SHERIFF APPEAL COURT

[2019] SAC (Civ) 26
GLW-CA119-15

Sheriff Principal Pyle
Sheriff Principal Murray
Appeal Sheriff Murphy QC

OPINION OF THE COURT

delivered by SHERIFF PRINCIPAL PYLE

in an appeal in the cause

SMITH & FRATER LIMITED

Pursuers and Respondents

against

DAVID FRATER

Defender and Appellant

Defender and Appellant: Fairley QC, Sanders, advocate; BTO Solicitors LLP
Pursuers and Respondents: Roxburgh, advocate; Morisons LLP

4 June 2019

Introduction

[1] This appeal concerns the application of the well-known rules on causation and mitigation of loss for damages claimed for the breach of a restrictive covenant in an employment contract which followed upon the sale of a limited company.

The Facts

[2] As will be seen, there was some discussion about the exact terms of some of the sheriff's findings in fact, but the primary facts were not disputed. For present purposes these can be described as follows:

1. The appellant and a Mr Ian Smith owned the whole issued share capital of the respondents whose business was the merchandising of building products and the manufacture of doors and kitchens.

2. In May 2008 the entire shareholding was sold to the Rowan Group. The appellant continued in employment with the respondents, entering into a new contract of employment. The contract contained restrictive covenants which, read short, provided that for a period of 12 months after termination of employment the appellant would not directly or indirectly hold any material interest in any business which was or would be in competition with the respondents' commercial activities and would not directly or indirectly solicit or entice away or seek to entice away from the respondents any person who was in their employment as a director, senior manager or sales person.

3. After the sale of the business the respondents decided to diversify into the kitchen studio business and for that purpose recruited in June 2011 a Mr Gordon Mitchell because of his experience in that business. Prior to that – in May 2010 – the respondents recruited a Mr Graeme Bell. In February 2011 he was promoted to the position of Operations Manager for the respondents' kitchen factory. Mr Mitchell reported to Mr Bell. The sheriff found in fact that the kitchen manufacturing business was integral to the respondents' existence and success and that both Mr Bell and Mr Mitchell were key employees.

4. In or about April 2012 the appellant took steps to set up a business with a Mr Gordon Chalmers who was at the time the respondents' sales director. For reasons related to that, Mr Chalmers was dismissed in May 2012. The appellant's employment also ceased – at the end of that month.

5. In breach of the restrictive covenant, the appellant took steps to secure the employment of Mr Mitchell and Mr Bell within the new business. On more than one occasion the appellant enquired whether Mr Bell would be willing to join the new business. Mr Bell refused. In June 2012 Mr Mitchell received a formal offer of employment at a salary of £40,000, subsequently increased to £45,000. He told the respondents about the offer and said that he would have to accept it unless they were willing to match the salary. The respondents subsequently agreed to do so. At the same time they increased Mr Bell's salary to £50,000.

It is relevant at this point to quote the sheriff's findings in fact on the reasons for the respondents taking these steps [italics added]:

"54 *The pursuers decided that it was vital to retain the services of Mr Bell and Mr Mitchell.*

55. The pursuers agreed to match the salary offered by the defender's new company; Mr Mitchell's salary was increased to £45,000 per annum.

56. *The pursuers decided it was important to retain the differential in salaries between Mr Bell and Mr Mitchell following the increase they agreed to give Mr Mitchell.*

57. Mr Bells' salary was increased to £50,000 per annum as a result; the breakdown was £45,000 salary and a guaranteed bonus of £5,000."

Also of particular relevance are eight of the sheriff's findings in fact and law:

"68. The defender's solicitation of Gordon Mitchell and Graeme Bell and his attempt to entice them away from the pursuers' employment constitutes *a breach* [italics added] of his contract of employment with the pursuers…

69. It was reasonably foreseeable at the time parties entered into the contract that any breach by the defender might cause loss of business to the pursuers.

> 70. The pursuers reasonably estimated that the loss of Mr Bell and Mr Mitchell as employees could cost the pursuers £350,000 to £400,000 each year in lost sales; they mitigated that loss by increasing their salaries so as to retain their services.
>
> 71. It was reasonably foreseeable at the time parties entered into the contract that the pursuers would make efforts to retain the services of any employees solicited by the defender in breach of his contract.
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> 72. The pursuers' response was a reasonable adoption of remedial measures designed to limit the loss to their business.
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> 73. The pursuers are entitled to recover reasonable expenses incurred in mitigating their loss.
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> 74. The pursuers would not have increased the salaries of the two employees had it not been for the defender's breach.
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> 75. The loss suffered by the pursuers as a result of the defender's breach of contract is the increased cost of the mitigation undertaken by them."

The sheriff calculated the respondents' loss on the basis that as each employee had had his salary increased by £10,000 it would take until 2027 for the salary to be increased by that sum. From the sum of that calculation were deducted tax savings and a net present value discount percentage rate. That produced a final sum in damages of £294,997, which was effectively calculable as 50% thereof for the solicitation of each of the two employees. The appellant does not dispute that calculation.

Appellant's Submissions

[3] Senior Counsel for the appellant submitted that despite the sheriff's finding in fact and law (no. 68 *supra*) that there was one breach of contract there were in fact two: the offer of employment to Mr Mitchell and the solicitation of Mr Bell. The appellant did not criticise the sheriff's approach to the Mitchell breach, but the sheriff made no findings in fact in respect of Mr Bell which would entitle her to conclude that the loss in respect of his increase

in salary was a natural and probable consequence of the solicitations towards him. In the Record the respondents aver (Article 5 of Condescendence; p6 of the Appeal Print) that Mr Bell was "at risk of leaving the Pursuers' employment", but the sheriff made no finding in fact which even reached that low bar of just a possibility. The sheriff made no findings that Mr Bell ever asked for a salary increase, ever threatened to leave or even considered doing so (either in consequence of the solicitations or as a reaction to news of the salary increase for Mr Mitchell) or, crucially, that Mr Bell's decision to remain was in any way causally connected to the respondents' decision to increase Mr Mitchell's salary. The law required not only that a particular loss was within the reasonable contemplation of the parties but also that there was a causal connection between the breach and the loss. Causation has to be considered separately from and ahead of issues of remoteness of loss or indeed mitigation of loss (*Galoo Limited* v *Bright Grahame Murray* [1994] 1 WLR 1360 (at p1370); *Quinn* v *Burch Brothers (Builders) Limited* [1966] 2 QB 370 (at p390); *Chitty on Contracts* (33rd edition) para 26-066). The sheriff's approach seemed to be to consider the only issue as one of whether the actions by the respondents in respect of Mr Bell were reasonable steps in mitigation of their loss. That was to ignore the requirements of the law to prove causation and remoteness, particularly the former. If it is accepted that the loss in respect of Mr Bell flows from the breach in respect of Mr Mitchell, the sheriff's findings in fact are insufficient in that while there is a finding in fact (no. 56) that the respondents decided that it was important to retain the differential in salaries between Mr Bell and Mr Mitchell following the increase they agreed to give Mr Mitchell, there was no finding as to why they reached that conclusion.

Respondents' Submissions

[4] Junior counsel for the respondents submitted that there were two breaches of contract, but that the loss which was claimed for the salary increase for Mr Bell flowed from the breach in respect of Mr Mitchell. The relevance of the solicitations to Mr Bell was only as part of the factual matrix. The respondents had a duty to take reasonable steps to mitigate their loss. The salary increase for Mr Bell was a reasonable step for the respondents to take faced with the appellant's breach in respect of Mr Mitchell, the measures taken "not to be weighed in nice scales at the instance of the party whose breach of contract has occasioned the difficulty" (*Banco de Portugal* v *Waterlow & Sons Ltd* [1932] AC 452, at p506).

Decision

[5] We agree with senior counsel for the appellant that if the loss in respect of the salary increase for Mr Bell arose solely from that breach there would be insufficient findings in fact to establish the causal connection between the breach and the loss. Indeed, we did not understand counsel for the respondents seriously to dispute that. In our view, however, the correct analysis is that the loss both in respect of Mr Mitchell and Mr Bell flow from the offer of employment to Mr Mitchell. If, as the appellant now accepts, it was within the reasonable contemplation of the parties when entering into their employment contract that his breach might cause loss of business to the respondents and in that event it was a reasonable step in mitigation of that loss that they increase Mr Mitchell's salary, it follows that any further steps the respondents decide to take pass the causation test, albeit always subject to them being reasonable steps to take in mitigation of such loss. The sheriff found in fact (no. 70) that the respondents reasonably estimated that the loss of Mr Bell *and* Mr Mitchell as employees could cost the pursuers £350,000 to £400,000 each year in lost sales. The loss of

both employees was inextricably linked. The appellant does not dispute that finding. The sheriff described it thus (para [51] of her note):

> "In fact [the respondents] averted that loss entirely by retaining the services of the two employees whom I am satisfied on the evidence were key to the success of their kitchen manufacturing division. The course taken to protect the business was one which a reasonable and prudent person might have taken in the ordinary course of business. [*British Westinghouse Electric and Manufacturing Co* v *Underground Electric Ry Co of London* [1912] AC 673] That allows the court to look at the whole facts in ascertaining the quantum of damages. In Viscount Haldane's words, the facts are allowed to speak for themselves. [*Ibid* p 690]"

We cannot fault that reasoning. It also implicitly gives a reason for the respondents considering it important to increase both salaries.

[6] The appeal falls to be refused. Expenses follow success and we find both the proof before the sheriff and the appeal suitable for the employment of junior counsel.