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Civil Litigation

Decision highlights considerations when choosing assessment date to quantify losses

By **Tara Singh**

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(August 28, 2018, 9:27 AM EDT) -- A decision by the Ontario Court of Appeal in *Rougemount Capital Inc. v. Computer Associates International Inc*. (2016) ONCA 847 sheds light on some thorny issues around the choice of an assessment date when quantifying losses.

Sixdion Inc. was an IT company providing comprehensive IT systems to Indigenous communities.

In 2004, it reached an agreement (note, the existence/validity of this agreement was the main liability issue in this matter) with Computer Associates International Inc. (CA), a computer software developer and licensor, whereby CA would provide capital to Sixdion in exchange for options to acquire a percentage of Sixdion's business.

In late 2004, CA decided not to proceed with the investment in and partnership with Sixdion. In 2005, Sixdion declared bankruptcy.

Rougemount Capital Inc., a creditor of Sixdion's (having acquired the action from Sixdion's bankruptcy trustee), brought a claim against CA for $20 million to $54 million, alleging that had CA not breached the terms of the agreement, Sixdion would have avoided bankruptcy and achieved the financial forecasts set out in the five-year business plan it had developed with CA in 2004.

CA defended, alleging, inter alia, that Sixdion had suffered no loss, as it would not have prevailed even if CA had complied with the terms of the agreement.

Different loss assessment dates proposed

The defendant's expert contended that damages should be assessed as at the breach date, being August 2004, and that a post-breach assessment date would not sufficiently account for the risks of any or all of the following coming to pass: Sixdion obtaining additional financing, earning the cash flows forecast in the business plan and ultimately avoiding bankruptcy.

Plaintiff's counsel acknowledged that the general presumption in estimating damages for breach of contract is that they are to be quantified at the date of breach but submitted that the court had liberty to choose an alternative date if assessment at the breach date would not fairly compensate the plaintiff. In keeping with this theory, the plaintiff's expert estimated losses as at 2012 and 2014, eight to 10 years subsequent to the creation of the business plan, contending that a breach-date assessment "would not have properly reflected the "upside" of executing the Business Plan."

Different loss quantification approaches proposed

While the parties' experts agreed that the measure of financial harm to Sixdion was lost "business value," they adopted different valuation approaches:

- The plaintiff's expert estimated the value of Sixdion's business as at 2012 and 2014 utilizing a capitalized cash flow (CCF) approach, estimating future maintainable cash flows principally based on the more favourable forecasts set out at the tail-end of the business plan.

- The defendant's expert did not prepare an independent estimate of value (i.e. he prepared a limited critique of the plaintiff's report); however, he offered an alternative calculation of value as at 2004 utilizing a discounted cash flow (DCF) approach which contemplated the entire period forecast in the business plan.

The trial judge found for Sixdion and awarded $11 million in damages. She accepted the plaintiff expert's position regarding a post-breach assessment date stating that "it would be unfair … to value Sixdion as of the fall of 2004, because to do so would fail to reflect the benefits the CA contract would have brought to Sixdion."

Further, she accepted the plaintiff expert's use of a CCF approach agreeing that "the discounted valuation at the date of breach was not appropriate because it would apply all of the weight to the early years when there were losses anticipated and very little weight to the latter years when all of the upside of the business plan would be realized."

Court of Appeal reverses lower court decision

The Court of Appeal acknowledged that while some deviation from presumptive assessment at the breach date has been allowed in special circumstances, these had not been satisfied in Sixdion's case.

It cited the findings of Justice John Laskin in another matter: "damages for breach of contract are generally assessed at the date of breach. An early crystallization of the plaintiff's damages promotes efficient behaviour: the litigants become as free as possible to conduct their affairs as they see fit. Early crystallization also avoids speculation …" (*Kinbauri Gold Corp. v. Iamgold International African Mining Gold Corp.* [2004] O.J. No. 4568).

The appellate court also took issue with the plaintiff expert's use (and the trial judge's reliance thereon) of the CCF approach because "the risk and unpredictability of Sixdion's future cash flows were ignored until a point many years after the date of breach … [it] failed to take into account the cumulative risk that the profits set out in the Business Plan might not materialize."

Essentially, the Court of Appeal found that the plaintiff's expert had failed, both in his selection of an assessment date and loss quantification approach, to account for the substantial risk which existed at the date of the breach, specifically that associated with Sixdion's survival. It found that the lower court decision "erroneously focused solely on maximizing the potential benefits to Sixdion under the contract with CA … and failed to take into account Sixdion's deeply troubled financial history and uncertain status going into the contract with CA and the fact that Sixdion was embarking on a new line of business."

Summary

Rougemount raises a number of important considerations relevant to loss quantification including:

- What is the proper assessment date? (date of breach or some alternative?)
- In selecting an assessment date, have all the relevant facts/circumstances been properly considered?
- What is the proper loss quantification approach? (CCF approach based on stable, maintainable cash flows, DCF approach based on forecast and possibly irregular cash flows, or some other approach?)
- Is the selected approach consistent with the facts/risks prevailing at the assessment date?

The findings in this matter should serve as a reminder for counsel and experts alike that there can be more than one date at which to quantify losses, and the selection of an assessment date is an important one that should be made in conjunction with the facts of the case.

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