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CONSTRUCTION LAW—2010 UPDATE
PAPER 1.1

The Life and Meaning of Tercon—A Basil Fawlty Guide

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THE LIFE AND MEANING OF TERCON—A BASIL FAWLTY GUIDE

I. The Life of ~~Brian~~ Tercon

The Life

- 2001: Tender call
- 2002: Action commenced
- 2006: SCBC favours Tercon
- 2007: BCCA reverses SCBC
- 2008: SCC grants leave
- 2009: SCC hears appeal
- 2010: SCC restores SCBC decision

The Experience

SCBC

- Adverse witness rule [Rule 40(17-20)]
- Essential findings of fact:
  - — Knowing breach of eligibility provision and duty of fairness
  - — "Smothered" the breaches by revising documents
  - — Conduct characterized as egregious

BCCA

- The phantom negotiation
- The clarity of the exclusion clause
- Don't bid if you don't like it!

Supreme Court of Canada

- SCC specialist
- Leave application
- Written argument
- Ontario's unexpected intervention

The Outcome

- After 13 judges and 3 courts, final score: 7:6 *against* Tercon
- But Tercon wins
- Thank goodness for Confederation!

II. The Meaning of ~~Life~~ Tercon

- Exclusion clauses must be clear
- Fundamental Breach is dead—or is it?
- The "applicability" of an exclusion clause—the *Tercon* test:
  1. Does the clause apply to the breach?
  2. Was the clause unconscionable at the time the contract was made, "as might arise from situations of unequal bargaining power between the parties"?
  3. Should the Court refuse to enforce the clause because to do so would be against public policy?

(1) Does the exclusion apply to the circumstances established in evidence?

The majority: If the exclusion clause does not deal expressly with the breach at hand, it is open to the Court to do justice through interpretation.

The minority: General words in an exclusion clause ("any claim for compensation of any kind whatsoever, as a result of participating in this RFP") are sufficient to exclude liability for particular breaches fundamental to or going to the very root of the contract in issue.

In relation to the duty of fairness, the SCC majority in *Tercon* put it this way [at para. 71]:

> It seems to me that clear language is necessary to exclude liability for breach of such a basic requirement of the tendering process [fairness], particularly in the case of public procurement.

The trial judge put it in even stronger terms [at para. 147]:

> It would take very clear language to effect a result whereby a party could be assured that irrespective of his non-performance of contractual obligations, he could benefit from an exclusion type clause ... [E] exclusion clauses are regarded with hostility and judged with exacting standards because of the high degree of improbability that the contracting party would have agreed to such a limitation of liability.

(2) Was the exclusion clause unconscionable at the time the contract was made, "as might arise from situations of unequal bargaining power between the parties"? (Hunter at 462)

The unconscionability being measured here is clearly not limited to that which activates the traditional doctrine of unconscionability—where the remedy is rescission of a contract between parties of unequal bargaining strength. Is this an expansion of the traditional doctrine? Or is it part of a new general principle of unconscionability as argued by Professor Waddams (at para. 539-540):

> Despite lip service to the notion of absolute freedom of contract, relief is every day given against agreements that are unfair, inequitable, unreasonable or oppressive. Unconscionability, as a word to describe such control might not be the lexographer's first choice, but it seems to be the most acceptable general word. ...
>
> The argument most frequently raised against recognition of the general power of relief is that it would contribute to uncertainty. But certainty, though an important value in contract law, is not an absolute one ... .

At para. 546, Professor Waddams describes how he considers a general principle of unconscionability would work in practice:

> One matter that has given rise to considerable question is the time at which unconscionability is to be judged. Should it be at the time of the agreement or at the time of the dispute? ... It is suggested that the appropriate time is the time of the agreement, for it is the fairness of the agreement that is in issue. If B, by an agreement, has certain rights against A, and it is then determined that the agreement is perfectly fair and reasonable, how can it be unfair or unreasonable for B to exercise those rights? This is not to say, however, that events subsequent to the agreement are irrelevant. To take an example given by the law commissions, suppose that B signs a document whereby B is bound to give notice in writing within 14 days of a loss, of any claim against A. B gives notice orally. A lets the time lapse and relies on the document. The first question is one of construction. Does the clause really mean that no claim can be made even though oral notice is given by a claimant unaware of the requirement in writing? As suggested above, an unreasonable result can often be avoided by techniques of construction, but if the words are too clear to admit of such a construction, then, to the extent that they are unreasonable, they can be struck down as unconscionable. The test is applied at the time of agreement, but the subsequent events are relevant in determining the true meaning of the agreement and in making apparent its latent unfairness (if it cannot be construed to avoid an unfair result). ...

(3) Should the Court refuse to enforce the clause because to do so would be against public policy?

Although this third leg of the *Tercon* test is couched as a question of public policy, it may be better explained as part of the general principle of general unconscionability—should the Court refuse to enforce the clause because to do so would be to permit a party to the contract "to engage in unconscionable conduct secure in the knowledge that no liability can be imposed upon it because of an exclusionary clause"? (*Tercon* at para. 119, citing *Plas-Tex* at para. 53) The minority judgment of Binnie J. continues, at para. 119:

> What was demonstrated in *Plas-Tex* was that the Defendant Dow was so contemptuous of its contractual obligation and reckless as to the consequences of the breach as to forfeit the assistance of the Court. The public policy that favours freedom of contract was outweighed by the public policy that seeks to curb its abuse.

The reasons of the minority suggest that the traditional public policy category of contracts injurious to the justice system (see para. 109 of *Tercon*) is being invoked in circumstances of unconscionable conduct. If so, this represents a new head of public policy which looks more like the traditional equitable jurisdiction of a Court to refuse enforcement of a contract or clause in circumstances of equitable fraud (see *Performance Industries*).

At the Supreme Court of Canada we argued that the boundaries of tolerable conduct have been traditionally drawn at equitable fraud of which the doctrine of unconscionability is a subset (see McCamus, *The Law of Contracts*, at 405). Although the *Tercon* judgment does not use the words "equitable fraud," it amounts to the same thing—"a party to a contract will not be permitted to engage in unconscionable conduct ...". The question is what conduct is considered sufficiently unconscionable that a Court will refuse to enforce exclusion clause on the grounds that such conduct is an abuse of contract and against public policy? Although "the contract breaker's conduct need not

rise to the level of criminality or fraud to justify a finding of abuse" (*Tercon* at para. 118), there does not appear to be a consensus at the Supreme Court of Canada as to where the line is. This will have to be developed on a case by case basis and the law in relation to equitable fraud should have a role to play in the continuing debate. In any event, there can be no bright line to determine when a clause or conduct is such that it is over the line—in measuring unconscionability there is no way to keep the judging from those who judge.

It is troubling that Binnie J., while setting out a test founded upon equitable principles, had this to say:

> While the Domtar Court continued to refer to "fundamental breach," it notably repudiated any judicial discretion to depart from the terms of a valid contract upon vague notions of 'equity' or reasonableness.

We argued that the Court should adopt the general principle of unconscionability measured both at the time of contracting and at the time of the breach. Our Factum put it this way:

> The difference between the judgment of Chief Justice Dickson and Justice Wilson diminishes when Chief Justice Dickson's judgment is read as adopting a general principle of unconscionability where the impugned clause (or the entire agreement) is unenforceable (rescinded) if it is so unfair or unreasonable as to be unconscionable. Although Justice Wilson would assess the unfairness or unreasonableness at the time of the breach, this is not different, in practice, from Chief Justice Dickson's approach in which subsequent events are relevant to an assessment of the unfairness, measured at the time of contracting. This is consistent with the approach taken by this Honourable Court in *Guarantee* as explained in *Shelanu*. In *Guarantee*, this court stated:
>
> > [W]hether fundamental breach prevents the breaching party from continuing to rely on an exclusion clause is a matter of construction rather than a rule of law. The only limitation placed upon enforcing the contract as written in the event of a fundamental breach would be to refuse to enforce an exclusion of liability in circumstances where to do so *would be unconscionable, according to Dickson, C.J. or unfair, unreasonable or otherwise contrary to public policy*, according to Wilson, J. [Emphasis added]
> >
> > *Shelanu Inc. v. Print Three Franchising Corp.* (2003), 64 O.R. (3d) 533 (Ont. C.A.) at para. 35
> >
> > *Guarantee Co. of North America v. Gordon Capital Corp.*, [1999] 3 S.C.R. 423 at para. 52

The remaining difference between the two judgments is in relation to fundamental breach. Chief Justice Dickson would "lay the doctrine ... to rest" whereas Justice Wilson would use it to mark off "the boundaries of tolerable conduct." Regardless, fundamental breach should be a major factor in determining whether it would be unconscionable, unfair or unreasonable to enforce an exclusion clause.

Hunter Engineering Co. v. Syncrude Canada Ltd., [1989] 1 S.C.R. 426 at paras. 59, 159

It is submitted that even where the parties are of equal bargaining strength, the question to be asked is: In all of the circumstances surrounding the particular breach, is it so unreasonable and unfair so as to be unconscientious for a person to take advantage of the protection of an exclusion clause?

Testing the enforceability of contracts and exclusion clauses in this manner recognizes that the tool at the court's disposal is the refusal to countenance equitable fraud. Equitable fraud was described in *Performance Industries v. Sylvan Lake Golf & Tennis Club Ltd.*, as follows:

> What amounts to "fraud or the equivalent of fraud" is, of course, a crucial question. In *First City Capital Ltd. v. British Columbia Building Corp.* (1989), 43 B.L.R. 29 (B.C.S.C.), McLachlin C.J.S.C. (as she then was) observed that "in this context 'fraud

> or the equivalent of fraud' refers not to the tort of deceit or strict fraud in the legal sense, but rather to the broader category of equitable fraud or constructive fraud ... . Fraud in this wider sense refers to transactions falling short of deceit but where the Court is of the opinion that it is unconscientious for a person to avail himself of the advantage obtained." (at 37). *Fraud in the "wider sense" of a ground for equitable relief "is so infinite in its varieties that the Courts have not attempted to define it", but "all kinds of unfair dealing and unconscionable conduct in matters of contract come within its ken": McMaster University v. Wilchar Construction Ltd.* ... [Emphasis added.]
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> *Performance Industries Ltd. v. Sylvan Lake Golf & Tennis Club Ltd.*, [2002] 1 S.C.R. 678 at para. 39
>
> McCamus, John. *The Law of Contracts.* York University: Irwin Law Inc. 2005, at 405

The judgments of Chief Justice Dickson and Justice Wilson are consistent with this approach. They resonate with "unfair, unreasonable, unjust and unconscionable," which terms attend all descriptions of equitable jurisdiction to refuse enforcement of bargains in circumstances of equitable fraud "where the court is of the opinion that it is unconscientious for a person to avail himself of the advantage obtained." In the context of tendering, *Chinook Aggregates Ltd. v. District of Abbotsford* is consistent with this approach:

> But where the appellant attaches a condition to its offer, as the appellant did in the case at bar, and that condition is unknown to the respondent, the appellant cannot successfully contend that the privilege clause made clear to the respondent bidder that it had entered into a contract on the express terms of the wording of that clause. There was no consensus between the parties that the wording of the privilege clause governed. *It would be inequitable to allow the appellant to take the position that the privilege clause governed* when the appellant had reserved to itself the right to prefer a local contractor whose bid was within the 10 percent of the lowest bid. [emphasis added]
>
> *Performance Industries Ltd. v. Sylvan Lake Golf & Tennis Club Ltd.*, *supra*, at para. 39
>
> *Chinook Aggregates Ltd. v. District of Abbotsford* (1989), 40 B.C. L.R. (2d) 345 (B.C.C.A.) at 349-350
>
> *Hunter Engineering Co. v. Syncrude Canada Ltd.*, at paras. 153 and 160
>
> *McMaster University v. Wilchar Construction Ltd. et al.*, [1971] 3 O.R. 801 (Ont. H.C.J.) at para. 46
>
> *Ryan v. Moore*, [2005] 2 S.C.R. 53 (S.C.C.) at para. 74
>
> *H.F. Clarke Ltd. v. Thermidaire Corporation Ltd.*, [1976] 1 S.C.R. 319 (S.C.C.) at 392, 398
>
> *Waters v. Donnelly* (1884), 9 O.R. 391 (C.L.) at 402
>
> *Morrison v. Coast Finance Ltd. et al.* (1965), 55 D.L.R. (2d) 710 (B.C.C.A.) at 713

III. Enforcement of Exclusion Clauses—The Role of Conduct

The conduct of the party seeking to enforce an exclusion clause is central to a court's inquiry into whether enforcement would amount to equitable fraud. In the present case, in concluding it was "neither fair nor reasonable to enforce the exclusion clause," the trial judge considered the Ministry's conduct from January 26, 2001 until the award of Contract B in the name of Brentwood. In summary, Ministry officials, knowing that they could not accept a bid from the Brentwood/EAC joint venture, concealed through a number of steps the true relationship between Brentwood and EAC. They:

a. Advised Brentwood/EAC on how to structure its RFP submission (submission in the name of Brentwood only, not in the actually name of the joint venture) so as to give the impression the bid met the Minister's requirements;

b. Divulged falsely to the unsuccessful proponents that the successful proponent was Brentwood rather than the Brentwood/EAC joint venture, despite actual knowledge to the contrary;

c. Falsified the PEP's final signed Step 6 Report by substituting a revised report, which removed all references to the Brentwood/EAC joint venture in order to conceal that the successful proponent was the joint venture;

d. Sought advice from legal counsel as to how to minimize the risk of liability for having accepted a non-compliant bid;

e. Failed to inform legal counsel of the January 24 letter from Brentwood or subsequent conversations with Brentwood in order to implement the original plan to consider Brentwood the successful proponent, not the Brentwood/EAC joint venture known to be ineligible; and

f. Awarded Contract B in the name of Brentwood—did not use the name Brentwood/EAC so as to avoid liability.

Judgment of Supreme Court below, at paras. 55, 61-64, 68-70, 73, 133-138, 150

It is submitted the Ministry's conduct was so unreasonable and unfair as to be unconscionable. The trial judge concluded:

> In the circumstances here, it is neither fair nor reasonable to enforce the exclusion clause. ... The conduct of the Ministry deprived the plaintiff of any benefit under the contract, including the opportunity to conclude a contract B and to eventually construct the Kincolith Extension. The Ministry acted egregiously when it knew or should have known that the Brentwood bid was not compliant and then acted to incorporate EAC indirectly in contract B whilst ensuring that this fact was not disclosed. These circumstances do not lead this court to give aid to the defendant by holding the plaintiff to this clause.
>
> Judgment Supreme Court below, at para. 150

In the context of a tendering contract with a duty of fairness, the conduct of the Ministry is relevant and justified the trial judge's refusal to give effect to the exclusion clause. As recognized by this Honourable Court in *Mason v. Freedman*: when a person "seeks to avoid a contract under a clause introduced for his relief, his conduct and his reasons for seeking to escape are matters of interest to the court."

Mason v. Freedman, [1958] S.C.R. 483 (S.C.C.) at 487

Fairness is defined as "honesty, impartiality, justice." It would be unconscientious indeed if the Ministry could abandon performance of a fundamental obligation of fairness without liability, by way of an exclusion clause. Such conduct "is sufficiently divergent from community standards of commercial morality" that, in the words of Justice Wilson, it would be unreasonable and unfair to enforce the 'no claims' clause. It would be unconscientious and in the broad sense of that word—unconscionable.

Judgment of Supreme Court below, at paras. 138, 150

Hunter Engineering Co. v. Syncrude Canada Ltd., at para. 152

Brown, L., ed., *The New Shorter Oxford English Dictionary* (Clarendon Press, 1993)

Harry v. Kreutziger (1978), 95 D.L.R. (3d) 231 (B.C.C.A.) at para. 241

IV. I'm a ~~Lumberjack~~ Tendering Authority and I'm Okay

- I give you fairness ... and I take it away
- Can you exclude liability for breach of a duty of fairness?

  "Clear language is necessary to exclude liability for breach of such a basic requirement of the tendering process ..."
- The answer lies in another question—what is fairness in the context of tendering?

It is suggested by the *Tercon* majority that it is possible, with clear language, to exclude liability for breach of the duty of fairness. The extent to which this is possible may depend upon the definition of fairness in the tendering context and whether it is equivalent to good faith. In our Leave Application we raised the point like this:

> The definitions of good faith in the employment and insurance contexts incorporate the notion of fairness. This raises the question: In the tendering context, are fairness and good faith synonymous? Prof. S.K. O'Byrne notes:
>
> > Whether there is a difference between a good faith term and a term going to fairness and equality as articulated by the Supreme Court of Canada will generally not make a difference. Put another way, these terms would impeach the same conduct—such as intentionally awarding to a non-complaint bidder. However, there is an argument that the Supreme Court of Canada's fairness term captures a wider range of conduct, including the situation where the owner simply misunderstands the situation and inadvertently awards to a non-compliant bidder. According to McCamus, this conduct might not be impeachable under a good faith term (because there was no bad faith) but would be actionable under a term to treat all bidders "fairly and equally." The other perspective is to note that good faith as defined by *Gateway* forbids unreasonable or unfair conduct. On this footing, it would be unreasonable to award a tender to a non-complaint bidder despite the owner being without *mala fides* in doing so. That is, such conduct is unreasonable even though it was inadvertent. If this analysis is correct, then the two terms—fairness and good faith—are synonymous.

If fairness in tendering includes the situation where an owner inadvertently awards the contract to a non-compliant bidder, then, one would think, liability for this type of breach should be capable of exclusion. The reason is, there is nothing unconscionable about a clause limiting liability for such a breach, nor would such conduct be considered unconscionable.

On the other hand, where an owner knowingly and advertently awards Contract B to a non-compliant bidder and seeks to cover up the breach, are the clause and the conduct to be considered unconscionable so that the clause is not applicable? The clear answer of the minority is no.

In the majority reasons, there may be a signal that good faith and fairness should be synonymous, at para. 58:

> The trial judge also found that there was an implied obligation of *good faith* in the contract and that the Province breached this obligation by failing to treat all bidders equally by changing the terms of eligibility to Brentwood's competitive advantage. ... I will simply quote her summary at para. 138:
>
> > The whole of [the Province's] conduct leaves me with no doubt that the [Province] breached the *duty of fairness* to [Tercon] by changing the terms of eligibility to Brentwood's competitive advantage. [emphasis added]

In fact, the trial judge did not deal with good faith at all.

In our Factum, we argued that good faith and fair dealing should be implied into tendering contracts by operation of law:

> This Honourable Court has recognized that an obligation of good faith and fair dealing is owed by operation of law in employment relationships and insurance contracts. The Ontario Court of Appeal has added the franchisor-franchisee relationship (*Shelanu*) as another which requires good faith. In the insurance context (*Fidler*), an insurer's duty of good faith was defined to include the duty to deal with its insured's claim fairly.
>
> *Shelanu Inc. v. Print Three Franchising Corp.*, at paras. 63-74, 96
>
> *Fidler v. Sun Life Assurance Co. of Canada*, [2006] 2 S.C.R. 3 (S.C.C.) at para. 63
>
> *Wallace v. United Grain Growers*, at paras. 95-98

Tendering contracts should be recognized as an added category of contract in respect of which an obligation of good faith and fair dealing is implied by operation of law, independent of the intention of the parties. Public policy considerations have a part to play in determining whether it is necessary to do so. Here, the implication of a duty of good faith and fair dealing would achieve the policy objective of protecting the integrity of the tendering system.

> *Hughes Aircraft Systems International v. Airservices Australia* (1997) FCA 558 at 43-46
>
> O'Byrne, S.K., "*The Implied Term of Good Faith and Fair Dealings: Recent Developments*," (2007), 86 The Canadian Bar Review 193, at 237-240
>
> Devonshire, Peter *"Contractual Obligations in The Pre-Award Phase of Public Tendering," supra*, at 237

In the event a duty of good faith and fair dealing is implied as a legal incident to a tendering contract, bidders can be assured of the invitor's performance. Whatever limitations or exclusions of liability might be placed in the tender documents, they cannot be resorted to in bad faith. This does not undermine the ability of the invitor to include and rely in good faith on "stipulations, restrictions or privileges" in the tender documents, a matter with which this Court was concerned in *Martel.*

> *Martel Building Ltd. v. Canada*, at para. 89
>
> *Burger King Corporation v. Hungry Jack's Pty Ltd.* (2001) NSWCA 187, at para. 173

V. The Good, the Bad and the Ugly

- Good

  —*Ron Engineering* lives on as the bread and butter of a litigious construction bar

- Bad

  —SCC is philosophically split re:

  - The necessity of *Ron Engineering*
  - The ability of a Court to enforce an exclusion clause

- Ugly

  —Uncertainty

VI. Blessed Are the Cheesmakers ...

- How will the test be applied in practice?
- Is fundamental breach a factor?
- Many questions remain unanswered

Does fundamental breach remain a factor in the interpretation of exclusion clauses and in the assessment of whether a particular clause or breach is unconscionable? The reasons of the majority suggest fundamental breach is alive and well:

> [48] ... As the judge put it, the bid by the joint venture constituted "material non-compliance" with the tendering contract: '[t]he joint venture with EAC allowed Brentwood to put forward a more competitive price than contemplated under the RFEI proposal. *This went to the essence of the tendering process*' (para. 126).
>
> [70] The closed list of bidders was the *foundation of this RFP* and there were important competitive advantages to the bidder who could side-step that limitation. Thus, it seems to me that both the integrity and the business efficacy of the tendering process support an interpretation that would allow the exclusion clause to operate compatibly with the eligibility limitations that were *at the very root of the RPF.*
>
> [76] ... In short, limiting eligibility of bidders to those who have responded to the RFEI was the *foundation of the whole RFP.* ... .
>
> [78] ... I cannot conclude that the parties, through the words found in this exclusion clause, intended to wave compensation or conduct like that of the Province in this case that *strikes at the heart* of the integrity and business efficacy of the tendering process which it undertook. [emphasis added]

There were a number of interesting questions raised in *Tercon*, specifically in relation to government procurement and the ability of government to contract out of its own legislated protocol, which are not dealt with by the Court. They are:

- Does the law permit government, by private law of contract, to use a "no claims" clause as a licence to make decisions unfairly and contrary to the provisions (and policy) of the governing legislation—even if its officials have concealed their unfair actions, thereby denying a timely public law remedy (judicial review)?
- Can the Ministry's officials contract out of this legislated protocol—which they are bound to administer fairly in the public law sense—via a "no claims" clause in the tender document?
- Should a "no claims" clause, insofar as it purports to insulate the government from conduct contrary to the legislation and to oust the jurisdiction of courts, be regarded as unenforceable as contrary to public policy?
- If the law permits government to contract out of its private law duty of fairness, does this not conflict with and undermine its public law duty of fairness from which it cannot resile?
- Will equity allow government to rely upon the "no claims" clause when it has, by false disclosure, effectively concealed a public law remedy (judicial review) which would have been effective only if taken at the time of disclosure, prior to the award of Contract B?

VII. The Ministry of Silly ~~Walks~~ Clauses

- There will likely be much drafting ...
- If the SCC minority is correct, even egregiously unfair conduct can be excluded
- The result—the death of *Ron Engineering* and of a fair and transparent process of public procurement
- Our view—there must be liability for a knowing breach of Contract A

- The public policy favouring a fair and transparent tendering system should override the policy in favour of freedom of contract
- The solution—a contractually mandated Referee process to determine the successful bidder