FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2024] CSIH 30
A214/20

Lord President
Lord Pentland
Lady Wise

OPINION OF THE COURT

delivered by LORD CARLOWAY, THE LORD PRESIDENT

in the reclaiming motion

in the cause

WILLIAM GRAY

Pursuer and Reclaimer

against

(FIRST) STEPHEN McCALLION and (SECOND) ZLX LIMITED

Defenders and Respondents

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Pursuer and Reclaimer: A MacKenzie (sol adv); Harper Macleod LLP
Defenders and Respondents: Massaro; Brodies LLP

4 October 2024

Introduction

[1] The pursuer reclaims (appeals) against the Lord Ordinary's refusal to dismiss the second defenders' counterclaim as incompetent in terms of Rule 25.1(1)(b) of the Rules of the Court of Session 1994. Separately, the defenders challenge the competency of the reclaiming motion on

the basis that the pursuer did not obtain leave to reclaim from the Lord Ordinary in accordance with RCS 38.2. The appeal concerns the proper interpretation and application of these two rules.

The pleadings

[2] The second defenders provide tax advice to, and process research and development tax rebate claims on behalf of, their clients. They provide these services by engaging consultants in Scotland and England. The pursuer was one such consultant. The first defender is the sole shareholder and director of the second defenders.

Principal Action

[3] In his written pleadings, the pursuer avers that, although the second defenders are, as a matter of law, an incorporated company, as a matter of fact they were a partnership between him and the first defender. There is a dispute about whose idea it was for the pursuer and the first defender to conduct business together and about the precise terms on which they agreed to do so. In broad terms, there is agreement that, in 2018, the two decided to enter into the research and development tax rebate claims business. The pursuer avers that the parties agreed that they would incorporate a new company, namely the second defenders, through which to carry out the business. He avers that he and the first defender agreed to share equally in the profits and management of that business. Initially, the first defender was to be listed as the sole shareholder and director of the new company. The pursuer would be paid by the second defenders as a contractor. After certain events had taken place, notably the termination of the first defender's employment with a separate company, Yamato Scale Dataweigh (UK) Ltd, the first defender was to transfer 50% of the shareholding in the new company to the pursuer.

These events came to pass, but the first defender refused to effect the share transfer. The pursuer concludes for an order for specific implement compelling the first defender to make the transfer.

[4] The defenders lodged joint defences. They deny that there was an agreement that shares would be transferred to the pursuer. They contend that there was only a general agreement that a share transfer might be agreed in the future. Such an agreement would be conditional upon the second defenders' success and upon the pursuer making a sufficient contribution to that success and demonstrating himself to be trustworthy and honest. The pursuer and the first defender ceased working together in February 2020. The relationship did not end amicably. The defenders aver that this was because the pursuer made a false application for finance to Audi in the first defender's name. This caused the first defender to incur a personal liability of £38,000. The defenders maintain that, after he left the second defenders' employment, the pursuer set up his own tax rebate claims business and took some of the second defenders' clients with him.

Counterclaim

[5] The second defenders lodged a counterclaim. They say that the counterclaim arises out of the same contractual relationships as those on which the pursuer's action is based. They contend that the pursuer breached both his common law duty of care and an implied term in the contract between them that he would perform his role with the care and skill of an ordinarily competent tax rebate claims adviser. They say that the pursuer failed to: have claim forms signed by clients; have the figures he submitted to HM Revenue & Customs approved by clients; attach accurate tax computations to clients' claim forms; comply with HMRC standards for tax agents.

[6] On quantum, the second defenders incorporate *brevitatis causa*: (i) a table with a summary of the pursuer's obligations, failures and the losses caused to the second defenders; and (ii) a spreadsheet providing a breakdown of those losses. The spreadsheet details, *inter alia*: (i) the names of those clients of the second defenders whose claims did not succeed as a result of the pursuer's failings; (ii) the particular ways in which the pursuer failed in the preparation and processing of those clients' claims; (iii) the value of the claims as submitted by the pursuer; (iv) the actual value of those claims; (v) the fee which the second defenders lost in the year in which those claims were submitted; and (vi) the fee which the second defenders reasonably estimate they lost during the subsequent four years in relation to each of the affected clients. The second defenders allege that the clients identified in the spreadsheet refused to continue to use their services as a result of the pursuer's failings.

[7] The pursuer's defence to the counterclaim is that he was not the consultant with responsibility for the claims. He takes a preliminary challenge to the competency of the counterclaim on the basis that it did not form part of, or arise out of, the same grounds of action as his claim against the defenders. It was not necessary to decide the matters raised in the counterclaim in order to determine the question in controversy between the pursuer and the first defender in the principal action. The counterclaim did not therefore comply with Rule 25.1(1)(b) and was incompetent. In addition, the counterclaim was so lacking in its specification of loss that it was irrelevant.

Relevant Rules of the Court of Session

[8] RCS 25.1(1) provides that a defender may lodge a counterclaim:

> "(a) where the counterclaim might have been made in a separate action in which it would not have been necessary to call as a defender any person other than the pursuer; and

(b) in respect of any matter–

(i) forming part, or arising out of the grounds, of the action by the pursuer;

(ii) the decision of which is necessary for the determination of the question in controversy between the parties; or

(iii) which, if the pursuer had been a person not otherwise subject to the jurisdiction of the court, might have been the subject-matter of an action against that pursuer in which jurisdiction would have arisen by reconvention."

[9] RCS 38.2 sets out the types of interlocutor against which a party may reclaim without leave of the Lord Ordinary. Insofar as relevant to the issues in this appeal, these include any interlocutor disposing of part of the merits of a cause (RCS 38.2(4) and (5)(a)). Interlocutors not so specified in RCS 38.2(1), (3) or (5) can only be reclaimed with the leave of the Lord Ordinary (RCS 38.2(6)).

The Lord Ordinary

[10] On 7 September 2023, the Lord Ordinary held that the counterclaim was competent. The rationale behind RCS 25 was expediency. A broad approach to the rule was merited. The principal action related to a business venture which had been entered into by the pursuer and the first defender and involved the transfer of 50% of the shares in the second defenders in furtherance of that business. The counterclaim related to the pursuer's action relative to the second defenders, taken in the interests of that business. The second defenders were an integral and material part of the business. Both claims had their origins in, or related to (*Tods Murray* v *Arakin* 2000 SLT 758, at para [10]), or arose out of, the business. The counterclaim fell within RCS 25.1(1)(b)(i) and was competent.

[11] A party required to have averments which gave their opponent fair notice of their case. An action (or counterclaim) could be dismissed for want of specification. That rule found its

proper application where the opponent did not know the case made against them and objected to being taken by surprise at a proof. Where facts were said to be within the opponent's knowledge, the level of specification may be less. In this case, there was a fundamental dispute about what was, or ought to have been, within the pursuer's knowledge. The second defenders' counterclaim was predicated upon the basis that the relevant claims were compiled and submitted by the pursuer. If the second defenders failed to establish those facts, they would likely fail to establish their case. It would be premature, standing the existence of a factual dispute, to take the draconian step of dismissing the counterclaim.

[12] The second defenders were entitled to peril their case on the contention that they had suffered loss of income, rather than loss of profit. If the court considered that the correct measure of loss was loss of profit, and the second defenders had no pleadings on that, they might find themselves unable to establish loss. The pursuer's position in relation to quantum would remain protected by allowing a proof before answer. Although the second defenders' pleadings on quantum were, in part, confusing, in light of the pursuer's motion to allow amendment of his own pleadings, it was not unreasonable to allow the second defenders an opportunity to amend their pleadings in the course of that procedure.

Submissions

The pursuer

[13] The reclaiming motion was competent. An incompetent action was one without merit. The Lord Ordinary's interlocutor, which repelled the plea to the competency, disposed of part of the merits of the cause. Leave to reclaim was therefore not required in terms of RCS 38.2(4) and (5)(a). The defenders' interpretation of "merits" was too restrictive. As a matter of plain English and simple logic, the merits of the cause must encompass its competency. Such an

interpretation gained support from the context of the remaining parts of RCS 38.2(5). A finding that it was incompetent to proceed further on the merits of the case could be reclaimed without leave (Mackay: *Manual of Practice in the Court of Session* at 295). That was the obverse of the interlocutor pronounced by the Lord Ordinary. Even if leave were required, it was still open to the court to determine competency in the exercise of its inherent jurisdiction to deal with matters that were *pars judicis*.

[14] The Lord Ordinary erred in holding that the counterclaim satisfied any of the requirements of RCS 25.1(1)(b). The pursuer's ground of action was a contract between the pursuer and the first defender. The second defenders were called only for their interest, because an order for the transfer of 50% of their shares may have practical consequences for them. The second defenders had an interest in the principal action only to that very limited extent. They had joined with the first defender in defending the principal action, but they did not aver that a share transfer would be inequitable because the pursuer had breached his obligations to them. There was no tripartite element.

[15] Taking each part of RCS 25.1(1)(b) in turn, subparagraph (i) did not apply. The broad approach taken by the Lord Ordinary did not find support in the authorities (*JW Chafer (Scotland)* v *Hope* 1963 SLT (Notes) 11; *Tods Murray* v *Arakin* 2001 SC 840). The action and the counterclaim concerned different legal relationships between separate legal persons. The contract between the first defender and the pursuer was the sole ground in the principal action. The counterclaim did not arise from that ground. Whether the first defender was contractually obliged to transfer shares to the pursuer was unrelated to whether the pursuer was liable in damages for breach of a separate and subsequent contract with the second defenders.

[16] Subparagraph (ii) did not apply. It was conceded that, in ascertaining the question in controversy, the court required to take into account the defence to the principal action as

pleaded, but not an unconnected counterclaim. The determination of the counterclaim was not necessary for the determination of the question in controversy in the principal action. The pursuer was domiciled in Scotland and was subject to the jurisdiction of the court so subparagraph (iii) did not apply.

[17] The pursuer's action was simple and straightforward. It could proceed expeditiously to proof. In contrast, the counterclaim was a wide-ranging professional negligence action. If the counterclaim were dismissed at this stage, the defenders could raise a separate action. To tie the actions together was anathema to expediency.

[18] The Lord Ordinary erred by refusing to dismiss the counterclaim as lacking in specification. The second defenders sued for lost commission. In order to have earned that commission, the clients would first have had to have recovered sums from HMRC. Taking the second defenders' claim at its highest, they had lost the opportunity to make commission because their clients had lost the opportunity to claim tax relief. The second defenders required to establish that, had the clients been competently advised, they would have made claims for tax relief and that those claims would have had a real and substantial chance of success had the breach of duty not occurred. If the second defenders surmounted that hurdle, the court would assess the value of the lost opportunity by reference to the underlying merits of the lost claims (*Perry* v *Raleys* [2020] AC 352, at paras 15 – 24; *Centenary 6* v *TLT* 2023 SLT 555). The principle of fair notice required the second defenders to aver the basic facts about the lost claims. This included, for example: what expenditure would have qualified for tax relief; what research and development that expenditure related to; under which legislative provisions the expenditure qualified; and in which financial periods the expenditure had occurred.

[19] The second defenders had provided no notice of the basic details of their clients' claims. Those details might reveal that the underlying claims had no, or only a remote, chance of

success. For example, they may have been timebarred, or have related to expenditure which did not properly qualify for tax relief. Without averments of the details of the lost claims, the court could not value the opportunity lost. The pursuer could not prepare for proof. The second defenders could not avoid the requirement to give fair notice by contending that the pursuer had knowledge of the claims. There was no fair notice of the second defenders' claim for lost commission in subsequent years. A client may have qualifying expenditure in one year, but that did not extrapolate into subsequent years. Tax relief claims would have been subject to a higher risk of scrutiny in the case of some of the clients (tier 2 or 3). The pursuer had sought commission and diligence in relation to the underlying claims, but there was a dearth of evidence on which to base any kind of qualitative assessment.

The defenders

[20] The reclaiming motion was incompetent. The pursuer had not obtained leave to reclaim. The Lord Ordinary's interlocutor did not dispose of part of the merits or fall into any of the other categories of interlocutor (RCS 38.2(1), (3) and (5)) which could be reclaimed without leave. The purpose of RCS 25 was expediency. Refusing to allow a counterclaim was a refusal of a specific procedure. The substantive rights which were the subject of the counterclaim could still be vindicated by a competent procedure (*Tods Murray* v *Arakin* at paras [6] and [8]). Such a refusal did not affect substantive rights. The fact that a plea-in-law had been sustained or repelled would mean that a substantive part of the cause had been dealt with in many situations, but not in *any* situation (Lord Carloway, *Civil Procedure*, in *Stair Memorial Encyclopaedia (re-issue)* at para 257). A decision to allow a counterclaim to proceed was not a decision which dealt with part of the merits of the cause.

[21] The counterclaim was competent in terms of both RCS 25.1(1)(b)(i) and (ii). In terms of (i), matters "arising out of" the pursuer's grounds of action included any defence to the action. Subparagraph (ii) performed a more expansive role than (i). It required consideration of the case as a whole (*Fulton Clyde* v *JF McCallum & Co* 1960 SLT 253, at 255 – 256). The question was, what was the controversy? The court had a discretion to refuse specific implement. It would generally do so where what was sought would force another party into a partnership or a contract of employment (McBryde: *Contract* (3rd ed) at para 23.20). The pursuer had averred that the parties were in a relationship akin to partnership. In the principal action, it was the defenders' contention that, even if there had been an agreement that the pursuer would receive 50% of the shares, the court should refuse to grant specific implement compelling the transfer. This was partly because the pursuer had breached his contract with the second defenders, thereby causing them substantial loss and damage. These averments were the same as the second defenders' averments in support of the counterclaim. The defenders were not seeking to establish breach of contract in the principal action. They contended that the pursuer's breach of contract made it inequitable to order specific implement. The pursuer, who sought to amend his pleadings on the matter, accepted that the contractual arrangement between the three parties was unclear. Based on the pursuer's averments, there was only one contract involving all three parties.

[22] The second defenders were entitled to avail themselves of RCS 25.1. The pursuer had raised the action against them. He had not called them only for their interest. Even if it was right to say that there were two different contracts underlying the principal action and the counterclaim respectively, *JW Chafer (Scotland)* v *Hope* and the line of authority cited therein (*Burt* v *Bell* (1861) 24 D 13; *Grewar* v *Cross* (1904) 12 SLT 84; *Scott* v *Aitken* 1950 SLT (Notes) 34; *Borthwick* v *Dean Warwick* 1985 SLT 269) did not assist in answering the question. *Chafer* could

be distinguished. In *Chafer*, the existence of a debt was admitted and the only defence advanced was set off. The court refused to permit a counterclaim to be advanced in order to set off of a liquid claim against an illiquid debt. In the present case, there was no admission of a debt being due. The defence advanced was not set off.

[23] A court would only dismiss an action for lack of specification if there was a lack of fair notice. The lack of specification required to be material (*Richards* v *Pharmacia c/o Pfizer* 2018 SLT 492 at para [47]; *Chalmers* v *Diageo Scotland* [2024] CSIH 2 at para [23]). The pleadings in support of the counterclaim contained averments specifying: (i) that the pursuer acted in breach of contract and duty when dealing with tax rebate claims on behalf of the second defenders' clients, leading to the rejection of those claims by HMRC; (ii) the identities of the affected clients; (iii) the ways in which the pursuer was said to have failed, with reference to a spreadsheet incorporated into the pleadings; (iv) that quantum comprised loss of commission for the year of submission of the failed claims and the subsequent four years; and (v) how the claim was calculated, with reference to the incorporated spreadsheet. The pursuer had met these averments with a bare denial. It had been the pursuer's responsibility to prepare and submit claims. He ought to know whether those claims had merit or not. There were difficulties with the pursuer, having submitted those claims to HMRC, now seeking to argue that they were without merit (*Centenary 6* v *TLT*, at para [121]). The Lord Ordinary was correct to conclude that the counterclaim was not materially lacking in specification. The pursuer had fair notice of the claim against him.

Decision

[24] Lodging a counterclaim under RCS 25 is the equivalent of raising an action (*HM Advocate* v *Frost* 2007 SC 215, Lord Osborne, delivering the opinion of the court, para [28]). It is

a form of procedure designed to avoid the necessity for a cross-action by the defender (Thomson and Middleton, *Manual of Court of Session Procedure*, at 78). A decision to allow a claim to proceed by way of counterclaim is a procedural decision. Such a decision does not determine any substantive rights (*Tods Murray* v *Arakin* 2001 SC 840, at para 6), although it may have practical consequences for the party's ability to vindicate those rights. The merits of a case are the substantive or real matters in issue, not the technical or procedural points raised (see Walker, *The Oxford Companion to Law* at 836 and Garner, *Dictionary of Legal Usage* (2011) at 573). A decision to allow a counterclaim to proceed is not a determination of part of the merits of the cause. Leave to reclaim the Lord Ordinary's interlocutor of 7 September 2023 was required in terms of RCS 38.2(6). It was not obtained and the reclaiming motion is therefore incompetent.

[25] The requirement to seek leave to reclaim in respect of certain types of interlocutor is an important aspect of judicial case management. It is in the interests of the efficiency of the civil justice system as a whole, as well as in an individual case, to have a mechanism by which the court can ensure that there is no proliferation of appeals on procedural points. The pursuer submitted that, even if leave ought to have been obtained, the court could still determine competency since competency was *pars judicis*. If that were correct, a party would be able to circumvent the requirement to seek leave. This would frustrate the important object of RCS 38.2 (*Robertson* v *Robertson's Ex* 1991 SC 21, LP (Hope) at 24). The matter is so obviously procedural and so clearly within the province of the Lord Ordinary as to make leave essential as a condition of review (*ibid*).

[26] Had the reclaiming motion been valid, it would have been refused. The counterclaim is competent in terms of RCS 25.1(1)(b)(ii). RCS 25.1(1)(b)(i) contemplates matters which are directly connected with the pursuer's grounds of action. The classic example is the action for payment in terms of a contract being met by a claim for damages for breach of that contract.

RCS 25.1(1)(b)(ii) contemplates matters which are more indirectly connected with the pursuer's grounds of action. The question in controversy between the parties is wider than the pursuer's grounds of action (*Fulton Clyde* v *JF McCallum & Co* 1960 SLT 253, Lord Migdale at 256). It can include matters put in issue by the defences which may, at first glance, seem only tangentially related to the pursuer's action.

[27] This counterclaim is an example of this. The dispute between the pursuer and the second defenders is intermingled with the dispute between the pursuer and the first defender. The defenders aver that the pursuer's breaches of contract and duty are part of the reason why it would be inequitable for the court to grant specific implement for the share transfer. They aver that, if there was a contract for a share transfer, it was conditional on, *inter alia*, the pursuer contributing to the success of the company. It cannot be said, in light of these breaches of contract and duty, that he did so. The hearing on the Procedure Roll concerned only the pursuer's preliminary pleas to the competency, relevancy and specification of the counterclaim. The pursuer's preliminary pleas to the relevancy and specification of the defenders' averments in the principal action were held over to another date. The Lord Ordinary was correct to assess matters on the basis of the averments on record as at the date of the Procedure Roll. The relationship at the centre of the action was tripartite in nature. The arrangement between the pursuer and the first defender was meaningless without the incorporation of the second defenders. The second defenders joined with the first defender in resisting the principal action. The fact that they were called only for their interest is of no consequence. A defender called for his interest is not bound to defend the action brought against him, but he is entitled to appear, lodge defences, and, subject to the usual rules of standing, lodge a counterclaim (Sheldon: *Title and Interest* in Macfadyen ed, *Court of Session Practice* C/122 at para [71]).

[28] The purpose of counterclaim procedure is expediency. A broad and common sense approach to RCS 25.1(1)(b) ought to be taken. The question under RCS 25.1(1)(b)(ii) is whether the factual or legal basis of the counterclaim is sufficiently connected to that underlying the principal action. If, as a result of a refusal to allow the counterclaim to proceed, the defender will have to raise a separate action and proceed to a proof on substantially the same facts as those which will be the subject of proof in the principal action, such an outcome is a strong indicator that a sufficient connection exists.

[29] Had the reclaiming motion been competent, the court would have repelled the pursuer's plea to the relevancy and specification of the counterclaim. There are sufficient averments on record to provide the pursuer with fair notice of the quantum of damages and the related matters which he may have to investigate further in order to prepare for proof. The pursuer's principal complaint was that there were no averments about the nature of the clients' underlying expenditure. The pursuer could not confirm whether that expenditure would have qualified for tax relief. However, the second defenders aver (statement of fact 3 of the counterclaim) that the second column of the spreadsheet provides the value of the qualifying expenditure which was incurred by each affected client. That general averment that the expenditure, in respect of which lost commission is claimed, qualified for tax relief is sufficient to allow the second defenders to lead evidence to prove that fact. If they fail to do so, they will probably fail to recover lost commission. The basis of the second defenders' claim for lost commission in the following four years is clear. They aver that the sums claimed are based on a reasonable estimate of the fee which they would have earned but for the pursuer's alleged failures. If following proof, the court does not consider that the estimate was reasonable, the second defenders will fail.

[30] The reclaiming motion is refused as incompetent.