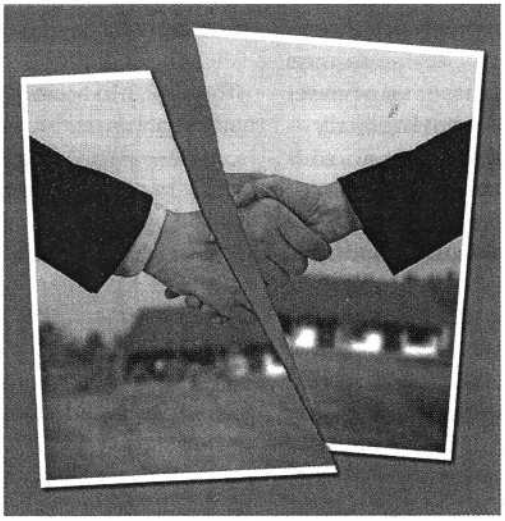
When broken promises cause damage

Options when business deals become breached contracts

What damages can a party recover for breach of a contract, including a technology or supply chain commercial contract?

In Canada, the answer lies in the two-branch rule in the old English case of Hadley v Baxendale. The first branch of the rule states that "the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, ie, according to the usual course of things from such breach of contract itself.



The second branch states that damages may be recovered where such losses "may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it." And where the defendant has knowledge of the particular circumstances of the plaintiff, an award of damages should be in accordance with "the amount of injury that would ordinarily follow from a breach of contract under these special circumstances so known and communicated."

Therefore, while direct losses which are deemed foreseeable, are compensable, indirect damages, which may or may not be foreseeable, depend on the communications between the parties before they entered into the contract, and may not be compensable. To be recoverable, indirect damages must be found to be foreseeable in light of the specific circumstances of a case.

While the general rule in Hadley v Baxendale is relatively simple to state, it is often difficult to apply. Not only must the circumstances surrounding the making of a contract be scrutinized, but the terms—express and implied—of the contract at issue must be carefully analyzed to assist in determining what type and amount of damages, including direct, indirect, compensatory, consequential, incidental, special, punitive, and exemplary, are available under the contract.

Of particular importance are limitation of liability clauses which are used to limit or remove liability for certain types of damages. These clauses are often problematic and are interpreted strictly by courts to limit their effects which can lead to harsh or unjust consequences.

Sometimes, a plaintiff is fortunate and is awarded damages—direct and indirect—without the application of a limitation of liability clause by a court in consequence of a breach of a contract.

In TKM Communications Inc v AT Schindler Communications Inc, the defendant supplied to the plaintiff wireless electronic communications equipment which did not work despite efforts by the plaintiff to re-install the equipment and troubleshoot problems. The plaintiff sued for damages for breach of contract and under the Sale of Goods Act (Ontario) on the grounds that the equipment failed to work in the required manner and that the goods were not reasonably fit for the particular purpose known to the defendant, in breach of the express and implied terms of the contract.

The Ontario Court of Justice (General Division) found that the defendant fundamentally breached the contract because its communication equipment failed to function as contracted.

The court held that the plaintiff had the right to accept the defendant's repudiation of the contract, and to treat the contract as being at an end and to sue the defendant for such "at large" damages as the plaintiff may have sustained.

The court further held that the plaintiff was entitled to be put in the same position as it would have been if the contract had been performed, subject to the obligation of the plaintiff to mitigate its damages, and awarded the plaintiff damages in excess of $60,000, not only for the reimbursement of the purchase price of the goods, but also as reimbursement for:

- The rental expense of equipment used to troubleshoot the problems;
- Costs incurred as a result of the failed project, which the plaintiff was obliged to pay;
- Payment made to a sub-contractor;
- Wages paid to employees of the plaintiff, excluding the president of the company, for work performed on the project.

That's what can and does happen when commercial contracts are broken and the law makes the promisor pay significant damages for failing to keep its promise. MM&D

Marvin Huberman, LLM, is a Toronto lawyer, mediator and arbitrator.
www.marvinhuberman.com