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Morris-Garner v One Step: Limiting the Scope of Gain-Based Damages

It is rare even for a Supreme Court case to provide a judgment as consequential as this one, finally bringing clarity to issues first raised by *Wrotham Park* in 1973,¹ imposing much-needed structure on the nature and availability of negotiating damages for breach of contract, and confining *Attorney General v Blake* as a wholly distinct form of award.² In a field of confused terminology, Lord Reed adopted the nomenclature “negotiating damages” for *Wrotham Park* damages.³ That term will be used hereafter.

A. LEGAL BACKGROUND

The orthodox legal position on damages for breach of contract in Scots law is that they are a substitute for performance. Their purpose, where specific implement is not possible, is to put an aggrieved party in the position he or she would have been in had the contract not been broken. Damages therefore look to the pursuer’s loss not the defender’s gain, with the classic formulation of the measure of compensatory damages found in *Robinson v Harman*.⁴ Then in 1973 came the *Wrotham Park* decision. In this case, a developer had built on land in breach of a restrictive covenant. The court declined to issue an injunction requiring the demolition of the houses so, citing Lord Cairns’ Act (now section 50 of the Senior Courts Act 1981) and notwithstanding the absence of any material loss, Lord Brightman made an award of damages as a “just substitute” in lieu of an injunction, assessed on the basis of a hypothetical release fee amounting to 5% of the profits made by the developer, a sum the court reckoned the developer might reasonably have demanded to have the covenant relaxed.⁵

A line of cases followed, all concerning either tortious interference with property rights or breach of restrictive covenants where no pecuniary loss occurred, in which damages were awarded in lieu of an injunction and assessed on the *Wrotham Park* basis.⁶ This line of cases, however,

¹ *Wrotham Park Estate v Parkside Homes* [1974] 1 WLR 798 Ch.

² *Attorney General v Blake* [2001] 1 AC 268.

³ *Morris-Garner v One Step* [2018] UKSC 20, para 3.

⁴ *Robinson v Harman* [1848] 1 Ex Rep 850; the same principle was articulated in Scotland in *Houldsworth v Brand’s Trs* [1877] 4 R 369 at 374 and 375, and *Govan Rope and Sail Co Ltd v Weir & Co* [1897] 24 R 368 at 370-371.

⁵ *Wrotham Park* 815

⁶ See Lord Reed’s assessment, *Morris-Garner* [2018], para 57-61.

revealed inconsistency in courts' understanding of the character of such damages. Thus, in the Court of Appeal case of *Surrey County Council v Bredero Homes*, Steyn LJ stated that, in his view, *Wrotham Park* damages were restitutionary in nature,⁷ an analysis subsequently rejected by Sir Thomas Bingham MR who, in *Jaggard v Sawyer*, asserted that he could not construe the damages in *Wrotham Park* as based on anything other than compensatory principles.⁸ On 27 July 2000, the House of Lords delivered its judgment in *Attorney General v Blake* and, in the process, rehabilitated the idea that *Wrotham Park* could be relevant in a breach of contract case. The ruling in this highly unusual case – where an account of profits was awarded to the Crown for breach of contract by the notorious traitor George Blake despite the absence of any financial loss – was by any measure inconsistent with the orthodox legal understanding of damages for breach of contract as compensation for the claimant's loss. In delivering the leading speech, Nicholls LJ stated that awards of this kind could be made in exceptional circumstances and where the plaintiff has a "legitimate interest" in depriving the defendant of his profit.

It was in attempting to show that, in some circumstances, an account of profits was available for breach of contract that Lord Nicholls discussed the *Wrotham Park* line of cases as instances where the need for a compensatory measure of damages had been disregarded.⁹ He concluded that cases existed where the claimant's interest in performance was not easily measurable in monetary terms. In these instances, damages measured by financial loss may be an inadequate remedy and so, in suitable cases, damages could instead be measured by the defendant's gain rather than the claimant's loss. The decision indicated that *Wrotham Park* damages, now conceptualised as gain-based, would be available more widely than before based upon the new *Blake* principle and as an alternative to normal (compensatory) damages in breach of contract cases where ordinary damages might not be a sufficient remedy. However the attempt to draw a connecting line between *Wrotham Park* and an account of profits left many unanswered questions to be resolved by subsequent case law.

Following *Blake*, the citation of *Wrotham Park* became more common in judgments and negotiating damages were treated as available at common law in cases of breach of contract.¹⁰ The single most important case in this new line was *Experience Hendrix*, in which Mance LJ described *Blake* as marking "a new start in this area of law."¹¹ The hypothetical release fee awarded in *Wrotham Park* and an account of profits of the sort awarded in *Blake* were treated as different points

⁷ *Surrey County Council v Bredero Homes* [1993] 1 WLR 1361, at 1369.

⁸ *Jaggard v Sawyer* [1995] 1 WLR 269, at 281; see also Millett LJ at 291.

⁹ *AG v Blake*, 282-3; Lord Hobhouse differed by regarding *Wrotham Park* damages as compensatory in his dissent in *Blake*.

¹⁰ eg *Veroe v Rutland Fund Management* [2010] EWHC 424 (Ch).

¹¹ *Experience Hendrix v PPX Enterprises* [2003] EWCA Civ 323, para 16.

along the same continuum, respectively a partial and total disgorgement of profits.¹² In the same case, Peter Gibson LJ stated that gain-based damages for breach of contract were available because of three factors: the deliberate nature of the breach; the difficulty in establishing the loss arising from the breach; and the claimant's legitimate interest in preventing the contract breaker from profiting.¹³ In *Marathon Asset Management v Sneddon*, Leggatt J articulated the new test for gain-based damages as being whether they were "a just response" (reflecting Lord Nicholls' approach in *Blake*) in situations where compensatory damages were inadequate redress for the wrong done.¹⁴ One of the most significant ideas to emerge from the line of cases following *Blake*, and illustrated by the present case, was the belief that damages assessed on the basis of a hypothetical release fee were available at the election of the aggrieved party in situations where identifying or quantifying a loss would be difficult.

On the basis of this line of cases, it seemed that there was emerging a new doctrine of gain-based damages with a test of whether or not such an award constituted, in the judge's mind, a "just response" to the wrong constituted by the breach. The tension between this approach and the orthodox understanding of damages for breach of contract as compensatory meant that it was only a matter of time before the Supreme Court was required to address the point.

B. THE FACTS

In 1999, the appellants, Morris-Garner, sold a business to the respondents, One Step Ltd, and entered into a three-year covenant not to compete with or solicit clients from them. In breach of this covenant, they subsequently established a new company in direct competition to the respondent who then brought proceedings.¹⁵ At first instance the appellants were found to have breached the non-compete and non-solicitation covenants and the claimants asserted that, in view of the difficulty of quantifying their loss, the usual remedy of compensatory damages would not do justice and that an account of profits was appropriate.¹⁶ This was rejected by the judge, Phillips J, who decided instead that, because of the difficulty One Step would have had in identifying their financial loss, this was "a prime example of a case in which *Wrotham Park* damages should be and are available."¹⁷ The sum awarded was "the amount which might reasonably have been demanded...for releasing the defendants from their covenants." Phillips J concluded his judgment with the observation that the claimants were entitled to elect between ordinary (compensatory) damages and

¹² Paras 36-37 and 44.

¹³ *Experience Hendrix* [2003], para 58.

¹⁴ *Marathon Asset Management v Sneddon* [2017] EWHC 300 (Comm), para 215.

¹⁵ *One Step v Morris-Garner* [2014] EWHC 2213 (QB).

¹⁶ Paras 99-100.

¹⁷ Para 106.

Wrotham Park damages.¹⁸ This decision was upheld by the Court of Appeal, closely following the criteria set down in *Experience Hendrix*, on the basis that it was a “just response” available at the discretion of the judge.¹⁹ A further appeal on the question of damages was then made to the Supreme Court.

C. THE DECISION

Lord Reed (with whom Lady Hale and Lords Wilson and Carnwath agreed) gave the leading judgment, which stands out for its detailed analysis of the doctrines articulated in *Wrotham Park* and their subsequent application. Lord Sumption gave a separate judgment upholding the appeal for slightly different reasons while Lord Carnwath also gave a separate judgment articulating his preference for Lord Reed’s reasoning over that of Lord Sumption. Due to limitations of space, neither of these judgments can be discussed here.

The key element of Lord Reed’s judgment is his discussion of the development and application of negotiating damages beginning with *Wrotham Park* itself. The *Wrotham Park* line of cases is split by Lord Reed into two discrete phases: during the initial phase, equitable damages were awarded in accordance with Lord Cairns’ Act based on a notional release fee in substitution for an injunction. Every reported case in this initial phase concerned tortious interference with property rights or the breach of a restrictive covenant over land with damages assessed at the amount the court reckoned might reasonably have been demanded for the voluntary relinquishment of the right which the court had declined to enforce.²⁰ The second phase began with *Blake* and involved the award at common law of damages calculated in a similar way though “on a wider and less certain basis.” It was *Blake* “in which the wider availability of such awards was signalled, but the seeds of uncertainty were sown.”²¹ Yet, as Lord Reed highlighted, negotiating damages were never sought in *Blake* and therefore lie outside the scope of its reasoning.²²

Discussing the key case of *Experience Hendrix*, Lord Reed concluded that the decision reached in that case could be supported purely on an orthodox (compensatory) basis and accordingly the following parts of the court’s reasoning had to be rejected: that difficulty in quantifying loss makes it unnecessary to identify such loss; that it is relevant to an award of damages that the breach of contract was deliberate; that it is relevant to an award of damages that the claimant has a legitimate interest in preventing activity carried out in breach of contract; and that damages for breach of contract and an account of profit are “similar remedies at different points

¹⁸ Para 108.

¹⁹ *Morris-Garner v One Step* [2016] EWCA Civ 180, para 121.

²⁰ *Morris-Garner*, para 61.

²¹ Para 48.

²² Para 82.

along a continuum.”²³ Lord Reed similarly rejected the contention of Lord Nicholls in *Blake* that user damages (that is, damages given for the unlawful use of another’s property) were not compensatory in nature.²⁴

The assessment of damages by reference to an imaginary negotiation is, in Lord Reed’s view, entirely consistent with the orthodox understanding of damages as compensatory.²⁵ Since they are not gain-based, there existed no right on the part of claimants to elect this form of damages; nor were gain-based damages available at the judge’s discretion as a “just response” where loss was difficult to identify or quantify. In certain limited circumstances, the loss sustained by the pursuer is the economic value of a right that has been breached, as for example where the breach concerns a restrictive covenant over land, a confidentiality agreement or intellectual property. In such instances, “[t]he defendant has taken something for nothing, for which the claimant was entitled to require payment”; ergo the pursuer’s loss can be measured by determining the value of this right considered as an asset.²⁶ This is true of only some contractual rights, particularly those governing the use of land, intellectual property or confidential information, but not all.²⁷ From this line of reasoning, Lord Reed concludes that there are only four situations in which negotiating damages are available: damages assessed by the value of a use wrongfully made of property (“user damages”) are available at common law in a small number of established categories for invasion of rights to corporeal movable or immovable property by detinue, conversion or trespass;²⁸ damages are available on a similar basis for breaches of intellectual property rights;²⁹ damages can be given under Lord Cairns’ Act in substitution for an injunction based on the value of the right which the court has refused to enforce;³⁰ and, in breach of contract cases, negotiating damages will be available only where the loss suffered is represented by the value of an asset of which the aggrieved party has been deprived, such as the right to control the use of land or intellectual property or a confidentiality agreement.³¹

Applying these findings to the present case, the court found that the judge at first instance had erred in assuming that the claimant had a right to elect how its damages would be assessed purely because loss was difficult to prove. No such election can be made, because the normal compensatory rules of damages apply and loss must always be established in order for a claim to be available. The court had gone further awry in supposing that the difficulty of quantifying the

²³ Para 90.

²⁴ Para 66.

²⁵ Para 91.

²⁶ Para 92.

²⁷ Para 93.

²⁸ Para 95(1).

²⁹ Para 95(2).

³⁰ Para 95(3).

³¹ Para 95(10).

financial loss justified the abandonment of any attempt to quantify it. The Court of Appeal had been mistaken in treating the egregiousness of the defendants' breach as justification for a non-compensatory award and, further, in contending that damages based on a notional release fee were available at the judge's discretion as a just response.³²

D. CONCLUSION

While this judgment does not overrule the *Blake* line of cases, the contexts in which negotiating damages may be awarded have been strictly limited and the door, for the time being, has been decisively closed on a gain-based approach.

There have been those, both in academia and in practice, who welcomed the *Blake* judgment, seeing it as a step towards a new and useful doctrine in English law whereby damages could be measured by reference to the contract-breaker's profits, something which would encourage adherence to agreements and offer enhanced protection where parties' interest in performance was not purely economic. From Lord Reed's analysis, we now have a clearly articulated legal foundation for the assertion that the *Wrotham Park* line of cases was always on all fours with the established principles of compensatory damages. *Blake*, meanwhile, is now seen to have been a case *sui generis*, something unique or very nearly so, and based on principles distinct from the general rules of damages.³³ Provided with this opportunity to address the development of gain-based awards, the Supreme Court has opted for the more conservative approach reasserting the exclusively compensatory nature of damages for breach of contract and sharply circumscribing the situations in which negotiating damages may be awarded.

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³² Paras 96-97.

³³ Cf para 82.