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RECENT DEVELOPMENTS & TRENDS IN CASE LAW

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Ontario Court of Appeal Affirms the "Minimum Performance Principle" in Calculating Damages for Breach of Contract

In a breach of contract case, the defaulting party may have had alternative ways of performing the contract. This has a direct impact on the Court's assessment of damages.

Since the Supreme Court of Canada's 2004 decision, Hamilton v. *Open Window Bakery*, 2004 SCC 9, Canadian Courts have applied the "minimum performance principle" to calculate damages for breach of contract. The doctrine provides that where the defaulting party has alternative modes of performing an agreement, damages for the breach of contract are calculated based on the mode of performance "least burdensome to the defaulting party and least profitable to the non-breaching party".

A recent decision of the Ontario Court of Appeal, *Atos IT Solutions v. Sapient Canada Inc.*, 2018 ONCA 374, affirms the validity of the minimum performance principle at common law. The decision further affirms that the application of the minimum performance principle by the Courts is not dependent on the parties' bad faith conduct.

Facts

Atos involved an action for breach of an agreement between a prime contractor and a subcontractor in which the subcontractor agreed to provide the prime contractor with two services related to an information software overhaul for Enbridge Gas Distribution (the "Subcontract").

The subcontractor agreed to provide data conversion services ("DC Services") to the prime contractor, as well as application management support services ("AMS") to Enbridge.

The Subcontract included two rights of termination. The prime contractor could terminate the agreement for cause by providing the subcontractor with notice in particular circumstances, including where the subcontractor "commits a material breach of its obligations under this Agreement and such breach is not capable of being cured" (the "General Termination Provision").

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The prime contractor also had a limited right to terminate the DC Services part of the Subcontract for "convenience" (the "DC Termination Provision").

The prime contractor relied on the General Termination Provision to terminate the Subcontract, effective immediately. The subcontractor sued the prime contractor for breach of contract.

At trial, the prime contractor argued that even though it had invoked the General Termination Provision to terminate the contract, damages should be calculated according to the DC Termination Provision, based on the minimum performance principle.

That is, the prime contractor was entitled to the "benefit of the less burdensome mode of performance of the Subcontract offered by the [DC Termination Provision]".

The trial judge rejected the application of the minimum performance principle, holding that the prime contractor relied on the General Termination Provision to terminate the contract and that it always intended to terminate the whole contract and not just the DC aspects of the Subcontract.

Accordingly, the DC Termination Provision was not "an alternative mode of performance permitting [the prime contractor] to terminate the entire Subcontract". The DC Termination Provision only entitled the prime contractor to terminate the DC services part of the Subcontract, not the AMS services portion.

Since the prime contractor intended to terminate the whole of the Subcontract, not just the DC services portion, it could not have damages for its termination of the DC services calculated using the less burdensome formula set out in the DC Termination Provision. The minimum performance principle did not apply.

The prime contractor appealed this ruling and sought a reduction of damages by the Court of Appeal.

The Court of Appeal, amongst other things, reversed this aspect of the trial judge's decision and reduced the prime contractor's damages accordingly.

What is the "Minimum Performance Principle"?

Relying on *Open Window Bakery*, the Court of Appeal noted that damages for breach of contract are intended to be compensatory. In addition, the "expectancy principle" provides that the defaulting party must pay damages that will "provide the non-breaching party with the financial equivalent of performance".

However, the expectancy principle may be limited by the minimum performance principle, which assesses damages for breach of contract "by reference to the promisor's minimum or least extensive performance".

Citing the English Court of Appeal in *Withers v. General Theatre Corp.*, [1933] 2 K.B. 536, the Court explained the minimum performance principle as follows:

> …If a vendor agreed to sell a purchaser 800 to 1200 tons of a certain commodity but failed to deliver any amount, the court would assess damages on the basis the vendor had failed to supply the lower amount—800 tons—not on the basis of a failure to supply the higher amount of 1200 tons.

In *Atos*, the Court of Appeal held that the trial judge erred in failing to apply the minimum performance principle when assessing damages for the prime contractor's termination of the contract.

In the Court of Appeal's view, the DC Termination Provision only defined the upper limit of the prime contractor's liability for damages in respect of the DC services. On the language of the Subcontract, it was open to the prime contractor to use the DC Termination Provision to terminate the DC services part of the Subcontract, while relying on the General

Termination Provision to terminate the rest of the Subcontract.

The minimum performance principle applied to the calculation of damages for the termination of the DC services because the alternative mode of performance included in the DC Termination Provision "shaped and constrained [the subcontractor's] reasonable expectations concerning the damages it could recover in the event [the prime contractor] terminated the DC services".

The Minimum Performance Principle Does not Depend on the Parties' Bad Faith Conduct

The subcontractor argued that, in view of the Supreme Court of Canada's emphasis on good faith conduct and honest contractual performance as set out in its 2014 decision *Bhasin v. Hrynew*, 2014 SCC 71, the minimum performance principle did not apply because of the prime contractor's bad faith conduct in breaching the Subcontract. Accordingly, the prime contractor could not take advantage of the less burdensome damages calculation formula set out in the DC Termination Provision.

The Court of Appeal rejected the subcontractor's position.

The Court noted that while the trial judge held that the prime contractor did not act in good faith in terminating the Subcontract, he never held that the lack of good faith barred the application of the minimum performance principle.

Moreover, the Court of Appeal held that the *Bhasin* decision suggests that the organizing principle of good faith is not necessarily incongruous with the minimum performance principle.

In *Bhasin*, the Supreme Court of Canada observed that even if there was a breach of good faith by the defaulting party in that case, the defaulting party's liability "would still have to be measured by reference to the least onerous means of performance".

In view of this comment, the Court of Appeal held that the *Bhasin* decision did not imply that a party's bad faith conduct could preclude the application of the minimum performance principle.

Minimum Performance is Alive and Well in Ontario

The *Atos* decision affirms that the minimum performance principle in calculating damages for breach of contract is alive and well at Ontario common law.

In keeping with the contractual parties' reasonable expectations, the Courts will assess damages in a way that is the least burdensome to the defaulting party where the defaulting party had several ways to perform the contract.

Atos further affirms that the parties' conduct has little to no bearing on the application of the minimum performance principle when assessing damages.