



CBV INSIGHTS

OCTOBER 2022

EXPECTATION DAMAGES VS. RELIANCE DAMAGES

A FINANCIAL EXPERT'S PERSPECTIVE

Ivy Tse, CPA, CA, CBV, CFF, MAcc

Eric Mah, CPA, CBV



CBV INSIGHTS

About Chartered Business Valuators Institute (CBV Institute)

CBV Institute leads the Chartered Business Valuator (CBV) profession – Canada’s only designation dedicated to business valuation since 1971. With CBVs and Students across Canada and around the world, we uphold the highest standards of business valuation practice through education, accreditation and governance of the CBV, for the benefit of the public interest. The integrity of the CBV accreditation is grounded in the rigour of the CBV Program of Studies and upheld by the Membership Qualification Examination and Code of Ethics.

Our Values

Everything we say and do is governed by our Code of Ethics and grounded in the values of integrity and mutual respect, for the benefit of the public interest.

CBV Insights

CBV Insights is a thought leadership periodical published throughout the year, sharing relevant insights on emerging topics of interest to our network and the general public. The opinions expressed by contributing authors in *CBV Insights* periodicals do not necessarily carry the endorsement of CBV Institute.



INTRODUCTION

Selecting an appropriate financial damages approach to use in calculating the losses suffered by a party in a breach of contract dispute is not always a clear-cut exercise. Undoubtedly, counsel and their client on both sides of a dispute have arguments for their view on the quantum of damages suffered. However, the onus is on financial experts to provide an independent and objective view on the quantum of damages. Financial experts in this position often find themselves asking: “What is the actual financial loss as a result of the alleged wrongdoing?” and “Can that loss be reliably calculated and reasonably supported?”

To help answer such questions, we explore two damages approaches that are generally contemplated in a disputed matter - reliance damages and expectation damages.

We first provide a brief overview of the nature of the two types of damages. We then review some judicial decisions which provide guidance in the selection of the appropriate damages approach. Lastly, we provide a list of potential considerations, from the perspective of financial experts, in calculating expectation and reliance damages.

WHAT ARE EXPECTATION DAMAGES?ⁱ

Expectation damages are a common measure of damages for breach of contract. It refers to a plaintiff'sⁱⁱ loss of the revenues they expected to have earned had the contract been performed, less the costs they would have incurred to earn those revenues. The aim of expectation damages is to put the innocent party in the same position as if the contract had been performed.

WHAT ARE RELIANCE DAMAGES?ⁱⁱⁱ

Reliance damages are expenditures incurred by a plaintiff in reliance of a performance of a contract. Although expectation damages are the normal measure for assessing damages for a breach of contract, a claimant may claim reliance damages where it is not possible to calculate what the profits would have been if a contract had been performed. Also known as “wasted expenditures”, the premise of reliance damages is to put the plaintiff in the position they would have been in had the contract never been made.

EXPECTATION VS. RELIANCE DAMAGES - CASE REFERENCES

“Expectation damages are essentially compensatory in that they put the plaintiff in the position he would have been in had the contract been completed. Sometimes these damages are readily calculable; for example, if a purchaser breaches a purchase agreement, the damages are the loss of profits from the sale.” - Dul v. Gatenby, 2019 YKSC 18^{iv}

“In awarding reliance damages, the court recognizes that the injured party has changed its position in reliance on the contract. The court tries to put the injured party in the position it would have been in had it not entered into the contract at all. Thus, reliance damages amount to wasted expenditures - expenses that the injured party incurred in reliance on the contract but would not have incurred had it known that the contract would be or had been breached...”
- PreMD Inc. v. Ogilvy Renault LLP, 2013 ONCA 412^v

RELIANCE DAMAGES ARE LIMITED TO:

- 1) Expenses that are “truly wasted”; and,
- 2) Recovery of the plaintiff's expectancy interest (i.e., the claimant cannot be put in a better position than it would have been had the contract been performed). - 2505243 Ontario Limited o/a ByPeterandPaul.com v. Princes Gate GP Inc. et al., 2021 ONSC 4649^{vi}



CASE SPOTLIGHT

To visualize the application of both damages approaches in a judicial setting, we provide a brief overview of a recent court decision that discusses the premises of expectation and reliance damages.

2505243 Ontario Limited o/a ByPeterandPaul.com v. Princes Gate GP Inc. et al., 2021 ONSC 4649^{vii}

While both the financial experts retained by the plaintiff and the defendant calculated expectation damages, Justice C. Gilmore posed concerns regarding the difficulty with the financial experts' calculations of damages due to the degree of uncertainty:

- *"While both experts acknowledged the effect of the pandemic on future profits, their estimates may now be inaccurate given the effects of the third wave of the pandemic..."*
- The plaintiff's expert's calculations assumed that the 10-year contract would be fulfilled plus two renewals. However, *"[it] is this Court's view that a 20-year relationship with these two entities is not a realistic assumption given the differences in their business models."*
- *"The projections for occupancy were far lower than anticipated when [the plaintiff] was at the Hotel and this was a future variable on which [the plaintiff's expert] could not speculate and would also no doubt be affected by economic factors tied to the pandemic recovery period."*
- *"...[B]oth experts are very dependent on variables which are 'incapable of assessment with any degree of certainty'."*

Justice C. Gilmore awarded reliance damages and found that the parties entered into the agreements on the understanding that the plaintiff would have the use of the capital improvements invested in the hotel throughout the course of the agreements.

Both experts calculated **expectation damages**.

Plaintiff's expert's conclusion: \$12M (mid-range) based on past losses, future losses plus two further five-year contract extension periods.

Defendant's expert's conclusions: \$819K of cash flow deficiency would have been incurred from July 2, 2020 to January 31, 2021.

Court determined expectation damages to be too speculative and awarded **reliance damages**.

Plaintiff claimed **\$9M** of reliance damages, broken down into three categories:

1) leasehold improvements; 2) bartered goods; and, 3) cash losses.

The Court's view:

The cash losses and barter transactions were excluded from the reliance damages claim.

The cash losses would form part of expectation damages, which were too speculative, and no reliable evidence was provided for the barter transactions.

Court awarded **\$7M in reliance damages** to plaintiff.

Defendant counterclaimed for \$2M in damages but was only able to substantiate \$736K in its evidence, which was the amount ultimately awarded.



The key takeaways in *2505243 Ontario Limited o/a ByPeterandPaul.com v. Princes Gate GP Inc. et al.* are as follows:

- Where too many variables and uncertainty exist in calculating the future profitability of a contract, had it been performed (i.e., the “But-For” cash flows), a reliance damages approach may be more appropriate than expectation damages;
- Changes in market conditions and unfolding of the relationship between the contracted parties can affect assumptions applied in a damages calculation;
- The quantum of damages claimed should be substantiated and proven with supporting evidence (e.g., with receipts); and,
- Breaking down costs into categories could be helpful in segregating the damages claim based on the case facts ultimately accepted by the court.

CONSIDERATIONS IN CALCULATING EXPECTATION DAMAGES

The basis of expectation damages is forward-looking information. Accordingly, the assumptions applied in estimating the quantum of lost profits are often subject to scrutiny. Given the challenges of reasonably predicting what would have happened had a contract been performed as agreed, it is imperative to consider the strength of the information supporting one’s assumptions in a quantification of loss exercise.

A financial expert may take into account the depth and breadth of information available. That is, how much information is available (breadth), and how detailed that information is (depth). The following are a few examples of factors considered when calculating expectation damages.

Past and Future Losses

- Damages are normally assessed and awarded during trial/arbitration hearing. However, the effective date of the loss assessment may be a legal issue which depends on the facts and circumstances of each case. For example, in an alleged wrongful contract termination case, it may be agreed that the effective date of the loss begins on the date the contract was terminated. On the other hand, in a breach of fiduciary duty case where multiple possibilities may exist depending on the series of improper actions that have taken place over time, the effective date of the loss assessment may not be as clear.
- Past losses are those incurred by the plaintiff between the date of the alleged breach and the effective date of the assessment.
- Future losses compensate the plaintiff for its prospective losses as a result of the injurious event after the effective date.
- As a simplified example, in 2022, Party B allegedly wrongfully terminated a supply contract it had with Party A, at which time there were 5 more years in the contract term. Party A sues Party B for damages. The court determines in 2024 that Party B is liable for past losses suffered by Party A from the date of the contract termination to 2024, and future losses from 2025 to 2027, which spans the remaining term of the contract.

Forward-Looking Information

- Availability of contemporaneously prepared forecasts modeling the contracted arrangement (i.e., the “But-For” cash flows). Compared to forecasts prepared for the purposes of litigation/arbitration, the latter would likely require a greater degree of scrutiny.
- Expertise, relationship, potential biases, and role of the preparer of the information provided.
- Availability of corroborative industry information.

Historical Information

- Duration, pattern, and stability of historical income.
- Performance of the business before and after the forming of the contract.
- Factors affecting and supporting historical earnings volatility.



Nature and Terms of the Contract

- Detail and specificity of the pricing and quantity of service/goods to be rendered.
- Existence of any contingent earnings based on milestones reached.
- Availability of any extensions to the contract term that may affect the period for which losses should be calculated.

Events Surrounding the Dispute

- Current and projected market/economic conditions pertinent to the contract.
- Attempts made by the plaintiff to mitigate its losses caused by the alleged breach of contract.

Quite often, given the uncertainties in predicting a set of reasonable But-For assumptions, financial experts find themselves preparing different scenarios or sensitivity analyses to demonstrate how significant variables would affect the damages conclusion. This assists the court by providing various reasonable conclusions depending on the case facts that are ultimately accepted.

CONSIDERATIONS IN CALCULATING RELIANCE DAMAGES

The following are a few examples of factors considered when contemplating a reliance damages claim.

Period of Loss

- Costs spent to prepare for the performance of the contract would be considered in a reliance loss claim, hence such would be considered past losses.
- Given the notion of “wasted expenditures”, future profits lost would likely not be considered.
- Depending on the facts and circumstances of each case, expenditures incurred prior to a contract being entered into may not be admissible, as demonstrated in *PreMD Inc. v. Ogilvy Renault LLP*, 2013 ONCA 412. The trial judge “declined to award any damages for the expenses PreMD incurred before it entered into its contract with Ogilvy Renault...”,^{viii} which was upheld by the Court of Appeal. The trial judge’s reasoning was:

“I am not convinced that perhaps, except in certain fact specific circumstances, of which this is not one, reliance damages extend to damages incurred before the contract was entered into... The expenses were not incurred in reliance on the contract, because the contract had not yet been entered into”.^{ix}

Uncertainty in Expectation Damages

- Lack of reliable forward-looking information.
- High degree of variability in the quantum of expectation losses.
- Are the assumptions regarding revenues and costs subject to uncertainty such that it may be difficult to calculate the But-For cash flows that would have been earned by the plaintiff had the contract been performed?

Expenditures Incurred by the Plaintiff

- Itemization of costs incurred in preparation of contract performance, including details such as the date on which the expense was incurred, the nature of each and the amounts.
- Availability of supporting evidence of the costs incurred.

Events Surrounding the Dispute

- Current and projected market/economic conditions pertinent to the contract.
- Attempts made by the plaintiff to mitigate its losses caused by the alleged breach of contract.

Financial experts may segregate various types of costs incurred into categories (e.g., by expenditure type or date incurred), for the court’s consideration, so that they may be grouped or adjusted depending on the case facts ultimately accepted.



HINDSIGHT INFORMATION

Hindsight refers to the use of information that was not known or “knowable” at a particular date.

There is significant amount of case law demonstrating that financial experts can and should consider information that becomes known after the date of the breach or injury, if the date of the loss assessment is a later date (i.e., a current date).

In contrast, where the date of the loss assessment is the date of the breach or injury, the use of hindsight information would generally be inappropriate in a damages quantification exercise.

The facts and circumstances of each case will often determine the appropriate consideration to make the injured party whole.^x

FINAL THOUGHTS

At times, a damages quantification exercise can appear confounding and complicated. An experienced financial expert can help navigate this process and provide an independent and objective perspective in determining a reasonable financial damages opinion.

THE SECRETARIAT TEAM

Ivy Tse, Director
Toronto
+1.647.313.3318
itse@secretariat-intl.com

Eric Mah, Associate
Toronto
+1.647.738.6111
emah@secretariat-intl.com

-
- i [https://ca.practicallaw.thomsonreuters.com/1-107-6593?originationContext=document&transitionType=DocumentItem&contextData=\(sc.Default\)](https://ca.practicallaw.thomsonreuters.com/1-107-6593?originationContext=document&transitionType=DocumentItem&contextData=(sc.Default)).
 - ii In this publication, we have used the term “claimant” and “plaintiff” interchangeably as a reference to the injured party.
 - iii [https://ca.practicallaw.thomsonreuters.com/3-107-7134?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://ca.practicallaw.thomsonreuters.com/3-107-7134?transitionType=Default&contextData=(sc.Default)&firstPage=true).
 - iv *Dul v. Gatenby*, 2019 YKSC 18 (CanLII), <<https://canlii.ca/t/hzrjq>>, retrieved on 2022-08-17.
 - v *PreMD Inc. v. Ogilvy Renault LLP*, 2013 ONCA 412 (CanLII), <<https://canlii.ca/t/fz8rj>>, retrieved on 2022-08-16.
 - vi *2505243 Ontario Limited o/a ByPeterandPaul.com v. Princes Gate GP Inc. et al.*, 2021 ONSC 4649 (CanLII), <<https://canlii.ca/t/jgr20>>, retrieved on 2022-08-12.
 - vii *2505243 Ontario Limited o/a ByPeterandPaul.com v. Princes Gate GP Inc. et al.*, 2021 ONSC 4649 (CanLII), <<https://canlii.ca/t/jgr20>>, retrieved on 2022-08-12.
 - viii *PreMD Inc. v. Ogilvy Renault LLP*, 2013 ONCA 412 (CanLII), <<https://canlii.ca/t/fz8rj>>, retrieved on 2022-08-16.
 - ix *PreMD Inc. v. Ogilvy Renault LLP*, 2013 ONCA 412 (CanLII), <<https://canlii.ca/t/fz8rj>>, retrieved on 2022-08-16.
 - x “The Comprehensive Guide to Economic Damages: Volume One”, Edited by Nancy J. Fannon and Jonathan M. Dunit, Copyright © 2020 by Business Valuation Resources, LLC (BVR), page 324.