

OPINION OF LORD BRACADALE : Outer House Court of Session. 29th July 2004

Introduction

- [1] Parties were agreed that there was no dispute on the facts and that I would be able to dispose of the petition at the stage of first hearing. Mr Moynihan QC appeared for the petitioners and Mr Howie QC appeared for the first respondents. The second and third respondents were not separately represented.
- [2] On 23 June 1998 the petitioners and the first respondents entered into an Open Cast Coaling Agreement ("the Agreement") for the extraction of coal by open cast mining methods from the Gasswater site at Cronberry, Ayrshire. The petitioners were the employers and the first respondents were the contractors. The contract obliged the first respondents to deliver to the petitioners coal over a period of time. The second respondent is the President of the Law Society of Scotland. The third respondent is an adjudicator purportedly appointed by the second respondent under the disputes procedure provided in the Agreement. The petitioners seek suspension of a purported notice given by the first defenders, referring certain matters to the disputes procedure and the purported appointment by the second respondent of the third respondent as adjudicator under the disputes procedure. Interim suspension was granted at an earlier stage.

Relevant terms of the Agreement

- [3] Clause 12.1 provides:

"The courts of Scotland shall have exclusive jurisdiction to determine any matter connected with, arising out of or in any way related to this Agreement (except where such matter is provided to be referred to the disputes procedure for determination in the case of which matters the jurisdiction of all courts is hereby expressly excluded)."

In terms of clause 1.1 of the Agreement, "disputes procedure" means "the binding adjudication procedure comprising schedule part 13 which shall apply only where expressly provided for in this Agreement". Part 13 of the schedule provides for the appointment of an adjudicator and various time limits associated with the process. Paragraph 2 of part 13 of the schedule provides:

"A disputed matter referred to the disputes procedure...shall be determined by an adjudicator to be agreed by the parties or failing such agreement...by an adjudicator having experience and expertise in civil engineering contracts appointed on the application of either or both of the parties by the President or whom failing the Vice President for the time being of the Law Society of Scotland."

- [4] Clause 3.1 of the Agreement provides that the employer shall in consideration of the performance by the contractor of the obligations incumbent on the contractor in terms of the Agreement, make payment to the contractor in accordance with clause 6. Clause 6.1 provides that the contractor must provide to the employer, not later than seven days after the expiry of each accounting period, a written statement specifying the daily tonnages of coal recorded by the despatch weighbridge and the sums claimed to be due for each accounting period. Clause 6.2 provides:

"Subject to the submission by the contractor of a statement complying with clause 6.1 the Employer shall make an advance payment to the Contractor of the sum claimed to be due and shown in such statement or if in the opinion of the Employer such statement is incorrect or does not reflect the sum properly due such sum as in all the circumstances the employer shall consider to be due to the contractor provided that:-

6.2.1 The Works have been and are being executed and where appropriate completed in accordance with this agreement... subject to the deduction of previous payments on account."

Clause 6.4 provides:

"Any dispute as to the amount paid by the employer against any statement submitted by the contractor under clause 6.1 may be referred to the disputes procedure for determination not later than 56 days after the date of the end of the accounting period to which the statement relates."

Clause 6.5 provides for the payment of interest.

Factual background

- [5] The first respondents commenced works on 29 June 1998. In accordance with the terms of clause 6.1, the first respondents provided written statements to the petitioners of the sums said to be due in respect of the accounting periods ending on 28 December 2002, 25 January 2003 and 22 February 2003. The petitioners accepted that the sums stated, which totalled approximately £3,000,000, were due but stated that they were retaining and setting off these sums against the loss and damage sustained by the petitioners as a result of a breach of the Agreement by the first respondents. The petitioners have raised an action in this court against the first respondents seeking payment of £4,500,000 in damages arising from alleged breaches of the agreement.
- [6] By notice dated 8 April 2003, the first respondents disputed the right of the petitioners to retain any sums due to the first respondents in terms of clause 6.2 of the Agreement and purported to refer the dispute to the disputes procedure in terms of clause 6.4 of the Agreement. By letter dated 30 April 2003, the first respondents applied to the second respondent for the appointment of an adjudicator in terms of paragraph 2 of part 13 of the schedule to the Agreement. By letter dated 2 May 2003, the first respondents notified the petitioners that the first respondents had applied to the second respondent for such an appointment. The second respondent has appointed the third respondent as adjudicator under the disputes procedure.

- [7] The petitioners aver that there is no dispute to refer to the disputes procedure under and in terms of clause 6.4 of the Agreement. They aver that there is no dispute as to the sums to be paid against each of the written statements issued by the first respondents. They aver that their claim for damages arising from the first respondents' breach of contract cannot be referred to the disputes procedure in terms of the Agreement. It is subject to the exclusive jurisdiction of the courts of Scotland.

Discussion

- [8] The issue which I have to determine is whether there is a dispute within the terms of clause 6.4 which brings into play the disputes procedure provided in clause 12. If such a dispute existed the respondents were entitled to give the notice referring the issue to the disputes procedure. If no such dispute existed the issue is one for the jurisdiction of the court and the petitioners are entitled to have the prayer of their petition granted.
- [9] The right to invoke the common law courts of the country for the decision of any question properly falling within their jurisdiction can only be excluded by express provision or clear implication in the terms of a contract (**Brodie v Ker** 1952 SC 216 at page 224). This approach is reflected in the terms of clause 12.
- [10] On behalf of the respondents, Mr Howie contended for a wide and literal interpretation of the phrase "any dispute as to the amount paid". He submitted that what was in contemplation was a case where the sum paid did not match the contractor's expectation. It was designed to address the question of whether or not the contractor has been paid the correct sum, that is to say, whether the amount paid was the amount that ought to have been paid. The petitioners say that £0 is the amount required to be paid. The respondents say that £3,000,000 should be paid. The consequence of this is that they are in dispute. Mr Howie submitted that the reason for the rejection by the employer of the contractor's assertion as to what was due does not matter. The essential point was that there was a dispute about the correct sum to be paid. This is a dispute in the ordinary English sense of the word. There is a dispute with respect to the amount paid and is accordingly covered by clause 6.4.
- [11] Mr Howie further submitted that such a literal construction was consistent with the purpose of this part of the Agreement, which was to secure cash flow to the contractor. Prompt payment was to be encouraged. The disputes procedure was a much quicker procedure than a contested action in the court. The object was to secure that *interim* payment was made and that disputes relating to *interim* payment should be dealt with quickly. In addition, he advanced an argument that such a construction was consistent with the terms of the Agreement read as a whole. On the other hand, Mr Moynihan was critical of this approach and contended for a narrower interpretation.
- [12] In order to form a view as to which approach is the correct one it is necessary to examine the arguments in relation to the question of retention. There was no dispute between the parties as to the nature of a common law right of retention. It is a right associated with mutuality of obligations under a contract. In *Gloag on Contract* (2nd edition) at pp. 626-7 it is described thus:
- "His remedy is then to withhold performance of his obligation to pay, in security of his claim for damages for the defective character of the work. His obligation to pay is not extinguished, but postponed, though it may ultimately be extinguished, on the principle of compensation, should it be found that the amount due as damages equals or exceeds the amount due under the contract as the price or hire."*
- Certain limitations are placed on the operation of retention. Mr Moynihan referred me to passages in the speech of Lord Jauncey of Tullykettle in the case of **Bank of East Asia v Scottish Enterprise** 1997 SLT 1213. In particular, he referred to the following passage at page 1217H:
- "In the light of these cases I turn to consider in a little more detail the three principles enunciated in **Turnbull v McLean**. The first one is readily applicable to a case where the obligation by A to pay the price is the counterpart of the obligation by B to complete the works or deliver the goods. I do not, however, consider that the Lord Justice Clerk intended to state that each and every obligation by one party to a mutual contract was necessarily and invariably the counterpart of each and every obligation by the other. It must be a matter of circumstances. Thus in a contract to be performed by both sides in stages, the counter obligation and consideration for payment of stage one is the completion of the work for that stage conform to the contract. The second principle must, having regard to the first principle, be construed as referring to performance by the other in relation to the part of the contract which the one party has failed to perform, rather than to the whole contract, although in many cases the part will amount to the whole. The third plainly has in contemplation the material part of a contract which the one party has refused to perform and which may be the subject of specific implement. So analysed it becomes apparent that these principles do not produce the result that any claim under a mutual contract can be set against any other claim they are under how so ever or when so ever such claim may arise."*
- [13] The general principle applies to all mutual contracts unless it is excluded expressly or by necessary inference by the terms of the contract in question. In **Redpath Dorman Long v Cummins Engine Co** 1981 SC 370, Lord Justice-Clerk Wheatley dealt with this issue at p. 374:
- "What was said in the **Gilbert-Ash** case is that you consider the terms of the particular contract as a whole to see whether there are any provisions therein which, either expressly or by necessary implication, write out the common law right."*
- [14] Again, there was no dispute that the question of whether there was a right of retention was one which was beyond the scope of the disputes procedure. As a general rule, in the absence of express or special power, an

arbitrator cannot explore questions of breach of contract and assess or award damages. Nor, in the absence of such powers, can an arbitrator consider pleas of compensation and set off (Stair Encyclopaedia of the Laws of Scotland, Vol 1, Arbitration, paragraph 50; *McEwan v Middleton* (1866) 5 M 159). There are no such powers under the disputes procedure. In order to assess the question of retention the adjudicator would require to assess the value of the claim against which the retention is sought. Carrying out such an assessment would entail an exploration of the merits of the claim to damages. Accordingly, it is not open to the adjudicator under the disputes procedure to address the question of retention. The result of this would be that, unless the right of retention is excluded, either expressly or by necessary implication, any contest about the right of retention would be a matter that would be within the ordinary jurisdiction of the court.

- [15] In order to sustain the wide interpretation for which he contended, Mr Howie argued that the right of retention had indeed been sacrificed in the Agreement. While not expressly excluded, the exercise of a right of retention was implicitly inconsistent with the terms of the contract and was accordingly excluded. This was a result of the rigid division of procedures. Where there was a dispute about amount to be paid and a question of retention, the court could not deal with the first part, because that was expressly to be referred to the disputes procedure, and the adjudicator could not deal with the second part. Since neither forum could deal with both sides of the matter it was clear that the right to plead retention on the strength of a cross claim in damages had been excluded. Mr Moynihan submitted that this submission was misconceived. It was well recognised that where there was an arbitration clause of limited scope, there could be two procedures. The arbitration could deal with the matters within its scope and litigation would deal with the rest. There was no difficulty at all in dealing with the issues separately. He referred to *Brodie v Ker* 1952 SC 216. In the present case, he submitted, because the adjudicator does not have power to deal with retention, any contest with respect to retention is not a dispute referable to the adjudicator under clause 6.4. That contest is not expressly excluded from the court and it follows that it is one that can be litigated in court.
- [16] In my opinion these submissions of Mr Moynihan are well founded. There is no express provision excluding a right of retention. It does not seem to me that it is a necessary implication of the Agreement that such a right is excluded. There are two issues to be considered. The first issue is the question of what payment the respondent was due to make with respect to the work done; and the second issue was whether there was a right of retention. The petitioner admits that the amount due is as stated. In that event the first issue does not arise. The only issue which arises is the second issue, that is to say, the question of the right of retention. If the first issue had been a live one it would have been perfectly possible for the court to refer for arbitration if an arbitral dispute were identified (see *Strathmore Building Services v Greig* 2000 SLT 815). Thereafter, the question of retention could be addressed in the context of litigation before the court. This is consistent with the approach of the court in *Brodie v Ker* (see the consulted Judges at pages 226-7 and Lord Patrick at page 239-240).
- [17] The consequence of the conclusion that (a) it is not a necessary implication of the terms of the Agreement that a right of retention is excluded; and (b) it would be open to the adjudicator to deal with an issue as to the amount paid, leaving to the court to deal with a question of retention, is that the words "any dispute as to the amount paid" cannot receive their full literal meaning. If the right of retention is, on the one hand, not excluded and, on the other, cannot be an issue referable to the disputes procedure, then it is an example of some sort of "dispute" that results in non-payment but is not referable to the disputes procedure. In my opinion this does not create a difficulty. The kind of dispute which is contemplated in clause 6.4 is a dispute relating to questions that might arise with respect to work done, tonnages delivered and rates at which prices were fixed. These are the kind of issues to which reference is made in clause 6.1. However, I am driven to the conclusion that the narrower interpretation of the phrase "dispute as to the amount paid", for which the petitioners contend, must be adopted.
- [18] The petitioners accept that the amounts specified in the statements of the sums said to be due in respect of the accounting periods ending on 28 December 2002, 25 January 2003 and 22 February 2003 were correct amounts. The effect of the exercise of a right of retention is that the obligation to pay these amounts is postponed, not extinguished (see the passage from Gloag quoted above). Accordingly, there is no dispute which is referable to the disputes procedure and the petitioners are entitled to have the prayer of their petition granted.

Decision

- [19] Mr Moynihan moved me to grant parts (1) and (2) of the prayer of the petition. I shall order suspension of (1) the purported Notice by the first respondents dated 8 April 2003; and (2) the appointment by the second respondent of the third respondent as adjudicator in terms of paragraph 2 of part 13 of the schedule to the Agreement. I shall reserve meantime the question of expenses.

Petitioners: Moynihan, Q.C.; Harper Macleod
First Respondents: Howie, Q.C.; Masons