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"Hypothetical negotiation" and damages for breach of contract
One Step (Support) Ltd v Morris-Garner [2018] 2 W.L.R. 1353

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Introduction

In *One Step (Support) Ltd* the Supreme Court considered the circumstances in which damages for breach of contract could be assessed by reference to the sum that a claimant could hypothetically have received in return for releasing a defendant from the obligation they had failed to perform, referred to as "negotiating damages". The wider issue addressed by the Supreme Court was the lack of clarity as to the theoretical underpinning of those damages and the consequent uncertainty as to when they were available. Lord Reed, with whom Lady Hale and Lords Wilson and Carnwath agreed, set out the ratio of the court's decision while Lord Sumption added his own analysis, which was, in turn, commented on by Lord Carnwath.

"Wrotham Park" damages

The expression "*Wrotham Park*" damages ("WP damages") comes from Brightman J's decision in Wrotham Park Estate Co Ltd v Parkside Homes Ltd [1974] 1 W.L.R. 798, where a restrictive covenant against development had been breached and the owner sought a mandatory injunction for demolition of the development. The judge held that it would not be just to order demolition so damages were granted in place of the injunction, the proper measure being the sum which the owner might reasonably have required in return for relaxing the covenant as a percentage of the profit made from the development.

The facts

The claimant, OS Ltd, bought a business providing support for young people leaving care, which had previously been run by the defendant (M-G) and her partner. As part of the usual non-compete package in such business sales, M-G agreed for a three-year period to keep information concerning the business's transactions confidential, not to engage in a business that was in competition with it or to solicit its clients without its consent that could not to be unreasonably withheld. Rather predictably, M-G emailed to her personal email account confidential market research information held by the business and established a new company that competed with the business she had sold and also solicited its clients, although M-G disputed this at trial. OS Ltd raised proceedings alleging breach of the covenants and sought as remedies an account of profits, alternatively "restitutionary damages" in the form of a release fee or further alternatively "compensatory damages" for breach of contract. OS Ltd produced reports by forensic accountants quantifying the loss allegedly suffered as a result of the breach of the covenants, the benefits obtained by M-G, and the hypothetical release or licence fee (the sum a reasonable person in the position of OS Ltd would have accepted for releasing M-G from the covenants and what a reasonable

person in the position of M-G would have agreed to pay for that release). However, notwithstanding the expert reports, OS Ltd submitted before the trial judge that estimating its loss would be extremely difficult, a submission accepted at first instance and on appeal but which Lord Reed said "did not hold water".

First instance

At the trial ([2014] EWHC 2213 (QB)) on liability and remedies (the issue of quantification was deferred) the judge decided that M-G had breached the non-compete, non-solicitation and confidentiality covenants. On remedies, he accepted OS Ltd's argument that the normal remedy of compensatory damages would not do justice between the parties because of the inherent difficulty of proving that any particular business had been lost and that ongoing damage was being sustained. He held that OS Ltd was entitled to elect between the alternative bases of: (i) *WP damages* (in the form of the amount that would notionally have been agreed between the parties, acting reasonably, as the price for releasing M-G from the restrictions, probably a percentage of M-G's profit on sale of the business); and (ii) ordinary damages; he rejected an application for an account of profits. At [104] he described *WP damages* as "simply one form of compensatory damages" and said it would be just to allow OS Ltd the option to recover them.

Court of Appeal

M-G appealed ([2017] Q.B. 1) on the ground that damages should have been awarded on the conventional compensatory basis as the sum required to put OS Ltd in the position it would have been in if the contract had been performed but Longmore, Christopher Clarke and King LJJ rejected the appeal and held that the judge had been entitled to allow OS Ltd to elect for the release fee basis. Both Longmore and Christopher Clarke LJJ admitted that they had had difficulty with the issue of the correct measure of damages and the former at [137] said that, as a matter of practical justice and on a broad-brush basis, M-G should make a reasonable payment for competing and soliciting in breach of contract. As a matter of principle, he said the release fee basis was justified because the breach had been deliberate, OS Ltd would have difficulty establishing financial loss and had a legitimate interest in preventing M-G making a profit in breach of contract [147].

Supreme court

Lord Reed said at [3] that the decision in *Wrotham Park Estate Co Ltd* should be regarded as being of little more than historical interest and that the expression "negotiating damages" should be used instead of *WP damages*. He started from first principles, stating at [31] that the law of contract gave effect to consensual agreements entered into by particular individuals in their own interests by granting remedies designed to give effect to what had been voluntarily undertaken by the parties and put the claimant in the same position as he would have been in if the contract had been performed. At [95] he set out 12 conclusions; in particular, common law damages for breach of contract were intended to compensate the claimant for loss or damage resulting from the non-performance of the obligation in question and were normally based on the difference between the effect of performance and non-performance on the claimant's situation (6); it was for the claimant to establish that a loss has been incurred, in the sense that he was in a less favourable situation, either economically or in some other respect, than he would have been in if the contract had been performed (7); where the breach of a contractual obligation had caused the claimant

economic loss, that loss had to be measured or estimated as accurately and reliably as the nature of the case permitted although the law was tolerant of imprecision where the loss was incapable of precise measurement with a variety of legal principles to assist in cases where there was a paucity of evidence (8); where the claimant's interest in the performance of a contract was purely economic, and he could not establish that any economic loss has resulted from its breach, the normal inference was that he has not suffered any loss and would only be awarded nominal damages (9); negotiating damages could be awarded for breach of contract where the loss suffered by the claimant was appropriately measured by reference to the economic value of the right that had been breached, considered as an asset, where the breach had resulted the loss of the valuable asset created or protected by the right that had been infringed (10); however, common law damages for breach of contract could not be awarded merely for the purpose of depriving the defendant of profits made as a result other than in exceptional circumstances (11); and common law damages for breach of contract were not a matter of discretion but were claimed as of right and were awarded or refused on the basis of legal principle.

Applying those conclusions, Lord Reed said at [96]–[97] that neither the judge nor the Court of Appeal had approached the issue correctly. The judge had been wrong to decide that OS Ltd was entitled to elect how its damages should be assessed merely because of the difficulty of quantification while the Court of Appeal was wrong to hold that damages based on a hypothetical release fee could be awarded as a "just response" to a particular breach of contract. He added that the substance of OS Ltd's claim was that it had suffered financial loss as a result of M-G's breach of contract because it had been exposed to competition that had resulted in reduced profits; although the loss was difficult to quantify it was a familiar type of loss for which damages were regularly awarded and, indeed, had been set out in expert reports. The hearing on quantum should be restricted to the measurement of the financial loss actually incurred without an option to elect for negotiating damages; the judge could take account of any evidence of a hypothetical release fee led by OS Ltd but that was not of itself the measure of the loss [100].

At [105] Lord Sumption noted that because of the inherent uncertainties in measuring the loss flowing from breach of covenants the claimant was usually awarded the value of the lost chance of doing more business but "even a chance must be valued by something better than guesswork". He said that the judge and Court of Appeal were wrong to see *WP damages* as an alternative measure of damages to the ordinary compensatory measure but, in his view, the notional price of a release might be relevant as an evidential technique for estimating what OS Ltd had lost and, indeed, the case law illustrated that it was frequently employed [123]. As a result, the judge's order should be modified so that it neither required nor excluded the use of a notional release fee as evidence of the loss.

He added at [126] that, although his reasoning differed from Lord Reed's, their conclusions were "closely aligned". Lord Carnwath, however, considered that the differences were significant and sided with Lord Reed's "entirely orthodox approach" [128].

Conclusion

The ratio of the Supreme Court decision is to be found in Lord Reed's judgment that considerably curtails the future use of negotiating damages as a measure of damages except in the restricted categories identified by Lord Reed. It remains to be seen how the courts will react to evidence of negotiating damages as an "evidential technique" since it is difficult to

see how it will relate to the evaluation of the “loss of a chance” that is the normal approach in breach of commercial contracts.