

DRAFT PROVISIONS TO REFORM THE LAW OF CONTRACTUAL RETENTION

21A Application of contractual retention

(1) A party to a contract ("PA") may temporarily withhold or suspend performance of an obligation that is due to be performed under the contract ("contractual retention")—

(a) following a breach of a counterpart obligation by the other party to the contract ("PB"),

(b) in anticipation of a breach of a counterpart obligation by PB (an "anticipatory breach"), or

(c) in relation to an obligation subsisting when the contract is ended by PA as a result of PB's breach or an anticipatory breach.

(2) For the purposes of subsection (1)—

(a) the contractual obligations of each party are presumed to be counterparts unless it can be shown that the parties do not intend the obligations to be counterparts,

(b) counterpart obligations may be contained in separate contracts as long as the contracts form part of the same transaction.

(3) The breach or anticipatory breach referred to in subsection (1)—

(a) must be a material breach in the case of an anticipatory breach

(b) need not be a material breach in any other case.

(4) The effect of the contractual retention must not be clearly disproportionate to the effects of the breach or anticipatory breach referred to in subsection (1).

(5) PA may contractually retain part of an obligation in order that the contractual retention is not clearly disproportionate in terms of subsection (4).

(6) PA may exercise contractual retention until PB has performed the obligation referred to in subsection (1) or has paid damages in lieu of performance.

21B Notification of contractual retention for an anticipatory breach of contract

(1) Where PA exercises contractual retention for an anticipatory breach by PB in accordance with section 21A(1)(b), PA must notify PB of the contractual retention—

(a) before the contractual retention begins, or

(b) as soon as reasonably practicable after the start of the contractual retention.

(2) For the purposes of subsection (1), a notification must be written or oral.

21C Contractual retention in proceedings

(1) In proceedings disputing a contractual retention on the basis of section 21A(4), it is for the party disputing the contractual retention to show that the contractual retention is clearly disproportionate to the breach or anticipatory breach.

(2) In proceedings for breach of contract, it is a defence for a party to show that their failure to perform an obligation constitutes contractual retention.

21D Interaction of contractual retention with existing law

Sections 21A to 21C are without prejudice to—

(a) the application of any enactment, or rule of law, in relation to—

(i) lien,

(ii) compensation or set off,

(iii) anticipatory breach of contract (except as specifically provided by this Act),

(iv) the remedy known as equitable or special retention,

(v) any other circumstances in which the right to retain or abate obligations is conferred, and

(b) the power of a court to refuse the exercise of contractual retention where that retention is or would be inequitable.

Explanatory Note

Contractual retention

Sections 21A to 21D deal with the self-help remedy of contractual retention. Contractual retention is a means to secure the performance of obligations without terminating the contract or in circumstances where the breach (or anticipatory breach) is not sufficient to justify termination of the contract. Contractual retention is sometimes referred to as “mutuality retention” or simply “retention” in case law, and is distinct from equitable or special retention (which results from a court exercising its equitable discretion to allow a party to retain performance of its obligations).¹ The term “contractual retention” is therefore used to provide a consistent term for this type of retention in the Bill and to distinguish it from special retention.

Section 21A – Application of contractual retention

This section broadly sets out the circumstances in which a party may exercise contractual retention.

Subsection (1) defines contractual retention as temporarily withholding or suspending performance of an obligation that is due to be performed under the contract. It then goes on to list the actions which may trigger contractual retention:

- Paragraph (a) sets out that the right to exercise contractual retention is triggered when the other party to the contract has breached a counterpart obligation.²
- Paragraph (b) sets out that the right to exercise contractual retention may also operate in response to an anticipated breach of a counterpart obligation by the other party to the contract (an “anticipatory breach”). The anticipatory breach occurs where it is clear the other party is going to breach the contract because they have signalled their intention not to perform or to perform in such a way that there would be a breach of the contract.
- Paragraph (c) sets out that contractual retention may arise where a contract has been ended as a result of the other party’s breach (or anticipatory breach) and there are subsisting obligations. Subsisting obligations may include, for example, the payment of damages for the initial breach of contract which led to the termination.

¹ See the discussion of special retention in Scottish Law Commission, “Report on Review of Contract Law: Formation, Interpretation, Remedies for Breach, and Penalty Clauses” (Scot Law Com No 252, March 2018), at paragraphs 11.17 to 11.20.

² Counterpart obligations are interdependent or reciprocal commitments made by each party to a contract.

Subsection (2) clarifies further what is meant by a “counterpart obligation”. There is a rebuttable presumption that the contractual obligations of each party are counterparts. The presumption can be displaced by showing that the parties did not intend for the obligations to be counterparts.³ In addition, to recognise that some transactions are formed of multiple related contracts and to respect the unity of that transaction, subsection (2) also makes it clear that the counterpart obligations may be drawn from different contracts so long as those contracts are part of the same transaction.⁴ This may be distinguished from where there are a series of separate, but related, contracts (such as re-ordering products on a rolling basis) which each represent a transaction in their own right.

The breach of contract giving rise to the contractual retention does not need to be a material breach when it is an actual breach of contract (subsection (3(a))) but must be a material breach if it is an anticipatory breach which gives rise to the contractual retention (subsection (3)(b)). However, the party exercising contractual retention must ensure that their contractual retention is not clearly disproportionate to the effect of the breach (subsection (4)). What is clearly disproportionate will depend on the circumstances, including the nature of the obligations being breached and contractually withheld. In order to satisfy the requirement that the contractual retention not be clearly disproportionate to the breach, the party exercising contractual retention may retain only part of an obligation (subsection (5)).

The right to exercise contractual retention ends when subsection (6) applies. Once the party who breached the contract giving rise to the contractual retention has performed the breached obligation, the contractual retention must end and the retaining party must perform the retained obligations. The party in breach may also end the contractual retention by paying damages in lieu of performance.

Section 21B - Notification of contractual retention for an anticipatory breach of contract

This section deals with circumstances in which the relevant breach giving rise to contractual retention is an anticipatory breach (see section 21A(1)(b)). Where this section applies, the party exercising contractual retention must satisfy the notification requirements set out in subsections (1) and (2). That is, the notification of contractual retention must occur either before the contractual retention begins, or as soon as reasonably practicable after the contractual retention has begun. The notification must be written or oral (subsection (2)).

³ For example, obligations may be determined not be intended to be counterparts by reference to the terms of the contract or its structure – a contract for a long project broken into phases might, for instance, suggest that counterpart obligations are only those which exist within each phase, rather than across the whole contract.

⁴ For example, in a case decided in 1919 the buyers of two ships under two separate contracts for which a single price was payable were allowed to refuse to pay the whole price in respect of a breach in relation to only one of the contracts. See *Claddagh Steamship Co v Steven & Co* 1919 SC (HL) 132.

Section 21C – Contractual retention in proceedings

This section contains provisions relation to proceedings for contractual retention.

Subsection (1) relates to proceedings which argue that a contractual retention was clearly disproportionate to the breach of contract that gave rise to it. Where a party disputing a contractual retention is arguing that the retention is clearly disproportionate to the breach in terms of section 21A(4), it is for that party to demonstrate that the contractual retention is clearly disproportionate.

Subsection (2) allows contractual retention to operate as a defence (as well as a tool to secure future performance of obligations). A party which has proceedings against it for breach of contract may argue that their failure to perform an obligation which would otherwise be a breach of contract actually constitutes a contractual retention.

Section 21D - Interaction of contractual retention with existing law

This section provides that the preceding sections on contractual retention do not affect the application of other enactments or rules of law related to lien, compensation or set off, anticipatory breach of contract or equitable or special retention. They also do not affect any other circumstances conferring rights to retain or abate obligations, which may include statutes which deal with particular areas of law. For example, section 112 of the Housing Grants, Construction and Regeneration Act 1996 contains a statutory right to suspend the performance of obligations under some construction contracts where the other party defaults on payment of a “notified sum”. Another example is the common law rule in leases that if a landlord fails, to any material extent, to execute repairs or improvements which they have agreed to make, the tenant may withhold payment of the rent.

Subsection (2) preserves the court’s equitable control on whether to allow a party to exercise contractual retention.⁵

⁵ See *McNeill v Aberdeen City Council* (No. 2) [2013] CSIH 102 as authority for retention being subject to equitable control by the court and *Inveresk plc v Tullis Russell Papermakers Ltd* [2010] UKSC 19 where Lord Hope noted that the right of retention is not absolute and the court has the power to prevent its abuse.

Policy Note

Current law

Closely aligned to the principle of mutuality is the remedy of retention. Retention is a “self-help” remedy based on the idea of obligations in a contract being interdependent or reciprocal. If one party does not perform their obligation then the other party need not perform theirs. For example, Party A enters into an agreement with Party B to provide goods in staged monthly deliveries over a period of twelve months, with B paying a sum of money after each delivery. Party A delivers the goods each month for the first three months (and B pays for each delivery shortly thereafter), does not deliver goods in the fourth month but does deliver goods for the fifth month. In this example, Party B can retain their performance (i.e., payment) for the failed delivery in the fourth month until such time as Party A actually delivers.

In its Report the SLC considered the remedy of retention to be functioning reasonably well but that clarification of certain issues was required, and that the clarification could be left to the courts and practitioners. Since the Report was published, however, there has been further case law which has raised questions about how and when retention can be used, and so the law remains unclear in certain respects.

Reform

Sections 21A to 21D of the Bill provide a clear statement of the law of retention, re-named ‘contractual retention’ which more closely describes its purpose and avoids confusion with the separate remedy in Scots law known as ‘special retention’.

Section 21A lays out what contractual retention is, when it may be used, and the criteria it must meet to be valid. A party (A) who is to perform a contractual obligation has a right to retain their performance until B has performed their obligation. The performance retained must be a counterpart obligation to that which B has not performed and A’s retention must not be clearly disproportionate to the effects of B’s failure to perform. The effect of section 21B is that a party contractually retaining an obligation in response to an anticipatory breach must notify the other party of the contractual retention within a reasonable time. The notice may be given orally or in writing and does not require to include any specific information.

Consultation

The Scottish Government [consulted on a statutory scheme for the law of contractual retention](#) in March 2025. This included a draft statutory scheme which largely restates what is understood to be the current law but with some reforms. Respondents to that consultation were generally of the view that Scots law of retention does require to be clarified and that the scheme proposed largely addresses those concerns.

While the majority of respondents were content with the scheme consulted upon, the Scottish Government made two changes after considering all the comments. These were

- that, with regards to anticipatory retention, Party A should be obliged to notify Party B of the anticipatory retention; and,
- that to retain performance, the breach must not be clearly disproportionate (instead of requiring the breach to have a non-trivial adverse effect on Party A) That is considered a sufficient and clear test for the parties to apply.

Alternative approach

An alternative approach would be to do nothing and leave the law as it currently stands and let the courts and practitioners clarify the issues with the current law. This is the same approach taken by the SLC in its Report. Respondents to the Scottish Government's consultation on the SLC's recommendations for reform, however, said that in the light of case law subsequent to the SLC's Report, the law is now less clear and that it would benefit from clarification.