Damages for Breach of Long Term Contracts

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Key points

1. The rules governing the assessment of damages can be easily stated but are difficult to apply. This difficulty is magnified in the context of long term contracts because time increases risk, the subject matter of these contracts is often complex, and problems of proof often intrude. The assessment of damages requires a mastery of the basal contractual principles, an understanding of the market, market prices, the time value of money, and the potential for fluctuations in price to occur over the duration of the contract.
2. Consideration must be given to the interest for which compensation is sought: there are important distinctions not only between expectation interests and reliance interests but also between expectation interests and performance interests. Sometimes a party's performance interest in a long term contract will not align with the party's financial interest.

Introduction

There are many rational risk minimisation reasons for parties to enter into long term contracts, for example, for the sale and purchase of a commodity such as gas. Long term gas contracts are commonplace because of the perceived advantages for both the seller and for the buyer. For the seller, it is assured of reliable cash flow, permitting it to make, more safely, large infrastructure investments to develop the relevant natural resource. For the buyer, it is assured of long term supply, also permitting it to make large investments in its own production facilities more safely.

Both buyer and seller would still take the risk of the insolvency of the other but long term contracts might be said to alleviate such insolvency risks to the extent each of them can depend on the other to perform. Indeed, they can raise capital (either debt or equity) 'on the back of' the predicted certainty of cash flow or supply created by the long term supply contracts themselves.

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