As Corbett J formulated it in *ESE Financial Services (Pty) Ltd v Cramer* 1973(2) SA 803, 809, is the basic requirement of the *exceptio*, viz. reciprocity of obligation, satisfied? It is necessary also to consider whether the respective obligations were contemporaneous, as it was because the Lord Ordinary thought that they were not that he held that the plea of retention should be repelled. I think that this question can be taken with the first, as it is so closely related to the question whether there was reciprocity. There is a third question – whether the alleged breach by Inveresk was material. In *Purak Ltd v Byzak Ltd* 2005 SLT 37, para 10, Lord Drummond Young said that the right only arises where one party is in material breach of contract: see also *Turnbull v McLean & Co* (1874) 1 R 730, 738, per Lord Moncreiff. But lack of materiality is not an issue in this case. The breaches of contract that are founded on by Tullis Russell are said to have been directly related to the benefits that they were seeking to obtain when they entered into the transaction. The amount sued for is more than £5m. It exceeds the sum sued for by Inveresk by a very large margin. It is sufficiently large to allow for the possibility that they may fail to prove all that they aver both in the other action and in this one.

40. As for the question of reciprocity, Tullis Russell aver that they are entitled to retain any sums due to Inveresk pending payment of the claims against them which are set out in the other action (CA31/07). These claims fall into two parts. First, there is an allegation that Inveresk were in breach of clause 15.4 of the Asset Purchase Agreement, which provides that the Vendor shall promptly notify the Purchaser of any claims against the Vendor brought by any party "in respect of any goods manufactured or services provided by the Vendor derived from any of the Assets". Secondly, there are allegations that Inveresk were in breach of clauses 2.1(c) and (e), 5, 14(6) and 16.2(d) of the Services Agreement. Clause 2.1(c) obliged Inveresk to maintain the existing levels of customer service to purchasers and potential purchasers of Products and Licensed Products, which as defined were the Products manufactured pursuant to the Services Agreement, and to promote the successful integration of the Owned Intellectual Property rights, as defined in the Asset Purchase Agreement, into Tullis Russell. Clause 2.1(e) obliged Inveresk to

conduct its business in the ordinary way so as to maintain that business relating to the Products and Licensed Products as a going concern. Clause 5 is a provision about Quality Standards, which are defined as the quality standards in respect of any Licensed Stock to be acquired in terms of the Services Agreement. Clause 14(6) obliged Inveresk to indemnify Tullis Russell against all loss and expenses incurred by Tullis Russell arising from Customer Claims, which as defined were claims relating to the Licensed Products or any other Products manufactured or supplied by Inveresk after the date of the Service Agreement but prior to 5 November 2005 or the date of termination of that agreement, whichever was the earlier. Clause 16.2(d) refers to Goodwill. It provided that Inveresk was not at any time after 5 November 2005 or the earlier termination of the Services Agreement to do or say anything which was likely to, or intended to, damage the goodwill or reputation of the Owned Intellectual Property Rights, which as defined had the meaning given to that expression in the Asset Purchase Agreement.

41. It can be seen from this brief summary that the two agreements have to be read together to understand the nature and effect of these various obligations. But the Lord Ordinary held, for the reasons set out in his careful analysis in paras 41-45, that the Asset Purchase Agreement was concerned only with the sale and purchase of the Assets as defined in that agreement – that is to say, the Owned Intellectual Property Rights, the Customer Information and the Related Assets. The Services Agreement, on the other hand, was concerned only with the stock, Licensed Products and Products manufactured or supplied by Inveresk under that agreement. On a proper construction of article 15.4 of the Asset Purchase Agreement, the Assets sold by Inveresk to Tullis Russell under that agreement and the reference to goods manufactured or sold by them derived from those assets must be a reference to goods manufactured or sold by them prior to the sale and purchase of assets under that agreement. The manufacture and sale of goods thereafter was covered by the Services Agreement. In his view therefore there was, on an ordinary reading of the two agreements, no overlap between them. The obligations in the Services Agreement could not be seen as counterparts of the Asset Purchase Agreement. For the breaches of the Services Agreement to be available in support of a plea of retention against the claim for Additional Consideration they must have been exigible by the time the Additional Consideration fell due. But the Additional Consideration did not become due and payable at any time before the end of the Services Agreement. The Services Agreement was a wholly separate stage of the overall transaction from the initial acquisition of the Assets.

42. It seems to me, with respect, that the approach which commended itself to the Lord Ordinary concentrated too much on the detail and overlooked the overall purpose and effect of the transaction. Although he was right to reject the argument that it was fatal to the plea of retention that the obligations referred to in action CA31/07 arose out of a different contract, he did not carry his finding that the

separate agreements were all part of the same transaction to its logical conclusion. The guiding principle is that the unity of the overall transaction should be respected. The analysis should start from the position that all the obligations that it embraces are to be regarded as counterparts of each other unless there is a clear indication to the contrary: see Gloag, p 594; *Macari v Celtic Football and Athlectic Co Ltd* 1999 SC 628, 639, per Lord President Rodger.

43. In *Hoult v Turpie* 2004 SLT 308, para 14, Lord Drummond Young said that the requirement that the obligations should be counterparts of each other should not be used in an artificial manner which breaks up the essential unity of a contract. He cautioned against overuse of the mutuality rule as a means of controlling the right of retention lest it swamp the principle that contracts must be duly performed. As he saw it, the most satisfactory means of control was the rule that, before a party is entitled to withhold performance, the other must be in material breach of contract. It has been suggested that this theory needs to be treated with caution, as the breach does not need to be so material as to justify rescission: Gloag and Henderson, *The Law of Scotland*, 12th ed, para 10.14, footnote 85; McBryde, *The Law of Contract in Scotland*, para 20.60. Subject to that qualification, however, it seems to me to be a useful protection against abuse. The right of retention must, of course, be kept under control. The rule that the relevant obligations must be counterparts of each other must be respected too, as the right of retention rests upon that principle. It is possible to regard a contract as operating in stages, with the result that the principle will apply separately to each stage: *Bank of East Asia Ltd v Scottish Enterprise* 1997 SLT 1213. But care should be taken not to lose sight of the overall purpose and unity of the transaction that the parties have entered into when conducting the analysis.

44. The essence of the case for the exercise of a right of retention is to be found in recital (C) of the Services Agreement. It records that the Services Agreement was entered into to enable Tullis Russell to obtain the full benefit and value of the assets being acquired under the Asset Purchase Agreement. Clause 2.1 of the Services Agreement states that the parties recognised that its purpose was to allow Tullis Russell time to integrate the manufacture and distribution of the Products into their existing operations and to protect the value of Tullis Russell's investment in the Owned Intellectual Property Rights in terms of the Asset Purchase Agreement. Underlying these complicated arrangements is Tullis Russell's concern that the value of their investment could be affected by Inveresk's conduct during and following the expiry of the life of the Services Agreement. The basis of the claim of damages is that the value of its investment in the assets purchased under the Asset Purchase Agreement was diminished by Inveresk's manufacture and distribution of products which did not meet the specified quality standards and the way they dealt with complaints by customers. The fact that the principal assets that Tullis Russell were seeking to acquire were intellectual property rights, whose value was vulnerable to things said or done by Inveresk after those rights were

transferred to Tullis Russell, helps to explain the complex nature of these arrangements.

45. Clause 15.4 of the Asset Purchase Agreement can be taken to refer, as the Extra Division held in para 52, to claims in relation to products manufactured before the transaction was entered into. The clauses of the Service Agreement that are founded on perform the same function in relation to products manufactured after that date. Although the transaction can be regarded as proceeding in stages, it is unrealistic to treat it as divisible into a series of separate and unrelated compartments. The obligations undertaken by Inveresk were all designed to serve the same end, which was to preserve the value of the intellectual property rights and other assets acquired by Tullis Russell after the Completion Date. As for the payments to be made by Tullis Russell, the Services Fees payable under clause 3.1 of the Services Agreement were a counterpart of Inveresk's obligation to perform the services referred to in the clause. But in my opinion their obligation to pay the sum of the Initial Consideration and the Additional Consideration to Inveresk was a counterpart of the performance by Inveresk of their obligations under both agreements.

46. For these reasons I would hold that the courts below were wrong to hold that the averments in support of the plea of retention were irrelevant. In my opinion Tullis Russell are entitled to withhold payment of any sums due to Inveresk as Additional Consideration pending the outcome of their claim for damages for breach of the clauses in both the Asset Purchase Agreement and the Services Agreement that they found upon.

*Conclusion*

47. I would allow the appeal. I would recall the Extra Division's interlocutor and set aside the Lord Ordinary's interlocutor of 11 September 2008. The future course of this action will be a matter for discussion in the commercial court. I would remit the action to the commercial judge to proceed as accords.

**LORD SAVILLE**

48. I agree with Lord Hope and Lord Rodger that the appeal should be allowed for the reasons that they give. I also agree with the views expressed by Lord Collins about the position in English law.

**LORD RODGER**

49. I agree with Lord Hope that, for the reasons he gives, the averments of the pursuers, Inveresk PLC ("Inveresk"), in support of their conclusion for payment by the defenders, Tullis Russell Papermakers Ltd ("Tullis Russell"), of the sum of £909,395 are irrelevant. I add some observations on whether, as the issue is put, Tullis Russell would in any event be "entitled" to "retain" any sum for which they were found liable in these proceedings, until their claim against Inveresk for payment of various much larger sums by way of damages for breach of contract is resolved.

50. Tullis Russell's damages claim against Inveresk is being litigated in another commercial action in the Court of Session. That action began just before this one but, in certain respects at least, it has made rather more rapid progress. In December 2008 Lord Drummond Young assigned a diet for the proof before answer to begin on 6 October 2009 and to take six weeks. In August 2009 - in a burst of optimism - this was reduced to four weeks starting on 27 October 2009. The proof began then and ran until 20 November, by which time the pursuers, Tullis Russell, had not finished leading evidence. The continued proof is due to begin on 4 May 2010 and to last for sixteen days.

51. In the present action for payment, the seventh plea-in-law in the defences on behalf of Tullis Russell raises the issue of retention: "The defenders, being entitled to payment by the pursuers of sums under the contract, are entitled until such sums have been paid to retain any sums found due to the pursuers." The Lord Ordinary (Lord Glennie) repelled this and all their other pleas-in-law and granted Inveresk decree for the sum sued for. The Extra Division refused Tullis Russell's reclaiming motion.

*The Parties' Submissions*

52. Before the courts below and before this Court the lines of battle were drawn very narrowly. Essentially, both sides proceeded on what I would regard as the erroneous basis that in Scots Law the whole matter is regulated by fixed rules and that the court has no power to intervene where it would be equitable to do so.

53. Mr Currie QC, who appeared for Inveresk, maintained that the rule was that retention of a sum was not possible unless a pursuer had failed to perform an obligation under the same contract as gave rise to the right to payment; moreover, the defender could retain the sum only if the pursuer had failed to perform the very obligation under the contract for which the payment of the sum was the

consideration. Here, he argued, Tullis Russell's claim for damages fulfilled neither of these conditions: their obligation to pay the price for the assets arose under Clause 2 of the Assets Purchase Agreement, while their claim for damages related to the separate Services Agreement; Tullis Russell's obligation was to pay the price as consideration for Inveresk transferring the ownership of the assets under Clause 2 of the Assets Purchase Agreement. In contrast, their claim for damages related to an alleged breach by Inveresk of clauses – in particular, Clause 16 – of the Services Agreement.

54. On behalf of Tullis Russell, the Dean of Faculty also proceeded on the basis that retention was entirely a matter of right, and that the right arose where the pursuer's claim for the price and the defender's claim for damages derived from what amounted to the same contract. He argued that the Inner House had been wrong, however, to see the two agreements between the parties in this case as separate contracts; there was, in effect, a single transaction which had been given effect in two contracts in order to assist Inveresk's tax position. This could be seen, for example, from Clause 4 of, and Part 1 of the Schedule to, the Assets Purchase Agreement and from Clause 22.2 of the Services Agreement. Even if the contracts were separate, they were so closely interlinked that they should be treated together for purposes of retention. Tullis Russell could not be required to pay the price for the assets when they were claiming damages for loss which they alleged they had suffered due to Inveresk failing to carry out, inter alia, their obligation, under Clause 16 of the Services Agreement, to enable Tullis Russell to obtain the full benefit and value of those assets. In effect, the matter should be treated as if the defenders were claiming damages for breach of a contract on which they were being sued for the price.

*The Approach of the Inner House*

55. In essence, the approach advocated by Inveresk before this Court was the same as the approach of the Extra Division. Indeed, subject to a minor qualification which is not of practical importance, Mr Currie went out of his way to adopt everything which the Division said on retention. This included the following passage, 2009 SC 663, 695:

> "The approach of the reclaimers, before us, appeared to be that a proper reading of the two agreements together led to the implication that the parties intended that performance of the obligation to pay the additional consideration was dependent on the fulfilment of the obligations under the services agreement and Clause 15.4 of the acquisition agreement and that was so because of the obvious interconnection of the matters covered by the two agreements. In our system, at least, where the matter is not covered by express

> agreement, what the court is searching for is identification of obligations which might fall to be seen to be mutual. There is, we think, a danger of focusing on the expression 'mutuality of contract' rather than on 'mutuality of obligation' in this context. Within a single mutual contract, there may be obligations which are mutually dependent upon each other and can truly be described as reciprocal. There may also be within that single contract an obligation, or obligations, in respect of which there is no direct reciprocal counterpart. That is what Lord President Rodger in *Macari v Celtic Football and Athletic Co Ltd* 1999 SC 628, 640G-H took from the speech of Lord Jauncey in *Bank of East Asia Ltd v Scottish Enterprise* 1997 SLT 1213 and what Lord Caplan had to say about the matter at page 650. In a single contract situation, the obligation of an employee to carry out his employer's instruction was not regarded as the counterpart of his employer's implied obligation not to seek to damage the relationship of trust and confidence between the parties. Accordingly, the operation of retention even within a single mutual contract, where not expressly provided for, operates subject to these requirements and qualifications."

Applying that approach, the Division went on to say, at p 696,

> "Applying the law, as set out authoritatively in *Bank of East Asia* and *Macari*, it does not appear to us that, on any view, the reciprocal obligation for payment of the additional consideration under the acquisition agreement was the performance of obligations under the services agreement. The reciprocal obligation in relation to the payment of the additional consideration arose solely from the acquisition agreement and constituted the obligation to transfer the assets in question in accordance with that agreement. The reciprocal obligation for the performance of the obligations in the services agreement was to be found in the terms of the services agreement itself. While it can, no doubt, be said that there was a connection between the obligations contained in both agreements, in that they both came into existence in the context of the whole transaction between the parties, that could have been said of the respective obligations in *Macari* and in the respective obligations in the South African case, [*ESE Financial Services (Pty) v Cramer* 1973 (2) SA 805 (C),] but, as in those cases, their enforcement was not, in our opinion, made dependent one upon the other."

56. As is plain from their emphasis on the need to focus on "mutuality of obligation", the Extra Division are really confining retention to situations where the defender says that the pursuer has not performed the particular obligation in respect of which he claims payment of the sum in question. In other words, the defender asserts his right not to perform his obligation to pay unless and until the pursuer performs the particular obligation which entitles him to payment - as opposed to some other obligation under the contract. Hence the references to *Macari v Celtic Football and Athletic Co Ltd* 1999 SC 628 where one of the issues was whether Mr Macari had been entitled to refuse to carry out the instructions of the managing director because the club were in breach of another obligation to him under the contract between the parties.

57. I shall have to examine the development of the law in a little detail. In short, however, the approach of the Extra Division conflates two different legal doctrines, to both of which, most unhelpfully, Scots Law tends to apply the label "retention". Firstly, a defender has a *right* to withhold or "retain" payment of, say, the price of goods which he says are materially defective, until the pursuer proves that he has supplied goods which are conform to the contract. Although their analysis was more detailed and sophisticated, that is the only kind of retention which the Extra Division considered in the passages which I have quoted. But the term "retention" is also applied to the (different) situation where a defender admits that, say, the price of goods is due. In that situation he cannot have any *right* to withhold payment of the price. But he can submit to the court that he should not be obliged to pay the price until some unliquidated claim which he has against the pursuer (here, a claim for damages) is resolved. In effect, the defender asks the court *to allow him* to "retain" the price meantime so that, if his claim for damages succeeds, he can offset the liquid damages against the liquid price.

58. Here the Extra Division concluded that the Additional Consideration was a liquid debt which Tullis Russell had no *right* to withhold because the obligation to pay it was not dependent on Inveresk performing their obligations under the Services Agreement. As explained, there was actually a further possibility: that, even if the Additional Consideration was liquid, *it would be just and equitable to allow* Tullis Russell to retain it until their damages claim against Inveresk was resolved. Their Lordships cannot be blamed for not considering that issue, since clearly it was not argued. Nevertheless, the point is of some general importance. So I shall deal with it, while recognising, of course, that my remarks are obiter, since the appeal is being allowed on other grounds.

59. I must first make good the distinction between the situations where the two different types of retention arise. I can then deal with the first situation very shortly, since, on that form of retention, I agree with the judgment of Lord Hope. I shall then examine how the court decides whether to allow retention of the second kind.

*Retention - withholding performance*

60. The fact that the word "retention" is used in a variety of ways, which can lead to confusion, is well recognised. See, for instance, W M McBryde, *The Law of Contract in Scotland* 3rd ed, (2007), pp 563-565, paras 20-62 - 20-65. In W M Gloag and J M Irvine, *Law of Rights in Security* (1897), pp 303-304, Gloag mentions a number of different doctrines to which the term has been applied. In particular, he identifies the right of a party to withhold performance of his obligation under a mutual contract, if the counter obligation is not performed. He also mentions the case of retention or lien, where the person in possession of property belonging to another is entitled to retain it in security of debts or obligations due to him by the owner.

61. In his later work, *The Law of Contract* (2nd edition, 1929), p 623, Gloag says that the term "retention" is often used to refer to the "right of one party to withhold performance of the obligations he has undertaken under a contract until performance of the obligations in which he is creditor." A similar approach is found, for example, in Kames, *Principles of Equity* (new edition, 1825), p 344. This formulation is wide enough to cover the situation where, for example, A leases 100 acres of land to B, but remains in possession of 10 of those acres. B is entitled to refuse to pay the rent unless and until A actually performs his obligation to give B possession of the entire 100 acres. B's obligation to pay the rent arises only once A performs his obligation to put B in possession of the whole 100 acres.

62. Lord Fullerton put the point succinctly in a much-quoted passage in *Graham v Gordon* (1843) 5 D 1207, 1211:

> "Rent is not liquid in the sense that a sum due by bond is. It is matter of contract in consideration of something to be done. It is paid for possession of the subject let. If the tenant says he has not got entire possession, that is a good answer to the claim for rent."

In such a case there is no question of the tenant withholding or retaining rent that is due to the landlord: on the contrary, the tenant withholds the rent on the ground that he has no obligation to pay it because the landlord has not performed the obligation for which the rent is the consideration. See also, for example, *Lovie v Baird's Trs* (1895) 23 R 1.

63. The same can apply where a pursuer claims the price for carrying out works. If the defender disputes that the works were properly carried out, the pursuer must prove that they were. Unless and until he does so, his claim is illiquid

and the defender is not obliged to pay. See, for instance, *Johnston v Robertson* (1861) 23 D 646, 656, per Lord Justice Clerk Inglis:

> "Every action on a mutual contract implies that the pursuer either has performed, or is willing to perform, his part of the contract; and it is, therefore, always open to the defender to say that under the contract a right arises also to him to demand performance of the contract before the pursuer can insist in his action."

64. In the present case Tullis Russell do not dispute that Inveresk transferred ownership of the various assets on the Completion Date, 9 June 2005, in accordance with Clause 2.1 of the Assets Purchase Agreement. At which point, Tullis Russell paid the Initial Consideration. But they say - and the Court now holds - that Inveresk have no liquid claim for the Additional Consideration for those assets because it has not been agreed or determined in accordance with Part 3 of the Schedule. So, for that reason, Tullis Russell are under no obligation to pay the Additional Consideration at present. Any possible obligation to do so will arise only when the Additional Consideration is ascertained, either by agreement, or under some procedure to be determined by the commercial judge. If and when that day arrives, Tullis Russell want to be able to withhold payment of the Additional Consideration on two grounds: first, because, they say, Inveresk are in breach of their reciprocal contractual obligations to them and, secondly, pending the outcome of their claims for damages against Inveresk in the other action.

*Withholding Performance and Claiming Damages*

65. Besides withholding payment until the pursuer establishes that he has performed the obligation giving rise to the obligation to pay, a defender may undoubtedly go further and claim that the pursuer's breach of contract actually caused him loss.

66. That said, the case law and literature on defenders' claims for damages in actions for the price of a contract are notoriously confusing. For a modern reader, the older arguments and discussions are particularly difficult to follow because the counsel and judges were working in a system where, in an action for payment of a debt, the defender could plead any entitlement to damages only as a defence to the pursuer's claim – in the hope of using those damages to reduce or even extinguish any sum that would otherwise be due to the pursuer. If he wanted to go further, and actually recover the full amount of any damages, the defender had to raise a separate action against the pursuer. So far as the Court of Session is concerned, that remained the position until the law was changed by section 6(2) of the Administration of Justice (Scotland) 1933 and Rule 13 of the Rules of Court 1935.

It then became possible for a defender to include in his defences a conclusion and pleadings, by virtue of which he could recover the whole sum of damages due to him without the need to raise a separate action.

67. In *Taylor v Forbes* (1830) 9 S 113 the pursuer sued for freight for carrying a cargo of flour for the defender from Perth to Aberdeen. The pursuer did not insert sufficient planks to line the hold and protect the cargo from contact with the bilge water. He claimed that it was not customary to do so. When the flour was unloaded, part of the cargo was found to have been damaged by the bilge water. The cargo was sold, the damaged part at a reduced price. The reduction in value exceeded the freight. The pursuer sued for the freight before the Judge Admiral and the defender pleaded his loss by way of defence. The Judge Admiral was satisfied that the damage to the flour had been due to the pursuer's fault in failing to line the hold properly. In view of the fact that the defender's loss exceeded the freight, he assoilzied the defender.

68. When the matter came before the First Division, the pursuer argued that his claim for the freight was liquid and that the defender had to pay that liquid debt – leaving him to bring any claim for damages in a separate action. The First Division rejected that argument. The brief report does not reveal their reasoning. But, in reality, the defender was saying that the pursuer was in breach of contract because had failed to make appropriate arrangements for carrying the flour to Aberdeen. So the pursuer had to show that, in the circumstances, he had earned the freight by duly performing his contract to carry the flour. Since his claim for freight was therefore illiquid, the defender was entitled to plead in defence the illiquid claim for loss which he had suffered as a result of the pursuer's failure to make appropriate arrangements for carrying the flour. (In fact, the line of cases reviewed and affirmed in *Aries Tanker Corporation v Total Transport* [1977] 1 WLR 185 indicates that the settled policy of English law, at least, is against allowing a claim in respect of cargo to be asserted by way of deduction from the freight. It is unnecessary for present purposes to decide whether the same would now apply in Scots Law.)

69. In *Johnston v Robertson* (1861) 23 D 646 the parties had contracted for the pursuer to erect a poor-house. The work was to be completed and the keys were to be delivered by a specified day, under a penalty of £5 per week of delay in completing it. The court held that this was not a penalty but a provision for pactional damages. Since the pursuer's claim for the price was itself illiquid, there could be no objection to the defender seeking to establish his countervailing illiquid claim for the appropriate pactional damages in the event that the jury held that the pursuer had not completed the works in time. Depending on the finding of the jury as to whether the work had been done properly, and as to any sum due as liquidated damages for delay, the pursuer's claim for the price would be reduced or, conceivably, extinguished.

*Retention of liquid debt for purposes of compensation*

70. In the cases I have been discussing the pursuer's claim is not liquid. He has to establish it and, in that situation, the defender can oppose the pursuer's illiquid claim for the freight or price with his own illiquid claim for damages arising out of the pursuer's alleged failure to perform the obligation in question. A defender may, however, admit, say, that the work has been done, that the price has therefore been earned, and that the pursuer has a liquid claim for the price, but nevertheless maintain that the pursuer is liable to him in damages for loss which he suffered as a result of the pursuer's failure to do the work within the time allowed by the contract. As Lord Justice Clerk Inglis recognised, 23 D 646, 655, that was, essentially, the nature of one aspect of the defence to the action in *Johnston v Robertson*: supposing the pursuer was entitled to claim the price, "still, in consequence of the pursuer's delay in executing the work, a counter claim [for damages] arises to the defender *under another clause of the contract*, on which he specially founds, and his defence under which he desires to try by his counter issues" (emphasis added).

71. In that part of his defence, the defender in *Johnston v Robertson* was seeking to retain payment of any sum, which he was otherwise due to pay as the price for the completed works, against his claim for damages for the loss which he had suffered as a result of the pursuer's delay in completing them. In other words, the defender maintained that, even if the pursuer were to prove his claim and it became a liquid debt, he should still not be required to pay the debt unless and until his claim for damages for breach of another clause of the contract had been resolved. In effect, the defender was maintaining that the court should allow him to make his illiquid claim, for damages for the breach of the other clause, liquid so that he could then use that liquid sum to compensate any liquid sum which he was found to owe the pursuer.

72. The point can be focused by a hypothetical example. Suppose that in January B buys an antique clock from a dealer, A. The parties agree that, although B is to become owner and the clock is to be delivered to him forthwith, the price is not to be payable until 1 June. In a separate clause of the contract the parties also agree that, in the period between January and 1 June A is to go to B's house and renovate the clock. B is to pay him £30 per hour for his work. In fact, A fails to attend to do the renovations and B has to instruct another expert who charges a much higher rate. On 1 June B is undoubtedly under an obligation to pay the price in respect of the transfer of ownership and delivery of the clock. But he has a claim for damages for his loss due to A's failure to carry out his obligation to renovate the clock.

73. If the approach of the Extra Division, which I have identified at para 56 above, is right, then the mere fact that B's obligation to pay the price of the clock is not the counterpart of A's obligation to renovate it means that B can never be permitted to retain the price in respect of his claim for damages for A's breach of that obligation – even if that claim could be easily and speedily quantified and even if it were made the subject of a counter-claim in the same process. B has to pay forthwith because A has delivered the clock and given him a good title. So the judge would have to grant A decree de plano for the price and allow him to enforce that decree against B. B would then be left to pursue his counter-claim against A for damages. In effect, therefore, on the Extra Division's approach, which Mr Currie adopted, retention would be confined to cases where the defender was simply withholding payment until the pursuer had proved that he had performed the particular obligation for which the price was the consideration. Retention of liquid debts under a contract would, in effect, be impossible. It would follow also that the court could never permit Tullis Russell to retain the price which is due under Clause 2 of the Assets Purchase Agreement in respect of their claim for damages for Inveresk's alleged breach of Clause 16 of the Services Agreement – even assuming that the two contracts could be construed as forming a single composite agreement.

74. Lord Hope has examined the two contracts and their relationship in great detail and has emphasised that care should be taken not to lose sight of the overall purpose and unity of the transaction entered into by the parties. Approaching the matter in that way, he has concluded that Tullis Russell's obligation to pay the total of the Initial Consideration and the Additional Consideration to Inveresk should be regarded as a counterpart of Inveresk's performance of their obligations under both agreements.

75. The transaction between the parties, involving an Asset Purchase Agreement and a (Transitional) Services Agreement, is of a very familiar, indeed commonplace, kind. And it may well be that, usually, it would be right to see the obligations in the two agreements as being related but not reciprocal. Here, however, leaving aside the matter of the coater machine and the associated fees, Clause 3.1 of the Services Agreement provides for payment of a monthly fee of £1m for the five months during which the services were to be provided. Clause 3.3 and part 4 of the Schedule contain elaborate provisions for the entire sum to be paid into an escrow account on completion or as soon as reasonably practicable thereafter. The total sum of £5m is the same as the Initial Consideration under the Acquisition Agreement. In these circumstances, it is hard to see these fees for the services to be supplied as being irrelevant to the real overall consideration that Tullis Russell are to pay for acquiring the assets. That factor points to Lord Hope's conclusion that, in this particular case, the two agreements have to be looked at together and that Tullis Russell's obligation to pay the Additional Consideration to

Inveresk should be regarded as a counterpart of Inveresk's performance of their obligations under both agreements.

76. It follows that, approaching the matter on the basis adopted by the Inner House and by counsel in argument before this Court, in agreement with Lord Hope, I would hold that, even if the Additional Consideration were ascertained, Tullis Russell would be entitled to withhold payment of that sum until the court decides whether Inveresk fulfilled their obligations under the Services Agreement. If it is held that they did, then Tullis Russell will, ipso facto, no longer be entitled to withhold payment. So decree will have to be granted against them for the Additional Consideration. Alternatively, if it is held that Inveresk breached the Services Agreement and so are liable in a sum of damages to Tullis Russell, then, by paying the damages, they, in effect, make good their failure to perform their obligations under the Services Agreement and become entitled to the Additional Consideration. But the liquid sum by way of Additional Consideration and the liquid sum by way of damages can be set off against one another.

77. The appeal raises a further, fundamental, point which requires to be addressed, however. Although in this case the Court finds that the the Additional Consideration is a component of the counterpart of Inveresk's obligations under both agreements, the hypothetical example of the clock which I have given in para 73 above suggests that there can be cases where a pursuer will have performed the obligation entitling him to payment of a particular sum, but the defender has a claim for damages for the pursuer's breach of another clause in the contract. The Extra Division's approach suggests that, in such a case, the defender could never be allowed to retain the price, since a party can only retain or withhold a sum which is not actually due, because the other party has failed to perform the obligation for which that sum is the consideration. But the authorities show, beyond all doubt, that, in certain circumstances, the court does permit a defender to retain a liquid debt which he would otherwise be obliged to pay to the pursuer. The necessary conclusion is that there is actually another type of retention which operates on a different basis in Scots Law. The Inner House did not refer to this second type of retention and counsel made no mention of it in argument – even though, in their seventh plea-in-law, quoted at para 51 above, Tullis Russell claim to be entitled to retain any sum that is "found due to the pursuers", pending the resolution of their claim for damages against Inveresk. If this Court, too, fails to mention the second type of retention, there is a risk that its existence will continue to be overlooked.

78. This second kind of retention is closely related to compensation. The right to compensation is based on the Compensation Act 1592:

> "Oure Souerane Lord and estaitis of parliament statutis and Ordanis that ony debt de liquido ad liquidum instantlie verifiet be wreit or aith of the partie befoir the geving of decreit be admittit be all Jugis within this realme be way of exceptioun Bot nocht eftir the geving thairof In the suspensioun or in reductioun of the same decreit."

The Act provides that judges are to admit any liquid debt that can be instantly verified by writ or oath before judgment is pronounced. Suppose, for example, A sues B for £20,000 as the price of a car which B bought from A and which A has delivered to B. Suppose, further, that A owes B a liquid sum of £10,000 under, say, a bond. In A's action for the price of the car, B can plead compensation. In other words, B pleads that A's liability to pay him £10,000 under the bond should be set off against B's liability to pay A £20,000 as the price of the car. In that situation, the effect of the plea of compensation is that B's debt to A is reduced by £10,000. The court therefore orders B to pay, not the full price, £20,000, but only £10,000. Provided that the two debts are liquid, the basis of the debts does not matter. So, for instance, B's obligation to pay £20,000 as the price of a car which he bought from A can be compensated by a judgment debt of, say, £20,000, arising out of an action of damages in which B sued A successfully for injuries which A negligently caused him in a ski-ing accident.

79. But, even when a defender cannot actually point to a liquid debt which is owed to him by the pursuer, he may insert a plea of compensation in his defences and refer to an obligation which is not yet liquid, but which he anticipates will become liquid. If the debt owed by the pursuer is indeed made liquid before the action against the defender is completed, then the defender will be able to compensate any sum for which he is found liable with the (now) liquid debt owed by the pursuer. But the pursuer's action may look like being completed before the pursuer's debt to the defender can be made liquid. In that event, the defender will want to delay the final disposal of the pursuer's action so as to give him time to make the pursuer's debt to him liquid and so be able to set it off against his own liability. This is where the law of retention comes in.

80. In such cases the defender argues that, even if the debt which the pursuer owes him is not yet actually liquid, it can (readily) be made liquid or is indeed in the course of being made liquid. So the defender should not be obliged to pay any sum which he may owe the pursuer before the sum which the pursuer owes to him is made liquid. In other words, the defender argues that the court should allow him to retain any sum for which he may be found liable to the pursuer until the sum owed to him by the pursuer can be ascertained and made liquid. At which point, the defender will be able to set off the sum owed to him by the pursuer against the sum which he owes to the pursuer.

81. The Compensation Act 1592 is clear enough: by its very terms, it applies only to the compensation of a liquid debt with another liquid debt. The whole point of this type of retention, however, is that, in certain circumstances, the court permits a defender to postpone payment of a liquid debt where the debt owed to him by his creditor is still illiquid. Echoing Lord Kames, *Principles of Equity*, p 344, Gloag explains, in Gloag and Irvine, *Rights in Security*, p 304, that "The law of retention of debts is an equitable extension of the statutory right of compensation." In other words, the judges have allowed retention of debts where that would be equitable, having regard to the essential purpose of the Compensation Act.

*The equitable nature of retention for purposes of compensation*

82. The starting point for the development of the law of retention was the very stipulation in the Compensation Act that compensation is possible only between liquid debts, *de liquido in liquidum*. Writing in the later eighteenth century, in his *Institute of the Law of Scotland* 3.4.16, Erskine describes what amounts to a liquid debt for these purposes: "Compensation is not regularly receivable where the debts on both sides are not clear beyond dispute. They must be ascertained, either by a written obligation, the oath of the adverse party, or the sentence of a judge." So the rule is that compensation is allowed only where the debts on both sides cannot be disputed. Erskine gives examples of such debts, before going on to say:

> "Though the foresaid act 1592 requires that all grounds of compensation be instantly verified, yet by our uniform practice for near a century, which seems grounded on the Roman law, C.4.31.14, if a debtor in a liquid sum shall plead compensation upon a debt due by his creditor to him which requires only a short discussion to constitute it, sentence is delayed *ex aequitate* against the debtor in the clear debt, that he may have an opportunity of making good his ground of compensation, according to the rule, *Quod statim liquidari potest, pro jam liquido habetur*" (punctuation and citation modernised).

83. The important point to notice is that, in postponing decree in such circumstances, the court is exercising an equitable power (*ex aequitate*). In effect, from the seventeenth century onwards, the Court of Session had recognised that, in certain cases, it would be inequitable to force the defender to pay a debt and to ignore a countervailing debt owed by the pursuer, simply because that countervailing debt had not yet been ascertained in a written obligation, or by the pursuer's oath or by a judgment. So the court would proceed on the basis of the old brocard to the effect that, if a debt can be made liquid in the near future (*mox*), it should count as a liquid debt. In other words, the court will not force a defender to

pay a liquid debt owed to the pursuer, if a debt owed to him by the pursuer can be made liquid in the near future. In such a case the court will delay matters to allow the defender to make the debt owed by the pursuer liquid. This will enable the defender to compensate his liquid debt to the pursuer with the (now) liquid debt owed by the pursuer.

84. The equitable nature of the court's power to delay is again emphasised in *Logan v Stephen* (1850) 13 D 262. A farmer sought to defend a claim for wages by the pursuer (variously described as his ploughman or his grieve) by reference to a claim based on an obligation of the pursuer as "cautioner and security" for a clerk who was alleged to have caused the farmer very large losses. The pursuer submitted that the defence was irrelevant. The First Division agreed and refused to allow the defender to retain the sum due to the pursuer as wages. Lord Cuninghame observed, at p 267:

> "Our ancient Scots Act (1592) sanctions the pursuer's plea, as it only admitted mutual claims which are liquid, to be compensated. We have no such case here. The ploughman's wages are liquid, while his master's claims are illiquid, and of a very unfavourable, if not an incredible aspect. No doubt, in practice, we sometimes allow counter claims not yet constituted, to be held *pro jam liquido*, when they admit almost of immediate ascertainment. But it is always a question of circumstances, and of sound judicial discretion and equity, in what cases that should be allowed. I cannot hang up a labourer's wages, by such claims as those now in question."

So the defender had to pay the wages that were due and, if so advised, seek to establish his claims against the pursuer in a separate action.

85. Lord Cuninghame referred to the court allowing retention on the basis of a counter claim which admitted "almost of immediate ascertainment." That is indeed the starting point. Plainly, much may depend on what will be involved in making the pursuer's debt liquid. If, for example, it simply involves counting up the number of items sold to the pursuer at an undisputed price, any delay involved is likely to be short and the court may be disposed to allow it. Stair, *Institutions of the Law of Scotland* 1.18.6 and Bankton, *An Institute of the Law of Scotland* 1.24.28 refer to a rule of thumb that, if it would take the pursuer a day to prove his liquid debt, the defender would be given a day to prove and liquidate his grounds of compensation. It would be a very different matter if, on the other hand, the defender's claim were for damages and he had not even begun proceedings against the pursuer. In general, the court will not permit retention in that kind of case, since the delay is likely to be considerable and the outcome uncertain. But, as the

cases show, since the court is exercising an equitable power, there are no absolutely hard and fast rules.

*Early cases on retention for the purposes of compensation*

86. In *Muir and Milliken v Kennedy* (1697) M 2567 a minor was sued as heir to his father, for a sum in a bond of caution granted by his father. The court allowed the defender time to show that the debt had already been paid. He then craved compensation for a sum allegedly owed to the estate on the ground that one of the pursuers had stayed for several years in his father's house. The pursuers objected that this claim was not liquid. The Lords, "considering the favour of this case, being a minor and the heir of a cautioner", and given that the pursuers' claim was being delayed in any event to allow the defender to try to prove that the debt had been paid, "gave him a term to prove his compensations, seeing *quod statim potest liquidari habetur pro jam liquido*." The reporter adds: "yea, the Lords have allowed this without these favourable circumstances."

87. In *Seton* (1683) M 2566, the court seems to have been influenced by the fact that the defender was a widow. She had been charged on a bond granted by her husband. She defended the action on the basis that the pursuer had owed her husband freight under a charterparty. The pursuer argued that the debt was not liquid, because the defender would need to prove that her husband had made the voyages. Initially, the court upheld that objection. The defender offered to remit the matter to the pursuer's oath. The court then allowed the matter to be proved *prout de jure* (by any means permitted by law) – referring again to the *quod mox liquidari* brocard. The court decerned for the sum in the bond, but superseded extract for three or four months, so "that if the debt be liquidate betwixt and that time, then the compensation was to be received." In other words, the court granted decree for the debt in the bond, but directed that it was not to be enforceable for three or four months, to give the defender time to establish the claim for freight, which could then be set off against the debt under the bond. The reporter thought that this went too far "and though it be materially just, yet it is a great relaxation of our antient form."

88. In *Brown v Elies* (1686) M 2566 the defender was again charged on a liquid bond. He claimed that the pursuer's father, who had assigned the bond to him, had actually, by virtue of a trust, uplifted and intromitted with sums equivalent to the debt under the bond. Again, the argument was that the defender's claim was not liquid. Under reference to various writers, there was discussion of how long the court could give a defender to liquidate a debt. In the event, the court gave him two weeks to do so. This was then extended for a further six weeks. But more than six months after that, due to difficulties in getting evidence from someone in the Highlands, the court allowed a further extension of nearly two months. Plainly, the

court took the view that it could allow whatever period it thought appropriate in the particular circumstances.

89. Whether or not all, or indeed any, of these cases would be decided in the same way today does not matter for present purposes. Rather, they are significant because they show a range of circumstances in which the court can allow a defender to retain a liquid debt. In particular, first, the cases demonstrate that the court is not hamstrung by the requirement that, for compensation, the debts must be liquid. That requirement is to be treated with a certain discretion - *cum aliquo temperamento*, to use the expression in one of the cases. Once that is admitted, in Lord Cunninghame's words in *Logan v Stephen* (1850) 13 D 262, 267, "it is always a question of circumstances, and of sound judicial discretion and equity." In other words, it is a matter for the court to decide, by an application of judgment to all the relevant circumstances, whether to delay the proceedings to give the defender the opportunity to make the pursuer's debt to him liquid. Secondly, since a liquid contractual debt can be compensated by a liquid debt arising out of a completely different contract or on a completely different basis, the court must equally have the equitable power to allow the defender to retain a liquid contractual debt to allow the defender to make any other kind of debt liquid. Whether the court will, in practice, do so depends on the policy it adopts – and there is, of course, no reason why the policy adopted by the court in the circumstances of the seventeenth century should necessarily be appropriate today. Thirdly, the court has more than one method at its disposal for giving effect to a claim to retain a sum until a countervailing debt can be made liquid. As in *Brown v Elies* and *Muir and Mulliken v Kennedy*, it can allow the defender to retain the debt until the circumstances of the debt allegedly due by the pursuer can be clarified. Alternatively, as in *Seton*, the court can grant decree for the sum sought by the pursuer, but supersede extract to give the defender time to prove the pursuer's debt, which can then be set off against the sum in the decree.

*Later cases on retention for the purposes of compensation*

90. The same general approach can be seen in the nineteenth-century cases, although by this time the court was anxious to emphasise that, as a rule, justice requires that a defender should not be allowed to postpone his liability to pay a liquid debt by reference to an illiquid debt of the pursuer.

91. Lord Cranworth LC made that point in an obiter passage in *National Exchange Company of Glasgow v Drew and Dick* (1855) 2 Macq 103. He characterised an argument of the Solicitor General for the respondents as involving setting off against a liquidated demand something that may be recovered of the nature of unliquidated damages. The Lord Chancellor continued, at pp 122-123:

> "I think, that not only by the law of England and of Scotland, but by the law of other civilized countries, that cannot be done; the inconvenience of it would be excessive. If a person has an actual liquidated money demand, which he seeks to enforce, the amount undisputed, it would be unjust, or might be unjust to him, to involve him in a question whether the person who is bound to pay him that liquidated sum may or may not have a right of action against him upon some collateral matter in respect of some damage on account of which he may have a right of action, for a fraudulent representation, or for an assault, or for a trespass, or any other of those various wrongs which may be inflicted upon the man, and for which he may be entitled to compensation. It is clear, in my opinion, that that cannot be the case either by the law of England, or the law of Scotland, or, as I believe, by the law of any other country."

92. The passage has all the sweeping confidence of the Victorian Age. Even so, the Lord Chancellor is careful to say that allowing in such collateral illiquid claims would be, "or might be", unjust to the pursuer – thereby leaving open the possibility that, in certain circumstances, it would not be unjust. Ultimately, therefore, it is for the judges, having regard to this general rule and the other rules that they have developed, to decide whether it would be just and equitable, in the particular circumstances, to allow a defender to retain a liquid sum which he would otherwise be bound to pay.

93. Some twenty years later Lord Deas observed in *Pegler v Northern Agricultural Implement Co* (1877) 4 R 435, 439:

> "The rule which prevents illiquid claims being set off against liquid claims is founded in justice. It is intended to prevent parties from being kept out of their money by claims which may turn out to be altogether groundless, and which may be put forward for the mere purpose of delay."

94. So, for instance, in *Thomson v Paxton* (1849) 11 D 1113 the court refused to sist an action for payment of instalments of rent, which were disputed, in order to allow the defender's action of damages against the pursuer, for his loss due to the disrepair of the house, to be conjoined. Nevertheless, Lord Justice Clerk Hope did suggest, at p 1115, that, before extract, the court might take account of the action of damages. He was indicating that, if the defender established his claim for damages before the decree for rent became enforceable, then, at that stage, the court would allow the one liquid judgment debt to be set off against the other.

95. Similarly, as already explained, in *Logan v Stephen* (1850) 13 D 262, the court refused to postpone decree for the pursuer's wages. But the judgments make plain that the judges were weighing up the equities and that, in doing so, they were influenced by the fact that the pursuer's claim was, in Lord Fullerton's words, at p 266, "a demand so liquid, so urgent, and even alimentary in its nature, as that for wages", while the defender's claims were problematical, to say the least.

96. In *Stewart & Co v J & A Dennistoun* (1854) 16 D 1061 the pursuers were the owners of a vessel chartered by Morton & Co. The defenders had undertaken to pay a specified sum, representing two-thirds of the freight due by Morton & Co, on production of a certificate that a full cargo of flour had been loaded at New Orleans to be taken to Hobson's Bay in Victoria. The certificate was produced. Morton & Co ordered the defenders not to pay, however, on the ground that the pursuers had not, in fact, loaded a full cargo. The pursuers sued the defenders for the specified sum and, of consent, Morton & Co were sisted as parties. Morton & Co had meanwhile raised an action for damages against the pursuers in the Court of Session. The defenders accepted that, in view of the certificate, the pursuers had a liquid claim against them, but submitted that the action should be allowed to lie over *ex aequitate*, pending the resolution of Morton & Co's action of damages against the pursuers. The First Division held that the sum should be paid. Lord President McNeill acknowledged, however, that the court had an equitable power to delay decree for payment, when he observed, at p 1064:

> "Perhaps if the case had been set down for trial next week, and no risk as to the condition of parties, it would be a different matter. But when the defence is in reference to an action of damages involving an inquiry into disputed facts in New Orleans and Hobson's Bay, it becomes a more serious question for the intervention of the Court."

Similarly, Lord Robertson said, also at p 1064, "Had this action been with issues adjusted, and set down for the next sittings, one might have been induced to interfere *ex equitate*: but it will never do to suspend this liquid obligation till proofs are taken at New Orleans and Hobson's Bay." In short, the circumstances favoured following the general rule.

97. *Munro v Macdonald's Execs* (1866) 4 M 687 shows the court exercising its jurisdiction in the defenders' favour. The pursuer sued executors for payment of a legacy of £100. The executors did not dispute the legacy but pleaded that it had been "compensated and extinguished" by sums of money belonging to the deceased which the pursuer, who had been his servant, had received from him and retained. The pursuer admitted that he had received £200 from the deceased, but said that it had been a gift. The executors had raised an action of count, reckoning and payment against the pursuer for these sums about a week before he raised his

action against them. In his action the Lord Ordinary granted the pursuer decree for payment of the legacy. The executors reclaimed. When the reclaiming motion came before the Inner House, the jury trial in the executors' action was due to take place the following week. The First Division decided to supersede consideration of the reclaiming motion until the following term, by which time the result of the jury trial would be known.

98. Lord President Inglis said, at p 688: "I do not like to disturb the maxim, that a liquid claim cannot be met by one that is illiquid. Still the maxim is subject to exception, if the claim is in such a position that it may be immediately made liquid." Lord Curriehill also noted, at p 688, that the rule that an illiquid claim cannot be pleaded by way of compensation to a liquid claim

> "is not without exception. If a claim is in the course of being made liquid, it may be pleaded by way of compensation. The word *statim* in the rule, as expressed in Erskine, implies some discretion on the part of the Court. A great deal of inquiry may be necessary in order to ascertain and make a claim liquid. But if it is in the fair course of being made liquid by decree at an early date, and there is no allegation of unnecessary delay, I think that the Court is entitled to exercise a discretion."

The fact that the court resolved the problem simply by postponing consideration of the defenders' reclaiming motion is a further illustration of the flexible approach that the court can adopt when dealing with such matters.

99. Much the same happened in *Ross v Ross* (1895) 22 R 461. The pursuer was the widow of Sir Charles Ross who died in 1883 and was succeeded by his pupil son. From then until 1893, when her son attained majority, the pursuer had acted as his sole tutor and curator. She was entitled to an annuity of £2,000 under her marriage contract and certain bonds of provision. In 1894 she raised an action against her son for payment of two instalments of the annuity. Her son admitted that the pursuer was entitled to the instalments, but denied that the sums were due, under reference to an action of count, reckoning and payment which he had brought against her, concluding for payment of £70,000 as the balance of her intromissions as his sole tutor and curator and as an individual. He had also raised an action against her, as executrix of the deceased's moveable estate, for payment of legitim. The son pleaded compensation and also that he was entitled to withhold payment of the annuity because of the pursuer's failure to pay him legitim or to account for her intromissions with the estate.

100. The Lord Ordinary repelled the son's defences and granted decree for payment of the annuity. He reclaimed. In this case also, the First Division decided to supersede consideration of the reclaiming motion until there should be some change of circumstances. They did so by sisting the action and leaving it open to either party to move therein.

101. Again, the judges appear to have been very much influenced by their appreciation of the particular circumstances – especially, the huge sums which Lady Ross had apparently spent while tutor and curator, her complete inability to produce accounts for her spending, and the fact that she was simultaneously claiming payment of the annuity, while, in her capacity as executrix and sole intromitter with the moveable estate, claiming the right to retain the capital value of the same annuity. In these exceptional circumstances Lord Adam did not think, 22 R 461, 464, "it would be consonant with justice to give this lady immediate decree for the sum she claims."

102. Lord M'Laren explained the position in this way, at pp 464-465:

> "In disposing of the pleas in this case I think that the Lord Ordinary has rightly dealt with the plea of compensation, because that is a matter of statutory regulation, and the plea is confined to cases where both debts are liquid or capable of immediate ascertainment; but then there is another principle under which one obligation may be suspended until the performance of a counter obligation – the principle of retention, and that, not being subject to the conditions of any statute, must be regarded as an equitable right to be applied by the Court according to the circumstances of each case as it shall arise. The doctrine has received much extension in cases of bankruptcy and insolvency… But the principle is not limited to bankruptcy cases, and it seems to me that the circumstances of the present case constitute a very clear ground for its application, because Lady Ross while in the management of her son's estates appears to have wholly neglected the duty of keeping strict accounts, which is incumbent upon every administrator of the property of others, and when she is called upon to account she states that the whole of the money has been expended, and that of a very large sum, amounting to nearly £4,000 a-year, she is unable to give any particulars. Now, that is a position which no guardian or administrator is entitled to assume, and upon the statement of these accounts, and also the claim of legitim, I cannot doubt that, if it appears to the Court that there is a probability that Lady Ross has already in her hands as much of her son's money as would satisfy this jointure, she would not be entitled to immediate decree. The judgment which I understand your Lordship will pronounce will be

> one merely suspending the procedure in this case, and if it turns out, contrary to all the probabilities, that the whole of the son's income has been legitimately and properly expended by his mother, and also that there is no legitim due to him, then of course Lady Ross will be entitled to decree for her jointure."

103. Although Lord M'Laren refers to the principle under which one obligation may be suspended until the performance of a "counter obligation", he is not using "counter obligation" to refer to an obligation for which the defender's obligation to pay was the consideration. In that case, after all, the defender's obligation to pay the annuities to the pursuer arose out of the marriage contract and bonds of annuity. Any counter obligations on her part arose out of her administration of the estate between 1883 and 1893 and out of her interest as executrix and universal intromitter with the moveable estate from which the legitim would have to be paid. (It is unnecessary to consider whether all these alleged debts would have been debts owed by Lady Ross as an individual.)

*Conclusions on retention for purposes of compensation*

104. *Ross v Ross* illustrates the fundamental point that, in cases of this kind, the defender seeks to retain a sum of money which is actually due to the pursuer – in that case, the instalments of his mother's annuity. So, either the pursuer has performed the obligation for which the obligation to pay the sum is the consideration or else, as in the case of a legacy, the defender's obligation to pay the sum is not the consideration for any obligation on the pursuer's part. Moreover, in *Ross v Ross* the claims against Lady Ross arose out of quite different circumstances. Yet the court had the equitable power to allow her son to retain the instalments of the annuity owed to her by sisting the action to see what happened in the other actions between the parties. In the event, Lady Ross seems to have had the better of her son: *Ross v Ross* (1896) 23 R (HL) 67 (the accounting action); *Ross v Ross* (1896) 23 R 802 (the action for legitim) and 1024 (action for equitable compensation).

105. If the court has the power to allow retention of a sum due under a contract when the illiquid debts are alleged to arise out of wholly different circumstances, a fortiori, the court must have power, in an appropriate case, to allow the defender to retain a sum which is due under one clause of a contract against a claim of damages for the pursuer's breach of a different clause of the contract. The same must also apply where the illiquid claims on which the defender relies arise out of different clauses in related contracts which give effect to a single transaction. Whether the court actually considers it right to exercise that power in the defender's favour will depend, however, on a consideration of all the circumstances.

106. Given that the court decides, on the application of an equitable test, whether to allow the defender to retain a sum which he would otherwise be bound to pay, the defender does not have any antecedent right to retain the debt. Rather, a defender who has an illiquid claim against the pursuer must ask the court, in the exercise of its discretion or judgment, to allow him to retain the liquid debt pending the resolution of his claim against the pursuer. For that reason, Tullis Russell's seventh plea-in-law, that they are "entitled" to retain any sum found due to Inveresk, is inappropriate – as are references, in this context, to a "right of retention". Since the defender has no right to retain the sum in the circumstances, he has to move the court to exercise its equitable power to allow him to do so. For this reason, the subject is, in many ways, conveniently and appropriately treated in the chapter on motions to sist process in Ae J G M Mackay, *The Practice of the Court of Session* vol 1 (1877), p 509, and *Manual of Practice in the Court of Session* (1893), p 266.

107. While the court has this equitable power, the judges constantly remark that an illiquid claim cannot be set off against a liquid claim. See, for example, *McConnell & Reid v W & G Muir* (1906) 14 SLT 79 and *Niven v Clyde Fasteners* 1986 SLT 344. When they use this formula, the judges are really saying that the established general rule is that the court will not permit a defender to postpone payment of a liquid debt so as to have the opportunity to make liquid what is presently an illiquid claim against the pursuer – and then to set that liquid debt off against the liquid debt which he presently owes to the pursuer. A clear application of that rule is found, for instance, in *Scottish North-Eastern Railway Co v Napier* (1859) 21 D 700. The general rule simply reflects what is considered to be sound legal policy, and so what is usually the equitable course to pursue. The reasons for the policy are outlined by the Lord Chancellor in *National Exchange Company of Glasgow v Drew and Dick* (1855) 2 Macq 103, 122-123, quoted at para 91 above, and by Lord Deas in the passage from *Pegler v Northern Agricultural Implement Co* (1877) 4 R 435, 439, quoted at para 93 above. I would not weaken that general rule in any way. I therefore emphasise that the court will depart from that general rule and allow retention, to give the defender the opportunity to make his illiquid claim against the pursuer liquid, only when, for some reason, that would be the just and equitable way to proceed in the particular circumstances. The fact that the defender's claim against the pursuer arises out of the same contract is a relevant factor. But *Stewart & Co v J & A Dennistoun* (1854) 16 D 1061, discussed at para 96 above, shows that the court would consider taking the same approach where the damages claim arose out of what could be regarded as a different aspect of the same transaction.

*The Present Case*

108. Obviously, given the decisions on the other points, there is no occasion for the Court to exercise its equitable power in the present case. Had it been appropriate to do so, the Court would have required to consider the overall situation at the present time. When the Extra Division gave judgment in June 2009, the proof in the action at the instance of Tullis Russell lay some months in the future. We would have had to consider the position when the proof is partly heard and is due to be completed in June. What the outcome will be we have, of course, no way of knowing.

109. The starting point would be that, as a general rule, payment of a liquid debt is not to be postponed just because the defender has an illiquid claim against the pursuer. Here, however, the defenders have raised an action to enforce their claim. The action has been sent for proof. The defenders do not appear to have delayed in taking that action forward and it has reached an advanced stage.

110. Even assuming in Inveresk's favour that the Assets Purchase Agreement and the Services Agreement are to be treated as separate contracts, they are unquestionably closely interlinked and form part of the same overall transaction. Indeed, the Services Agreement is really ancillary to the Assets Acquisition Agreement in the sense that certain of Inveresk's obligations under it are designed to forward the interests of Tullis Russell under the Assets Purchase Agreement. The parties would never have entered into the Services Agreement if they had not been entering into the Assets Purchase Agreement at the same time.

111. So Tullis Russell's claims for damages relate to breaches of an agreement which is inextricably linked with the agreement under which Inveresk are suing them for payment in the present action. The sums sought are large. Moreover - whatever the technicalities - as Lord Hope has explained, the reality is that, in substance, Tullis Russell are claiming damages for what they say was a reduction in the value of the assets which they bought, due to a breach by the sellers, Inveresk, of their undertaking, inter alia, to enable Tullis Russell to obtain the full benefit and value of those assets.

112. I would have regarded these circumstances as being, potentially, sufficiently special to justify a departure from the general rule that payment of a liquid debt is not to be postponed because the defender has an illiquid claim against the pursuer. Depending on the position at the relevant time, it might well therefore have been just and equitable to postpone the requirement for Tullis Russell to pay any sum, due to Inveresk by way of Additional Consideration, pending the decision in Tullis Russell's action against them. But since the Court

has concluded that Inveresk have still to establish the amount of any Additional Consideration, it is unnecessary, and would be unprofitable, to speculate on what method (e g, a sist) the Court would have adopted to achieve that end.

*Conclusion*

113. For these reasons, I would allow the appeal and make the order proposed by Lord Hope.

**LORD COLLINS**

114. I agree with Lord Hope and Lord Rodger that the appeal should be allowed for the reasons which they give.

115. I add only that, although the approach may be different, English law would reach a similar result. In English law a cross-claim may give rise to an equitable set-off if it flows out of and is inseparably connected with the dealings and transactions which give rise to the claim: *Bank of Boston Connecticut v European Grain & Shipping Co* [1989] AC 1056, 1102. There can be a sufficiently close connection even though the claim and cross-claim arise out of two different contracts: *BIM Kemi AB v Blackburn Chemicals Ltd (No 1)* [2001] 2 Lloyd's Rep 93 (CA).

116. Even where the strict requirements of set-off are not fulfilled, for example because there is not the requisite identity of parties, the court may prevent injustice by granting a stay of execution of the judgment on the claim until resolution of the cross-claim. In *Burnet v Francis Industries plc* [1987] 1 WLR 802 (CA) it was held that where a judgment debt was owed by a subsidiary company to a third party, and where the subsidiary's parent company had a claim against the same third party, the court had jurisdiction to order a stay of execution of the judgment, applying *Canada Enterprises Corp Ltd v Macnab Distilleries Ltd* [1987] 1 WLR 813n (CA, decided in 1976), a case involving more complex facts.

**LORD CLARKE**

117. I also agree with Lord Hope and Lord Rodger that the appeal should be allowed for the reasons which they give.

118. I have read with great interest Lord Rodger's analysis of what he calls a second kind of retention. His reasoning and conclusions both seem to me to be convincing, although I am reluctant to express a final view of my own on this aspect of the law of Scotland without hearing argument.

119. Finally, I agree with the views which Lord Collins has expressed about English law.