monetary claim to repetition of those payments;[18] and under section 75 that claim can be exercised against the creditor and set off against the liability under the loan. It might be arguable that in connected sale-and-loan cases the debtor who has rejected the goods also has the right to repetition of the full price even although that price was *de facto* paid by the creditor; the supplier who has been paid for goods sold surely cannot deny the debtor-buyer repetition of that price on the grounds that the payment was actually made by a third party. If this is right, then exercising a "like claim" against the creditor will again simply involve extinguishing the loan obligations. It is by no means clear that the suggested policy argument can trump the argument from the language of the Act; but it is as clear from the First Division's decision as it was to the present writer in 1984 that "the 1974 Act has not made all other law on sale of goods and breach of contract irrelevant. The Act must be considered against the wider legal background".[19] The policy argument is not wholly unsupported by legal ones.

Two final thoughts. The consumer, Mr Durkin, bought his laptop from PC World in 1998. It took 12 years for his case to get as far as Parliament House. No doubt there are many reasons for this, but how many consumers would or could last this long in pursuit of their claims? The other is the complete lack of customer care displayed by the supplier and the creditor (in particular) in dealing with Mr Durkin's claims at the outset of the problem. For that reason alone, one hopes the First Division's is not the final word on the subject.[20]

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# Mutuality, Retention and Set-Off: *Inveresk plc v Tullis Russell Papermakers Ltd*

## A. THE PROBLEM OF RECIPROCITY IN CONTRACTUAL OBLIGATIONS

Mutuality provides the most important principle governing the relationship between breach of contract and contractual performance. It can justify the withholding of performance as a response to breach and explains when performance by one party may be considered conditional upon performance by the other party because their

18 See W M Gloag, *The Law of Contract*, 2nd edn (1929) 59-60. Cf W W McBryde, *The Law of Contract in Scotland*, 3rd edn (2007) paras 20.142-143.

19 MacQueen (n 16) at 67.

20 It is understood, however, that lack of resources means that there will be no appeal to the Supreme Court by Mr Durkin.

obligations are reciprocal in nature. Nevertheless, since receiving detailed judicial elaboration by the House of Lords in *Bank of East Asia Ltd v Scottish Enterprise*,[1] a tension has arisen over the precise extent to which obligations on each side of a contract should be considered reciprocal between the parties and therefore to be treated as direct counterparts. Retention – the withholding of performance – is only permissible in this context when the obligations are counterparts. The question is whether the contract should be seen in essence as an indivisible unity in which all obligations on one side are normally counterparts of those on the other, or as a structured set of distinct obligations which may or may not be counterparts of one another. Interpreting the terms of the contract to elicit the intentions of the parties plays a crucial role, of course, but once this is done the scope of the principle of mutuality becomes fundamental in determining the rights of the parties once a breach has occurred.

In this regard, *Bank of East Asia* and the subsequent Inner House case of *Macari v Celtic Football and Athletic Co Ltd*[2] seemed to mark a significant clarification of how the doctrine should be applied, emphasising that obligations should be contemporaneous as well as reciprocal, and that not all obligations on one side of a contract were automatically counterparts of those on the other. In both cases obligations in particular contracts were distinguished as *not* being counterparts of one another, meaning that parties in breach were *not* able to justify withholding performance of the obligation in question. However, a series of opinions by Lord Drummond Young, sitting in Outer House cases such as *Hoult v Turpie*[3] and *Purac Ltd v Byzac Ltd*,[4] has subsequently sought to revive an older emphasis on the unity of the contract. A substantial divergence of view about the application of the mutuality principle therefore opened up, awaiting further clarification from an appellate court.

## B. THE SCOPE OF THE DECISION IN *INVERESK*

In *Inveresk plc v Tullis Russell Papermakers Ltd*[5] the Supreme Court has provided an answer which sides with the unity of contract approach but also extends the application of mutuality and retention in important respects. However, it also went on (in Lord Rodger's judgment) to examine quite independently the scope of retention as a wider remedial category in its own right, and for which the principle of mutuality is only one of a number of possible grounds which also includes set-off, or compensation. This has allowed the interaction between mutuality, retention and set-off to be considered, providing very helpful elucidation of a highly technical and complex area in which substantive rights interact with procedural rules as well as the equitable jurisdiction of the court. Whilst Lord Hope's judgment is important

1 1997 SLT 1213.
2 1999 SC 628.
3 2004 SLT 308.
4 2005 SLT 37.
5 [2010] UKSC 19, 2010 SLT 941.

from a doctrinal point of view because of its focus upon the scope of mutuality in justifying retention, Lord Rodger's makes a significant contribution in explaining how retention may also arise under different criteria in the context of set-off, and how this differs from but may interact with retention justified on the basis of mutuality.

## C. THE DISPUTE IN *INVERESK*

The facts of *Inveresk* posed a new problem. A sale was concluded between paper manufacturers, but the overall agreement was constituted by two separate contracts which addressed different aspects of the agreement. One contract provided for the sale by Inveresk to Tullis Russell of intellectual property rights to certain brands of paper, associated customer information and related assets (the Asset Purchase Agreement). Payment was by way of an Initial Consideration (£5 million) with an Additional Consideration to follow calculated according to the volume of certain sales achieved by the buyer in the year or so following the sale. An important aspect of the sale was to impose further obligations on the seller, Inveresk, under a further contract (the Services Agreement) which required Inveresk to continue to manufacture, distribute and sell certain products for several months after the sale, thus safeguarding the maintenance of the value of the brand, and facilitating the transfer of customer business and integration of manufacturing and distribution of the product into the operations of the buyer, Tullis Russell. In return, further sums were payable by Tullis Russell to Inveresk under the Services Agreement. The litigation arose because Inveresk raised an action for payment of the Additional Consideration against Tullis Russell, who defended the claim on two grounds: first, that the Additional Consideration had not been determined under the relevant contractual provisions, and secondly, even if it had been, it was nevertheless entitled to withhold payment since Inveresk was in breach of the Services Agreement. Tullis Russell raised a separate action for breach of contract in this regard. Lord Hope addressed the first ground, and in an exhaustive and convincing analysis based on detailed interpretation of the contract terms concluded that the Additional Consideration had not been determined in accordance with the contract, and thus was not yet payable. The action was to be remitted back to the Commercial Court for further procedure to resolve this question. However, the wider significance of the Supreme Court's decision lies in the *obiter* remarks of Lord Hope and Lord Rodger concerning the second ground.

## D. MUTUALITY

Tullis Russell's submission was that even if the Additional Consideration *were* to be ascertained it was entitled to retention of this payment under the Asset Purchase Agreement "pending" payment of its claims for breach of contract under the Services Agreement. The problem was that the matters in dispute between the parties related to obligations which had been enshrined in two separate contracts. The argument of Inveresk was twofold: first, retention could only operate "where the respective

claims arise out of one contract", as opposed to "two contracts, albeit both arising from a single transaction",[6] so obligations constituted in separate contracts could not be counterparts; secondly, in any event, even if the contracts were treated as a unity, the obligations in question were *not* counterparts of each other.

Lord Hope decisively rejected both arguments. On the first, he sided with the approach of Lord Glennie in the Outer House in rejecting the formalism of Inveresk's submission that obligations in one contract could not be regarded as counterparts of those in another. Instead he stressed an "overall agreement" or "same transaction" approach, grounded quite simply in giving effect to the intentions of the parties and recognising that one agreement may for various legitimate reasons be given effect through two or more separately constituted contracts or "contractual documents". Nothing could be automatically assumed about the intentions of the parties from the structuring of their agreement or "transaction" into more than one such contract. Form alone was not determinative. Lord Hope observed that "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" (emphasis added).[7]

On the second argument, however, Lord Hope disagreed with Lord Glennie's application of the mutuality principle and concluded that the obligations in question were indeed counterparts. Why? Lord Glennie had viewed the obligations in question as lacking reciprocity and contemporaneousness because they related to distinct stages of the transaction. However, in Lord Hope's eyes, this gave insufficient weight to the "overall purpose and effect of the transaction". Instead, "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".[8] It was "unrealistic" to treat the transaction as "divisible into a series of separate and unrelated compartments. The obligations undertaken by Inveresk were all designed to serve the same end".[9]

## E. RETENTION AND SET-OFF

Lord Rodger agreed with Lord Hope's analysis of mutuality but devoted his judgment to expounding what he characterised as a further and wholly distinguishable basis alongside that of mutuality for Tullis Russell's retention of any payment under the Asset Purchase Agreement. This basis was the law of set-off. In doing so Lord Rodger was highly critical of counsel for appearing to overlook the existence of this second basis for retention. He applied this criticism to the Inner House even more forcefully,

6 Para 27.
7 Para 36.
8 Para 42.
9 Para 45.

rejecting their apparent "confining" of the role of retention to mutual obligations and noting that "the approach of the Extra Division conflates two different legal doctrines" which Scots law "unhelpfully" calls retention in both cases.[10] In a sense it is understandable how this mistake could arise, since retention *under a contract* arises as a doctrine expressing the relevant rules and principles governing the conduct of the parties in relation to the principle of mutuality. However, it also arises outside contract law as a doctrine governing the enforcement of claims in relation to the operation of set-off. The wider point of Lord Rodger's judgment is simply to emphasise that as retention is a doctrinal category in its own right and not a single doctrine coextensive with or simply derived from mutuality, considering it systematically as a separate category is necessary in order to expose clearly to view the existence of "two different types of retention".[11]

Whereas retention based on mutuality is an entitlement of a contracting party, Lord Rodger points to a second form of retention based solely on the equitable jurisdiction of the court and involving the temporary procedural suspension of a payment claim pending ascertainment of a counterclaim arising from some other obligation. Lord Rodger expresses the anxiety that "there is a risk that its existence will continue to be overlooked".[12] This analysis might seem at first sight rather startling, especially to those who have equated retention simply with mutuality. In fact it draws upon a well-established body of law, and one clearly stated in modern academic works as well as in the older authorities helpfully discussed by Lord Rodger.[13] However, it is one which is normally treated within the category of set-off and as such might appear to have no direct relevance to claims based on mutuality. Indeed, it would seem that counsel simply failed to think beyond the principle of mutuality. This is surprising, given that Tullis Russell was simultaneously pursuing its own breach of contract claim against Inveresk, meaning that the availability of set-off would always have been relevant. This omission could have had major repercussions had the Supreme Court followed Lord Glennie in the Outer House in viewing the obligations between the parties as not being counterparts, because the law of set-off would still have provided a further possible basis for withholding payment to Inveresk. Indeed Lord Rodger indicated that if it had been pleaded, the circumstances in *Inveresk* were "potentially, sufficiently special to justify a departure from the general rule" so that the court would have permitted retention of the Additional Consideration on this ground.[14] Essentially Lord Rodger's judgment is a sharp reminder that the law of set-off ought to have been considered in formulating Tullis Russell's defences, since there is an equitable power in the court exceptionally to defer consideration of a claim for

10 Para 57.

11 Paras 56, 57 and 59.

12 Para 77.

13 W M Gloag and R C Henderson, *The Law of Scotland*, 12th edn (2007) paras 3.32 and 10.15; W W McBryde, *The Law of Contract in Scotland*, 3rd edn (2007) para 25.57; W A Wilson, *The Scottish Law of Debt*, 2nd edn (1991) paras 13.5 and 13.9.

14 Para 112.

payment when this may be met by a defence of set-off in relation to a claim for a debt which can imminently be made liquid.[15]

## F. CONCLUSION

*Inveresk* would seem to bring authoritative clarification to the question when one contractual obligation should be considered the counterpart to another. However, in an important sense the Supreme Court has simply restored the traditional emphasis on the unity of the contract to be found in much older cases such as *Turnbull v McLean*, but slightly obscured by the more recent approach in *Bank of East Asia* and *Macari*.[16] There is less inconsistency in this than might appear, since the problem for the courts is that different types of contract bring out different aspects of the mutuality principle. In some contracts (such as an employment contract) there will be obligations with no counterpart at all, whilst in others the performance obligations will often be structured in stages which might lack contemporaneousness (such as a building contract) or might not (such as a sale). The doctrine is therefore re-framed to help make sense of its application in each new context, but without necessarily intending any innovation. Nevertheless, *Inveresk* has innovated by establishing a presumption that obligations are counterparts, and the question will simply be whether it is sufficiently clear in future cases how this may be rebutted. Lord Hope referred to the need for a "clear indication to the contrary".[17] The other new element in *Inveresk* is the stress on a purposive approach which focusses upon obligations within an overall "transaction", however constituted in terms of separate contracts. This aligns well with the modern approach to related areas such as contractual interpretation, bringing to mind Lord Wilberforce's regard in that context for "the commercial purpose of the contract".[18] Again, the question will be whether the concept of "transaction" has been clearly enough defined and conceptualised, or whether it will give birth to a new area of ambiguity and uncertainty.

Regarding retention, Lord Rodger's dismissal of "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"[19] should not be seen to have any adverse impact on the availability of retention justified by mutuality. It is clearly directed towards the operation of set-off. However, Lord Rodger's decision to adopt retention itself as the principal category around which to structure his discussion might risk causing some confusion, given that his objective is to articulate two very distinct "doctrines" of retention which have little in common with one another in doctrinal or policy terms. The policy behind mutuality relates to promoting the performance of contracts, whereas the policy of set-off is "to avoid a multiplicity of

15 Paras 79 and 83.
16 *Turnbull v McLean* (1874) 1 R 730.
17 Para 42.
18 *Reardon Smith Line v Hansen-Tangen* [1976] 1 WLR 989 at 995.
19 Para 52.

actions, and to save unnecessary expense".[20] In some ways, Lord Rodger is simply reviving an older category of treatment which was used by Gloag and Irvine in their discussion of "the law of retention of debts".[21] However, given the different basis for each type of retention, a taxonomy based on different "doctrines" of retention might be less clear than one in which the main level of analysis relates to the substantive basis for the retention in question, i.e. mutuality, or set-off. In other words, it is not so much that retention was misunderstood in *Inveresk* as that set-off was overlooked. On the other hand, it cannot be denied that the unfortunate omission of the set-off argument in *Inveresk* would have been avoided under Lord Rodger's systematic analysis of retention.

A further interesting point also emerges from Lord Rodger's judgment, which flows from his analysis of how breach is "made good" through damages. If Inveresk were held to be in breach of their obligations to Tullis Russell, then "by paying... damages, they, in effect, make good their failure to perform their obligations under the Services Agreement and become entitled to the Additional Consideration".[22] Thus a right of retention grounded in mutuality does not necessarily persist for ever, if the party who retains performance progresses to completion a claim for damages. This important point is not always made clear in discussions of the scope of mutuality, and Lord Rodger's elaboration of it is extremely valuable. Damages purify the breach in question, and thereby release the party in breach to sue on the contract. In practice this may facilitate set-off. However, it is significant that whether this happens or not is within the control of the innocent party – it may decline to pursue its damages claim, as in *Graham v United Turkey Red*,[23] in which case the contract-breaker does remain permanently barred from pursuing its own contractual claim. This may effectively lead to a disproportionate "forfeiture" in cases where that contractual claim exceeds the loss which could have been claimed in damages,[24] though if the contract has been rescinded *Graham* suggests that a remedy *quantum lucratus*, i.e. in unjustified enrichment, may nevertheless provide some redress (only if it is pleaded, of course, which in *Graham* it was not). Lord Rodger's contribution is therefore not only to elucidate the wider remedial category of retention and to stress the role and breadth of the equitable power of the court in the context of set-off, but also to elucidate the complexity of the ways in which retention, mutuality and set-off may interact with judicial remedies and the wider law of obligations.

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20 *Burt v Bell* (1861) 24 D 13 at 14 per the Lord President (McNeill); McBryde, *Contract* (n 13) 745.
21 W M Gloag and J M Irvine, *Law of Rights in Security* (1897) 304.
22 Para 76.
23 1922 SC 533.
24 *Graham v United Turkey Red* 1922 SC 533 at 537 per Lord Anderson.