The Canadian Design-Build Institute’s (CDBI) Risk Management Committee is pleased to provide this risk management article for the members of CDBI. The following article addresses the risks and issues associated with contract management and outlines some key details when a breach of contract occurs.

The Risk Management Committee of the Canadian Design Build Institute will continue to circulate articles of this nature to members as they become available. We trust this will be found to be of interest and beneficial to the members.

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**The Minimum Performance Principle and The Calculation of Damages for Breach of Contract**

By Paul V. Stocco, Partner Brownlee LLP and Heather Cave, Student-at-Law, Brownlee LLP

In breach of contract cases, one of the key legal issues is calculation of damages suffered by the non-defaulting party. The typical rule is that damages are awarded so as to give the non-defaulting party the benefit that it would have enjoyed from the contract had the contract been fully performed. Contracts sometimes contain limitation of liability clauses that restrict and clarify the types and amounts of damages that can be claimed by and awarded to a non-defaulting party. However, there are also instances where the calculation of damages is less clear. For example, when there are alternative ways of performing the contract at issue, and where the alternative ways of contractual performance give rise to different damages calculations, a Court will choose the scenario that is least profitable to the non-defaulting party and least burdensome to the defaulting party. This is known as the “minimum performance principle”, and this principle has been recognized since the Supreme Court of Canada’s decision in *Hamilton v Open Window Bakery*. In the recent decision in the case of *Atos IT Solutions and Services GMBH v Sapient Canada Inc.*, the Ontario Court of Appeal confirmed that this principle is alive and well.

The *Atos* case involved a contractual dispute between a prime contractor, namely Sapient Canada Inc. (“Sapient”) and its subcontractor Atos. Sapient was contracted by Enbridge Gas Distribution Inc. to replace its existing software systems. In turn, Sapient subcontract Atos to perform two different types of services in relation to this project: (i) data conversion (“DC”) services, and (ii) application management support (“AMS”) services.

The completion of the work was delayed, and Sapient terminated its subcontract with Atos for cause. Atos disputed the termination. In its action against Sapient, Atos claimed damages for loss of profits. The trial judge determined that the contract had been wrongfully terminated and awarded damages in favour of Atos. On appeal, Sapient challenged the damages.
The subcontract at issue included two different termination provisions. Under the first clause (i.e. the “DC Termination Provision”), Sapient had a right to terminate the DC services “for convenience”. Under this clause, damages for termination of the DC services for convenience would be calculated on the basis of a specific formula. By contrast, the second termination clause allowed Sapient to terminate the entire subcontract “for cause”. Under this second termination clause, damages were calculated differently than under the first termination clause.

Given that Sapient had terminated the subcontract “for cause”, the trial judge held that the damages calculation under the DC Termination Provision (i.e. the termination “for convenience” clause), did not apply. As a result, the damages award for the termination of the subcontract was greater than it would have been had the DC Termination Provision damages formula applied.

In its appeal of the damages award, Sapient argued that under the “minimum performance principle”, it didn’t matter which termination clause was relied on. Sapient argued that the minimum performance principle dictated that the less onerous “for convenience” formula should have been applied. The Court of Appeal agreed.

As the Court of Appeal explained, the basic principle underlying damages for breach of contract is that damages are compensatory. The defaulting party is only required to pay damages in an amount that puts the non-defaulting party in the position it would have been in had the contract been fully performed. Put another way, damages are designed to give the non-defaulting party the benefit that it was expecting from the contract.

However, where the defaulting party has more than one option as to how it might have chosen to perform the contract, damages are assessed on the assumption that the defaulting party would have chosen the option that is least onerous to it rather than the option that is most beneficial/most profitable to the non-defaulting party. If, for example, a contract required a party to supply goods in an amount ranging from 800-1200 tonnes, the minimum performance principle holds that damages for breach of that contract would be assessed on the basis that only 800 tonnes would have been supplied.

The Court of Appeal also held that it was immaterial that Sapient had terminated the subcontract in bad faith¹. Breaches of a contractual duty of good faith do not affect the principle that damages must be measured in accordance with the minimum performance principle. Even where a defaulting party is found to have acted in bad faith in its termination of a contract, a non-defaulting party cannot recover more than what it would have been entitled to had the defaulting party only complied with its least onerous requirements under the contract.

As a result of the decision in Atos, parties entering into contracts should bear in mind that if they want to secure for themselves a particular method of performance, and if they want to avoid the application

¹ The Court of Appeal discussed the recent Supreme Court of Canada decision in Bhasin. The Court of Appeal held that although the Bhasin decision recognized the organizing principle of good faith contractual performance and a common law duty of honest performance of contractual obligations, the Bhasin decision did not supplant the minimum performance principle and its application to the calculation of damages.
of the minimum performance principle, then the contract must be clear and unequivocal that only one method of performance is contemplated. Otherwise, the minimum performance principle is likely to apply to restrict the damages for breach of contract to the least onerous option available to the defaulting party.

The Court in Atos also dealt with a contractual limitation of liability clause. Sapient relied on the clause at issue to argue that it excluded the “loss of profits” claimed by Atos as a result of the termination of the contract. The Court of Appeal undertook a contextual review of the wording of the clause at issue. The Court of Appeal determined that the exclusion did not apply so as to prevent Atos from claiming loss of profits flowing from the termination of the contract.

The Atos decision is relevant for the construction industry for a number of reasons. Firstly, construction contracts typically have alternative modes of performance. For example, a construction contract may have both a “contract time” (e.g. start date and substantial performance date) and a “construction schedule” that aren’t always the same. In the event of a contractual termination by an owner, it is possible that a contractor’s damage claim for loss of profits could be calculated differently depending on whether the construction schedule or the contract time is used. Specifically, if the contractor’s claim for damages, arising from the termination, is for “loss of profits”, that calculation will be affected by the costs (both fixed overheads and variable costs) that would have been incurred by the contractor had it performed the work. Depending on what schedule is used, those costs will vary, and that variation will affect the loss of profit claim. The “minimum performance principle” dictates that the scenario that is least burdensome to the defaulting party and least beneficial to the non-defaulting party will be used.

Secondly, as the limitation of liability clause at issue in Atos is a common one, the Court of Appeal’s decision reminds parties that the wording of any limitation of liability clause should be precise and clearly worded in order for it to be enforceable. Lastly, though much has been written in respect of the Bhasin decision and whether it fundamentally changed contract law, the Court of Appeal confirmed that breaches of a contractual duty of good faith or breaches of a common law duty of honest performance do not impose a higher measure of damages.

Paul Stocco
Partner, Brownlee LLP
Paul V. Stocco is a partner and the head of the Construction Law Team for the Alberta based law firm of Brownlee LLP. Paul’s practice involves providing advice to his clients on issues relating to all aspects of construction contracts including design-build and P3s, and construction procurements involving tenders and RFPs. Paul also represents clients involved in construction litigation at all levels of Courts. Paul is the editor of Brownlee LLP’s Constructive Thinking newsletter and is a member of the Law Society of Alberta and the Law Society of Upper Canada (Ontario). The Construction Law Team at Brownlee LLP practices in conjunction with a number of lawyers at the firm whose practice includes Municipal Litigation and Corporate Commercial Litigation. brownleelaw.com