This is the talk that was delivered by Mark Harper QC to the Northern Circuit Commercial Bar Association on 17 October 2018

Morris Garner v One Step (Support) Limited

[2018] 2 WLR 1353

[2018] UKSC 20

The respondent had bought from the appellants a business providing support for young people leaving care. They entered into an agreement containing non-compete and non-solicit covenants. The respondent brought proceedings alleging breach of that agreement. The judge held that the appellants had breached the covenants and the contractual and equitable duty of confidence and that it would be difficult for the respondent to identify the financial loss it had suffered. He declared that the respondent was entitled to seek damages under the principles in *Wrotham Park Estate Co Ltd v Parkside Homes Ltd [1974] 1 W.L.R. 798* for such amount as would notionally have been agreed between the parties, acting reasonably, as the price for releasing the appellants from their obligations, or alternatively ordinary compensatory damages. The appellants' appeal to the Court of Appeal was refused.

"23 The issues in the present appeal are agreed by the parties to be, first, where a party is in breach of contract, in what if any circumstances is the other party to the contract entitled to seek negotiating damages, ie damages assessed by reference to a hypothetical negotiation between the parties, for such amount as might reasonably have been demanded by the claimant for releasing the defendants from their obligations; and secondly, whether the Court of Appeal was correct to uphold the judge's finding that such damages are available in this case."

The appeal to the Supreme Court was allowed and in the judgment the Court modified principles (4) and (5) laid down by Lord Walker JSC in ***Pell Frischmann Engineering Ltd v Bow Valley Iran Ltd [2011] 1 WLR 2370 at [48].*** The Court also provided a useful consideration of the principles applicable to the award of damages in tort, contract and in lieu of an injunction.

1. Damages awarded under the principle laid down in ***Wrotham Park Estate Co Limited*** are no longer to be referred to as *"Wrotham Park Damages"* but instead as ***"negotiating damages"*** ([2] and [3]);

2.

    a. Common law damages for breach of contract are intended to compensate the claimant for loss or damage resulting from the non/inadequate performance of the obligation in question and were normally based on the difference between the effect of performance and non/inadequate performance on the claimant's situation ([31] – [36]);

    b. A useful summary is provided at [36]:

"It follows from the principle in Robinson v Harman that the language of election is not appropriate in a discussion of the quantification of damages for breach of contract. The objective of compensating the claimant for the loss sustained as a result of non-performance (an expression used here in a broad sense, so as to encompass delayed performance and defective performance) makes it necessary to quantify the loss which he sustained as accurately as the circumstances permit. What is crucial is first to identify the loss: the difference between the claimant's actual situation and the situation in which he would have been if the primary contractual obligation had been performed. Once the loss has been identified, the court then has to quantify it in monetary terms."

3. Where a breach had caused a claimant to suffer economic loss that loss should be measured or estimated as reliably as possible with tolerance as to imprecision where a loss was incapable of precise measurement. In this regard [37] and [38] are relevant:

"37 The quantification of economic loss is often relatively straightforward. There are, however, cases in which its precise measurement ****1367*** *is inherently impossible. As Toulson LJ observed in Parabola Investments Ltd v Browallia Cal Ltd (formerly Union Cal Ltd) [2011] QB 477 , para 22:*

"Some claims for consequential loss are capable of being established with precision (for example, expenses incurred prior to the date of trial). Other forms of consequential loss are not capable of similarly precise calculation because they involve the attempted measurement of things which would or might have happened (or might not have happened) but for the defendant's wrongful conduct, as distinct from things which have happened. In such a situation the law does not require a claimant to perform the impossible, nor does it apply the balance of probability test to the measurement of the loss."

An example relevant to the present case is the situation where a breach of contract affects the operation of a business. The court will have to select the method of measuring the loss which is the most apt in the circumstances to secure that the claimant is compensated for the loss which it has sustained. It may, for example, estimate the effect of the breach on the value of the business, or the effect on its profits, or the resultant management costs, or the loss of goodwill: see Chitty on Contracts *, 32nd ed (2015), vol 1, paras 26-172–26-174. The assessment of damages in such circumstances often involves what Lord Shaw described in the* Watson, Laidlaw *case 1914 SC (HL) 18, 29–30 as "the exercise of a sound imagination and the practice of the broad axe".*

38 Evidential difficulties in establishing the measure of loss are reflected in the degree of certainty with which the law requires damages to be proved. As is stated in Chitty *, para 26-015: "Where it is clear that the claimant has suffered substantial loss, but the evidence does not enable it to be precisely quantified, the court will assess damages as best it can on the available evidence." In so far as the defendant may have destroyed or wrongfully prevented or impeded the claimant from adducing relevant evidence, the court can make presumptions in favour of the claimant. The point is illustrated*

by Armory v Delamirie (1721) 1 Str 505 , where a chimney sweep's boy found a jewel and took it to the defendant's shop to find out what it was. The defendant returned only the empty socket, and was held liable to pay damages to the boy. Experts gave evidence about the value of the jewel which the socket could have accommodated, and Pratt CJ directed the jury "that, unless the defendant did produce the jewel, and shew it not to be of the finest water, they should presume the strongest against him, and make the value of the best jewels the measure of their damages: which they accordingly did.""

4. There is no discretion to depart from the principle of compensatory damages – *"they were claimed as of right and awarded or refused on the basis of legal principle"* [95]. The Trial Judge had therefore been wrong to proceed on the basis that difficulties in assessing damages justified a departure from the principle. The Court of Appeal was wrong in its approach of a *"just response"*.[1]

5. The award of "negotiating damages" was to be confined to those cases *'where the loss suffered was appropriately measured by reference to the economic value of the right that had been breached, considered as an asset where the defendant had taken something for nothing, for which the claimant was entitled to require payment"*. They were still compensatory in nature and "negotiating damages" were just a tool for identifying the value of what had been lost ([48] – [95] – conclusions at [91] – [94] after a review of the relevant authorities)

"91 The use of an imaginary negotiation can give the impression that negotiation damages are fundamentally incompatible with the compensatory purpose of an award of contractual damages. Damages for breach of contract depend on considering the outcome if the contract had been performed, whereas an award based on a hypothetical release fee depends on considering the outcome if the contract had not been performed but had been replaced by a different contract. That impression of fundamental incompatibility is, however, potentially misleading. There are certain circumstances in which the loss for which compensation is due is the economic value of the right which has been breached, considered as an asset. The imaginary negotiation is merely a tool for arriving at that value. The real question is as to the circumstances in which that value constitutes the measure of the claimant's loss.

92 As the foregoing discussion has demonstrated, such circumstances can exist in cases where the breach of contract results in the loss of a valuable asset created or protected by the right which was infringed, as for example in cases concerned with the breach of a restrictive covenant over land, an intellectual property agreement or a confidentiality agreement. Such cases share an important characteristic with the cases in which Lord Shaw's "second principle" and Nicholls LJ's "user principle" were applied. The claimant has in substance been deprived of a valuable asset, and his loss can therefore be measured by determining the economic value of the asset in question. The defendant

[1] The CA considered that the test was whether an award of damages on the Wrotham Park basis was the just response in the particular case

has taken something for nothing, for which the claimant was entitled to require payment.

93 It might be objected that there is a sense in which any contractual right can be described as an asset, or indeed as property. In the present context, however, what is important is that the contractual right is of such a kind that its breach can result in an identifiable loss equivalent to the economic value of the right, considered as an asset, even in the absence of any pecuniary losses which are measurable in the ordinary way. That is ****1382*** *something which is true of some contractual rights, such as a right to control the use of land, intellectual property or confidential information, but by no means of all. For example, the breach of a non-compete obligation may cause the claimant to suffer pecuniary loss resulting from the wrongful competition, such as a loss of profits and goodwill, which is measurable by conventional means, but in the absence of such loss, it is difficult to see how there could be any other loss.*

94 It is not easy to see how, in circumstances other than those of the kind described in paras 91–93, a hypothetical release fee might be the measure of the claimant's loss. It would be going too far, however, to say that it is only in those circumstances that evidence of a hypothetical release fee can be relevant to the assessment of damages. If, for example, in other circumstances, the parties had been negotiating the release of an obligation prior to its breach, the valuations which the parties had placed on the release fee, adjusted if need be to reflect any changes in circumstances, might be relevant to support, or to undermine, a subsequent quantification of the losses claimed to have resulted from the breach. It would be a matter for the judge to decide whether, in the particular circumstances, evidence of a hypothetical release fee was relevant and, if so, what weight to place upon it. However, the hypothetical release fee would not itself be a quantification of the loss caused by a breach of contract, other than in circumstances of the kind described in paras 91–93 above."

6.

a. This approach has been applied in cases of trespass and intellectual property infringement rights (see [26]) by reference to the principle of *"abstraction or invasion of property"* – ***Watson, Laidlaw & Co Ltd v Pott, Cassels & Williamson 1914 SC (HL) 18 at p31*** or the *"user principle"* – ***Stoke-on-Trent City Council v W&J Wass Ltd [1988] 1 WLR 1406 at p1416 per Nicholls LJ***

b. Such damages were still compensatory in nature [30]

"In these cases, the courts have treated user damages as providing compensation for loss, albeit not loss of a conventional kind. Where property is damaged, the loss suffered can be measured in terms of the cost of repair or the diminution in value, and damages can be assessed accordingly. Where on the other hand an unlawful use is made of property, and the right to control

such use is a valuable asset, the owner suffers a loss of a different kind, which calls for a different method of assessing damages. In such circumstances, the person who makes wrongful use of the property prevents the owner from exercising his right to obtain the economic value of the use in question, and should therefore compensate him for the consequent loss. Put shortly, he takes something for nothing, for which the owner was entitled to require payment."

c. See Supreme Court in ***Prudential Assurance Co Limited v Revenue & Customs Commissioners [2018] 3 WLR 652 at [47];*** *"such awards are based on wrongdoing and are designed to compensate for loss"*

7. The present case was not such a case and no basis upon which a Court could be satisfied that the negotiated price for the release of the covenants represented the loss that had been suffered by the Claimant ([21] and [96] – [100]).

"98 This is a case brought by a commercial entity whose only interest in the defendants' performance of their obligations under the covenants was commercial. Indeed, a restrictive covenant which went beyond what was necessary for the reasonable protection of the claimant's commercial interests would have been unenforceable. The substance of the claimant's case is that it suffered financial loss as a result of the defendants' breach of contract. The effect of the breach of contract was to expose the claimant's business to competition which would otherwise have been avoided. The natural result of that competition was a loss of profits and possibly of goodwill. The loss is difficult to quantify, and some elements of it may be inherently incapable of precise measurement. Nevertheless, it is a familiar type of loss, for which damages are frequently awarded. It is possible to quantify it in a conventional manner, as is demonstrated by Mr Hine's report.

99 The case is not one where the breach of contract has resulted in the loss of a valuable asset created or protected by the right which was infringed. Considered in isolation, the first defendant's breach of the confidentiality covenant might have been considered to be of that character, but in reality the claimant's loss is the cumulative result of breaches of a number of obligations, of which the non-compete and non-solicitation covenants have been treated as the most significant, as explained in para 17 above.

100 The judge has ordered a hearing on quantum. That hearing should now proceed, but it should not be, as he ordered, an assessment of the amount which would notionally have been agreed between the parties, acting reasonably, as the price for releasing the defendants from their obligations. The object of the exercise is that the judge should measure, as accurately as he can on the available evidence, the financial loss which the claimant has actually sustained. How that assessment is best carried out is, in the first instance, a matter for the judge to consider, proceeding in accordance with this judgment. If evidence is led in relation to a hypothetical release fee, it is for the judge to determine its relevance and weight, if any. It is important to understand,

however, that such a fee is not itself the measure of the claimant's loss in a case of the present kind, for the reasons which have been explained."

Comment

The decision is to be welcomed because it provides certainty and clarity of approach to the calculation of damages in cases such as the one before the Supreme Court. It will be welcome news to forensic accountants as they will expect to be assisting parties, legal teams and the Courts in considering the best approach to calculating the losses suffered potentially in relation to pre-expert report case management conferences when the scope of expert evidence will be determined.

However, the decision does not stand up to scrutiny when considered against the reasoning at [30], [98] and [99].

The restrictive covenants and the obligations of confidence were imposed to protect the Claimant's business and in particular goodwill. The Defendant's breaches of those obligations resulted in loss and damage to the business and the goodwill and the Claimant (just like the holder of IP rights) had its right to control the use of its business and goodwill infringed. There is therefore no justification for excluding "negotiating damages" as a means of assessing loss in cases such as this.

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