

Outsourcing

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Summary and Discussion of *Atos v Sapient*, 2016 ONSC 6852

The Ontario Superior Court of Justice recently addressed a dispute about an outsourcing project, making interesting rulings concerning (i) limitation of liability clauses, including the exclusion of liability for lost profits, (ii) what constitutes a “material” breach of an agreement, (iii) the good faith termination of an agreement, and (iv) proof of damages. The decision in *Atos v Sapient* should be considered by parties in both the drafting and performance of subcontract agreements.

The case turned on principles of contractual interpretation, good faith, and proof of damages. Atos (formerly Siemens) successfully sued Sapient for wrongfully terminating a subcontract. Although Atos had breached the subcontract, there was no “material breach” as defined in the agreement so Sapient had no right to terminate; there was no breach that materially affected Sapient’s ability to perform the primary contract that was incurable or not cured by Atos on 30 days’ notice.

Sapient had also terminated in bad faith. The Court found Sapient had tried to create the material breach so that it could defensibly terminate the subcontract and improve its financial position in the primary contract. As damages for Sapient’s breach, Atos received its lost profits under the contract notwithstanding a limitation of liability clause, which, among other things, excluded “loss of profits.” The Court was reluctant to exclude lost profits since they are the default remedy for breach of contract. Accordingly, the Court restricted the limitation of liability clause to exclude only indirect damages.

Atos had also breached the subcontract in failing to fully perform it. Sapient counterclaimed. The Court considered Sapient’s damages claim and rejected it for lack of proof. Sapient founded its claim on a number of unreasonable assumptions and failed to give any evidence of specific loss.

The Outsourcing Project and the Dispute

In 2006, Enbridge Gas Distribution ran an RFP process to replace legacy software with enterprise resource planning (ERP) software from SAP. The defendant Sapient had an ongoing commercial relationship with Enbridge but lacked experience with SAP software. Siemens Austria had extensive experience with the applicable SAP software, however, neither Siemens Austria nor Siemens Canada (later called the plaintiff Atos) had any relationship with Enbridge. Sapient and Siemens agreed that Sapient would submit an RFP bid and Siemens would act as subcontractor providing know-how about the SAP software. Enbridge awarded the Prime Contract to Sapient.

The Prime Contract provided that Sapient would convert data from Enbridge’s old systems to be used with the new SAP software and would provide application support for the new system. Under the Subcontract between Sapient and Siemens, Siemens was responsible for data conversion, user support and application management and support services (AMS).

The project started in June 2007. It was soon embroiled in delays and by December 2008 the project was behind schedule in all areas. In May 2009, Sapient and Siemens agreed that Sapient would assume management of the data conversion services. Less than two months later, Sapient terminated its Subcontract with Siemens for material breach on the basis that Siemens had failed to perform the data conversion services to the expected performance

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requirements or industry standards. The day after terminating the Subcontract with Siemens, Sapiant made a new agreement with Enbridge for Sapiant to provide AMS services. Thereafter, Enbridge approved a milestone payment to Sapiant relating to the readiness for rollout 1, which was the full amount of the payment due in respect of that milestone. Sapiant paid no monies to Siemens in respect of this milestone payment notwithstanding it was Siemens that had carried out the work in relation to that milestone.

Material Breach

The Court found that Sapiant breached the Subcontract by wrongfully terminating it.

Sapiant had the right to terminate the Subcontract if there was a “material breach” that was incurable or that was not remedied within 30 days after Sapiant notified Siemens of the breach. The Subcontract did not define “material,” but the trial judge relied on the contractual context to interpret the word “material.” Another provision of the Subcontract using the term “material” required Sapiant to notify Enbridge of any breach or suspected breach of the Subcontract that “may affect Sapiant’s ability to perform its obligations under the Prime Contract in a material respect.” The judge found that “material breach” within the meaning of the termination clause, therefore, meant “a non-trivial breach that affects or may affect Sapiant’s ability to perform its obligations under the Prime Contract in a material respect.”

Consequently, Sapiant could only terminate for cause if there was a breach that materially affected its ability to perform the Prime Contract that was either incurable or not cured by Siemens on 30 days’ notice.

The trial judge went on to reject each of Sapiant’s allegations of material breach. The Court dealt with each alleged breach in turn, but noted more generally that Sapiant had never treated Siemens as if it were in material breach of the Subcontract. Had it done so, Sapiant would have been required under the terms of the Prime Contract to immediately notify Enbridge as well as provide notice of the breach to Siemens. Sapiant

had done neither. Thus, how Sapiant behaved after the breach was found to be relevant to whether the breach was material.

Ultimately, the Court found that the available evidence could not establish that any of the breaches had in fact materially affected Sapiant’s performance of the Prime Contract and so Sapiant had breached the Subcontract itself by improperly terminating it.

Absence of Good Faith Termination

Sapiant argued that it was entitled to terminate for Siemens’ failure to meet a particular milestone. This ground for termination was not included in Sapiant’s termination letter to Siemens. The Court found that Sapiant was not entitled to terminate on the basis that Siemens’ missed the milestone because (i) Sapiant had not clearly referenced this basis for termination in the termination notice to Siemens (the Subcontract required such notice), and (ii) Sapiant’s termination right was discretionary; such discretion had to be exercised in good faith and Sapiant had failed to do so.

Emails of Sapiant executives produced at trial revealed that they no longer saw the Prime Contract as financially attractive. Before terminating the Subcontract, Sapiant had met with Enbridge in an attempt to resolve the increased costs that it was facing.

The Court found that Sapiant had attempted to contrive a material breach of the Subcontract to improve its own financial position in the Prime Contract by cutting out Siemens. In this regard, the crucial piece of evidence was the data conversion part of the project. Siemens had identified a number of issues with data conversion that management were contributing to the delays. Sapiant took no action and even dismissed the suggestions of bringing in an independent consultant, despite Sapiant’s own analysis having led to similar suggestions. Shortly after taking control of the project from Siemens, Sapiant adopted many of the reforms it had previously rejected. In addition, when Sapiant terminated the Subcontract, alleging deficiencies with the data conversion, this part

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of the Subcontract was essentially complete. Together, this was enough to convince the Court that Sapiant had deliberately delayed so that it could terminate the Subcontract for its own benefit. This was not acting in good faith in its decision to terminate.

The Court did not address whether Sapiant had acted honestly or reasonably.

Damages

Both Sapiant and Siemens claimed damages against the other for breach of contract. A part of Siemens' damage claim was for loss of profits. The claims for damages raised two major issues: (i) was Siemens' claim excluded by the contract, and (ii) did Sapiant adequately prove its losses?

Contractual limitation of recovery for "loss of profits"

Following existing common law, the Court held that lost profits were the standard remedy for breach of contract. In other words, breach of contract entitles an innocent party to the payments they would have been given under the contract less the costs they would have incurred when performing the contract.

Sapiant argued that any claim for lost profits was excluded by the contract terms. The Subcontract contained a typical clause excluding loss of profits:

...NEITHER [SIEMENS] NOR SAPIANT WILL BE LIABLE TO THE OTHER FOR INDIRECT, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES OR FOR LOSS OF PROFITS ... EVEN IF THE PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES...

The Court found that Sapiant's interpretation of the contract would mean excluding the default remedy for breach of contract and that the other exclusions contained in the limitation of liability clause meant that the section should be read as prohibiting only indirect kinds of damages and not direct expectation damages. The reference to "loss of profits" was restricted to "consequential loss of profits" and the clause gave

Sapiant no protection from Siemens' claim for loss of profits characterized as direct expectation damages. In other words, the Court refused to allow Sapiant to escape from the direct financial consequences of its contractual breach, i.e., payment to Siemens of the balance of the contract price.

Proof of Quantum of Damages

By counterclaim, Sapiant sued Siemens for failure to fully perform the subcontract and the Court found Siemens liable for breach of contract. One of the heads of damages Sapiant claimed was for unplanned costs attributable to delays by Siemens. Sapiant claimed these damages were based on the difference between its projected costs for the project at the outset and its actual costs. In its submissions, Sapiant relied on the principle that where damages are difficult to assess, the court must do the best it can in the circumstances to determine such damages. The Court noted that a litigant is not relieved from its duty to prove the facts upon which damages are estimated. Where an absence of evidence makes it impossible to assess damages, the litigant is entitled to nominal damages at best. The onus was on Sapiant to prove its damages and the Court determined that it had not provided it with either adequate or appropriate evidence to enable the Court to make a proper determination of damages, entitling Sapiant to nominal damages at best.

Sapiant's damages submission had assumed that its initial projection of costs was accurate. Sapiant, however, had never completed a project implementing SAP software and it hired no outside help when projecting costs. Furthermore, Sapiant's claim appeared to have been compiled by Sapiant's lawyers and the Sapiant personnel who testified to the damages calculation at trial had no direct knowledge of how it was calculated. The Court expected Sapiant to provide detailed evidence to support Sapiant's assumptions and that linked the alleged delay to particular added costs.

For further information, please contact any member of our Outsourcing group.