

Complex Commercial Litigation

One-Step Beyond? The UK Supreme Court clarifies the availability of *Wrotham Park* damages

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In *Morris-Garner and another (Appellants) v One Step (Support) Ltd (One Step/Respondent)* [2018] UKSC 20, the UK Supreme Court has upheld an appeal challenging a party's claim for "negotiating damages" for breach of contract. In doing so the Supreme Court took the opportunity to clarify the circumstances in which damages for breach of contract may be assessed by reference to the sum which the claimant might reasonably have demanded from the defendant for the hypothetical release of the obligation which has been breached. This measure (known as *Wrotham Park* damages after a case of that name) stands in contrast to the ordinary compensatory assessment of damages as the measure of the financial effect of performance versus non-performance of the contract on the claimant.

The Supreme Court rejected the approach taken by the Court of Appeal and at first instance that "negotiating damages" (as they should now be called) may be available for breach of contract claims where it would be a "just response" in the circumstances, taking into account the difficulties the claimant would have in establishing financial loss.

Rather, the Supreme Court held that "negotiating damages" may be awarded for breach of contract where the loss suffered is appropriately measured by reference to the economic value of the right which has been breached, considered as an asset.^[1] The result of the Supreme Court's decision is that "negotiating damages" is not a measure of damages which will be routinely available in breach of contract claims.

Background

This case concerns the sale of the Respondent business - One Step - by the founder and at that time 50% shareholder and director, Karen Morris-Garner (the first Appellant), to Mr and Mrs Costelloe (fellow 50% shareholders) in 2009. One-Step provided supported living services to children leaving care and vulnerable adults. As part of the sale, the first Appellant entered into various restrictive covenants requiring her to keep certain business information confidential and prohibiting her from engaging in a competing business or soliciting clients for a period of 3 years. In addition, the second Appellant and employee of One-Step (Andrea Morris-Garner) agreed to be bound by similar non-compete and non-solicitation covenants upon termination of her employment. Unbeknown to the Respondent, the Appellants had already incorporated another entity, Positive Living Ltd (**Positive Living**), which later began competing with One-Step for business. In addition the first Appellant had already emailed a large quantity of One-Step's confidential information to herself.

Positive Living operated successfully and was sold by the Appellants in 2010 for £12.8 million. By contrast, One-Step's business suffered a downturn which it attributed to competition from Positive Living. The Respondent brought a claim against the Appellants for breach of the restrictive covenants and the use of confidential information, seeking a claim for account of profits or alternatively *Wrotham Park* damages (i.e. the notional amount which would have been agreed by the parties to release the Appellants from their obligations).

Decisions of the lower courts

- At first instance, the court found that the Appellants had breached their restrictive covenants and duty of confidence. It was held that the facts were not so exceptional as to warrant an award for

account of profits (a measure which strips the wrongdoer of his gains). However, recognising that One Step would have difficulty in establishing the damages it had suffered in the usual way given the secrecy surrounding the Appellants' establishment of the competing business (thereby denying One Step the opportunity of injunctive relief), the court concluded that it would be a "just response" for *Wrotham Park* damages to be available. Accordingly a declaration allowing One Step to elect between ordinary compensatory damages or damages on the *Wrotham Park* basis was granted.

- The Court of Appeal agreed that *Wrotham Park* damages were available based on a two-stage test: (i) whether a claimant would have real difficulties in establishing financial loss (albeit a complete absence of an identifiable financial loss was not required); and (ii) whether damages on the *Wrotham Park* basis was the just response in the case – a matter for the judge to decide on a broad brush basis and which did not require a finding that "manifest injustice" would be caused if *Wrotham Park* damages were denied. (In this regard, both the Court of Appeal and the trial judge placed weight on the deliberate nature of the breach and on One-Step's interest in preventing the Appellant's profit-making activities.) Unlike a claim for account of profits, the Court of Appeal confirmed that there was no requirement for "exceptional" circumstances.

Decision of the Supreme Court

The Supreme Court (Lord Reed giving the main judgment) rejected the Court of Appeal's approach, cautioning against the "just response" reasoning and emphasising that common law damages for breach of contract are not a matter of discretion but claimed as of right and awarded or refused on the basis of legal principle.

- The Supreme Court distinguished between three scenarios: (i) "user damages" assessed by reference to the value of the use wrongfully made of property, readily awarded for the invasion of rights to tangible property or breaches of intellectual property rights; (ii) damages awarded in substitution for specific performance or an injunction under the Lord Cairns' Act; and (iii) common law damages for breach of contract to compensate the claimant for the loss suffered as a result of non-performance of the obligation.
- In relation to common law damages, as noted above, the usual measure is the difference between the effect of performance and non-performance on the claimant. However, where the loss suffered by the breach of contract is appropriately measured by reference to the economic value of the right which has been breached, considered as an asset, the Supreme Court confirmed that "negotiating damages" can be awarded. For example, where a claimant has the benefit of a restrictive covenant over land which gives it the right to control the use of land, there is an identifiable loss where that covenant is breached even where there is no pecuniary loss. The same would likely apply for breaches of intellectual property agreements or confidentiality agreements. In those circumstances the defendant has taken something for nothing for which the claimant is entitled to require payment. The hypothetical negotiation between the parties for the release of the obligation is a tool for arriving at the economic value of the right valued as an asset.
- Although it might be argued that any contractual right could be described as an "asset", the Supreme Court confirmed that in circumstances where the claimant's interest is purely financial, "negotiating damages" will not be an appropriate measure of damages. This gives rise to a difficult conceptual distinction. The question to consider appears to be whether even in circumstances where there is no pecuniary loss, is there still an identifiable loss equivalent to the economic value of the right? Ultimately the nuances as to the types of breach of contract claims which can lead to an award for "negotiating damages" falls to be clarified by further judicial decisions.

Applying the above to One-Step:

- The Supreme Court concluded that One-Step's interest in the performance of the covenants was purely commercial. The breach of contract had exposed One-Step's business to competition it would not otherwise have had, resulting in a loss of profits and possibly good will. Accordingly One-Step had suffered pecuniary loss which although difficult to quantify was a familiar type of loss which could be compensated by the ordinary measure of damages for breach of contract. Therefore, "negotiating damages" were unavailable.
- Although not a question on appeal, the Supreme Court recognised that the breach of confidence provisions, considered in isolation, might have given rise to "negotiating damages". But on the facts

of the case, One-Step's loss was the result of breaches of a number of provisions, of which others (i.e. the non-complete and non-solicitation covenants) were more significant.

Following the majority's view "negotiating damages" are available where the loss suffered can be appropriately measured by the economic value of the right breached, considered as an asset. Where that right has purely financial consequences, it appears that "negotiating damages" will not be available regardless of the difficulty of quantifying the loss suffered.

[1] See Lord Reed at [95(10)]

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