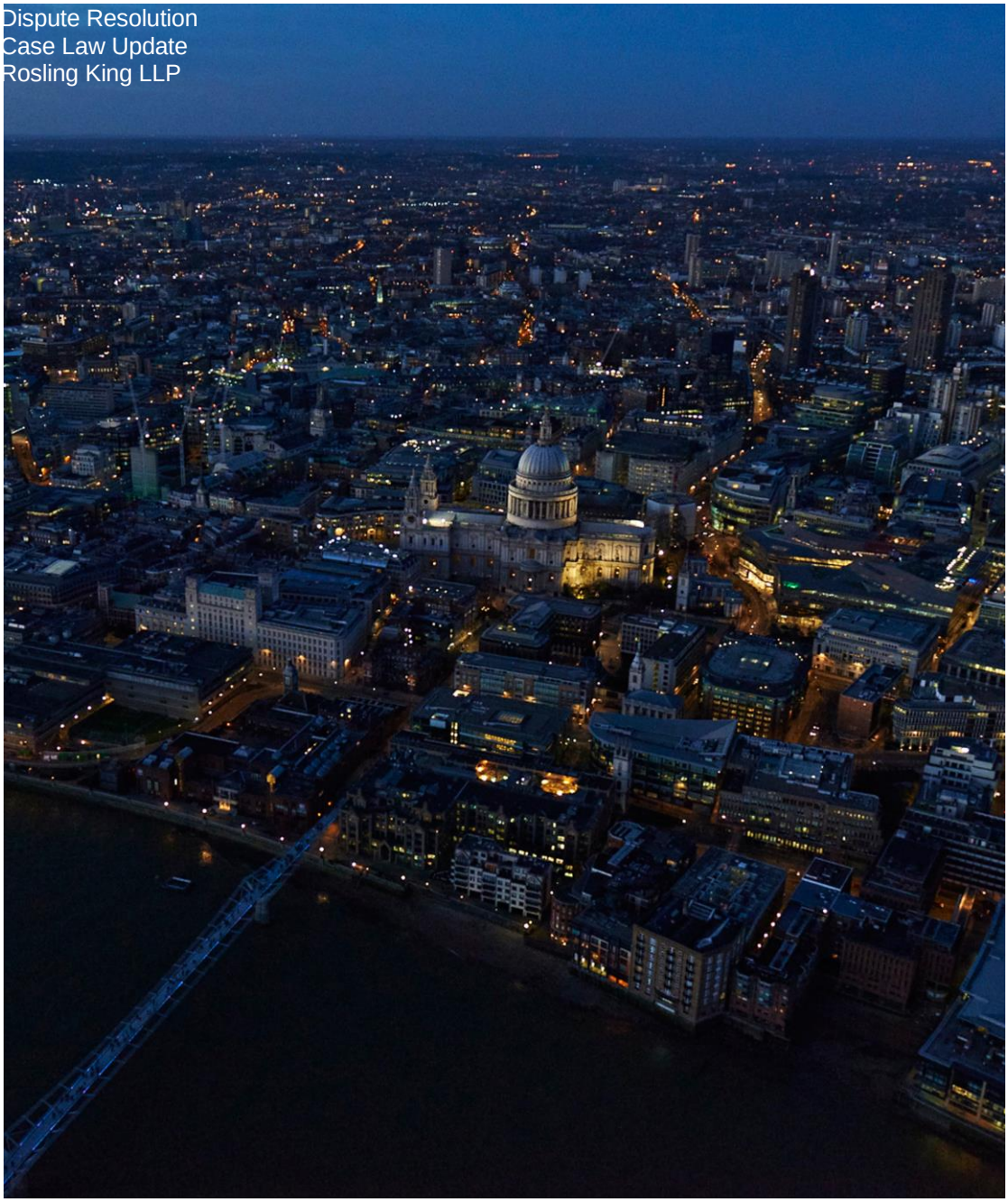
Dispute Resolution
Case Law Update
Rosling King LLP



The Facts

In 1999, the First Defendant ("**A**") established a business providing support for young people leaving care. In 2002, A agreed to sell a 50% interest to Mr Costelloe ("**Mr C**") and Mrs Costelloe ("**Mrs C**"). The Claimant, One Step (Support) Ltd ("**One Step**") was incorporated as a vehicle for the transaction. A and Mrs C each subscribed for 50% of the issued share capital of One Step and were appointed as directors. They entered into a shareholders agreement, which included a provision enabling each of them to serve notice on the other in the event of a deadlock, either to buy the shares of the director serving notice at a specified price,or to sell their own shares at the same price.

A and Mr C ran the business and the Second Defendant ("**B**") performed a managerial role. Over the years, the working relationship between A and Mr C deteriorated. In May 2006, Mrs C gave notice of her intention to serve a deadlock notice. In July 2006, A and B incorporated another company and were the only shareholders, Positive Living Ltd ("**Positive Living**"). In August 2006, Mrs C served a deadlock notice under which A opted for Mrs C to buy A's shares.

In December 2006, a buy-out agreement was signed whereby A sold her shares to Mrs C for £3.15m, resigned as Director, and agreed to be bound for 3 years by non-compete and non-solicitation covenants. As part of the same transaction, B terminated her employment with One Step and agreed to be bound by the same covenants.

In August 2007, Positive Living began trading in direct competition with One Step. In 2008, One Step experienced a significant downturn and wrote to Positive Living to ensure compliance with the covenants but the matter was not pursued. In December 2009, the 3 year period specified in the covenants expired and in September 2010, A and B sold their shares in Positive Living for £12.8m.

In July 2012, One Step brought the present proceedings against A and B, alleging breach of covenant. One Step sought damages on two grounds. Firstly, under normal damages principles for an account of profits, or secondly and alternatively, on a 'negotiating damages' basis, in such a sum as One Step, hypothetically, may have reasonably demanded for releasing the Defendants from their covenants.

First Instance and Court of Appeal

The Trial Judge found the Defendants had acted in breach of covenant. However, he did not order a remedy in the form of an account of profits, instead he said this was a prime example of where 'negotiating damages' were, and should, be available. In his judgment, he supposed that the difficulty of quantifying the loss justified the abandonment of any attempt to quantify it. He therefore ordered for damages to be assessed by such an amount as might reasonably have been demanded in 2007 for releasing the Defendants from the covenants. An appeal was dismissed with the Court of Appeal agreeing with the decision at first instance.

Supreme Court Decision

The question the Supreme Court had to consider was - where a defendant is in breach of contract, what, if any, circumstances is a claimant entitled to seek 'negotiating damages' (damages assessed by a hypothetical negotiation between the parties as to what a claimant could reasonably have charged for releasing a defendant from the obligation which he failed to perform)?

Lord Reed gave the majority judgment and overturned the decisions of the lower courts, and in doing so restricted the circumstances in which negotiating damages were recoverable for breach of contract.

He stated that it was neither sufficient nor relevant that just because the damages were difficult or impracticable to quantify, that 'negotiating damages' were appropriate. The test as to where 'negotiating damages' were appropriate should be limited to circumstances "'where loss suffered by the claimant is appropriately measured by reference to the economic value of the right which has been breached, considered as an asset". This will be the case where the breach of contract results in the loss of a valuable asset created or protected by the right which was infringed, such as breach of a restrictive covenant over land, IP agreement or a confidentiality agreement. In this instance, the breach of the non-compete covenant did not satisfy the test.

Lord Reed stated that the present case was brought by a commercial entity whose only interest in the Defendants' performance of their obligations under the covenants was commercial. The basis of One Step's claim was that it had suffered financial loss as a result of the breaches of covenants, which exposed One Step to competition it would otherwise have avoided. The natural result was therefore a loss of profits. Lord Reed conceded that the loss would be difficult to quantify and some elements may be incapable of measurement. However, the type of loss was nevertheless familiar and should be dealt with under normal principles and not on a 'negotiating damages' basis.

Commentary

This case is a useful reminder of the approach the Courts will take when it comes to calculating damages.

For further information, please contact Georgina Squire or the Partner with whom you usually deal.