

# Blakes Bulletin

## Litigation & Dispute Resolution/Procurement

### Fundamental Breach Doctrine "Laid to Rest" but Public Policy Considerations Reinvigorated in Procurement Cases

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In its recent decision in *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways) (Tercon)*, the Supreme Court of Canada (SCC) eliminated the doctrine of fundamental breach and outlined a new three-step process to analyse the applicability of exclusion of liability clauses, which are particularly prevalent in the public procurement context. The SCC unanimously set out its new framework for analysis of such clauses, but split five-to-four on the application of the clause to the facts of the case. The majority of the SCC found the exclusion clause inapplicable to the breach of contract by the B.C. government, in order to uphold the integrity of the public procurement process.

#### FACTUAL BACKGROUND

The B.C. Ministry of Transportation and Highways (Ministry) issued a request for proposal (RFP) for the construction of a highway in northwestern B.C. Key terms of the RFP included a prohibition on bids that were joint venture agreements, and the following exclusion of liability clause, which was the subject of the case:

"Except as expressly and specifically permitted in these Instructions to Proponents, no Proponent shall have any claim for any compensation of any kind whatsoever, as a result of participating in this RFP, and by submitting a proposal each proponent shall be deemed to have agreed that it has no claim."

Six contractors submitted bids for the project. The winning bid selected by the Ministry was a joint venture agreement between a qualified bidder and another (unqualified) party. The Ministry concealed this fact from the other five bidders.

The plaintiff, Tercon Contractors Ltd., was an unsuccessful bidder which had been ranked second by the Ministry. It claimed C\$3.3-million in damages,

equivalent to the profit it expected to earn on the contract, on the basis that the Ministry had breached the terms of the RFP by awarding the contract to an ineligible bidder. The SCC upheld that claim.

#### TRIAL AND APPEAL DECISIONS

At trial, the B.C. Supreme Court found that a contract existed between the Ministry and the plaintiff based on the terms of the RFP. The judge concluded the Ministry had breached the terms of the RFP and acted "egregiously" in taking active steps to hide the fact that the winning bid was non-compliant. The judge held that the exclusion clause did not specifically exclude liability for the Ministry accepting a non-compliant bid. The B.C. Court of Appeal reversed that decision, finding that the exclusion clause was clear and protected the Ministry from liability even if it breached the terms of the RFP.

#### SUPREME COURT OF CANADA: FUNDAMENTAL BREACH AND PROCUREMENT CONTRACTS

The SCC addressed two issues in its decision: the doctrine of fundamental breach generally, and the interpretation of exclusion clauses in procurement contracts. The court was unanimous in eliminating the doctrine of fundamental breach and providing a new analytical framework to replace it, but divided five-to-four in the interpretation of the exclusion clause in the RFP. The majority of the SCC upheld the trial judge's decision and found the exclusion clause inapplicable to the Ministry's actions, upholding the plaintiff's claim for damages.

#### Doctrine of Fundamental Breach Replaced

The doctrine of fundamental breach was developed by the courts to restrict the operation of exclusion of liability clauses, and enable an aggrieved party to a contract to obtain redress from the other party despite the existence of the exclusion clause. A fundamental breach was said to occur when one party's breach of a contract had the effect of depriving the other party of substantially the whole benefit of the contract. In such a case, the party in breach of contract would not be protected by the exclusion clause in the contract.

CONT'D ON PAGE 2

CONT'D FROM PAGE 1

*Tercon* establishes a new three-step process to determine how a court should deal with an exclusion of liability clause. First, a court must examine the terms of the contract and interpret the exclusion clause to determine if it applies to the circumstances of the case. This requires an examination of the parties' intentions as expressed in the contract, and in the context in which the contract was formed. In this case, the public procurement context was key to the interpretation of the exclusion clause.

Second, if the exclusion clause applies, the court must examine whether the clause was unconscionable at the time the contract was formed. This requires an examination of the circumstances of contract formation: were the parties in a position of such unequal bargaining power that the contract should not be enforced as drafted?

Finally, if the clause applies and is valid, the court must determine whether an "overriding public policy" should outweigh the public interest in the enforcement of the contract. The court will not sanction egregious conduct approaching serious criminality or fraud. What appears to animate this public policy element is a broader consideration of the public interest, beyond the effects of the breach of contract on the parties alone. By way of example, the SCC referred to a case in which a party knowingly supplied defective plastic resin to a customer which used it to fabricate natural gas pipelines. The pipes degraded, causing leaks and explosions, with considerable damage to property and risk to human health. The SCC held that the supplier was so contemptuous of its contractual obligations and reckless as to the consequences of the breach that the court would not allow it to benefit from the exclusion clause in the contract. In earlier days, this was characterized as a "fundamental breach" of the contract; now it is characterized as "contrary to public policy".

### **Application to Exclusion Clause in RFP**

*Tercon* may or may not have resolved the ongoing debate among procurement practitioners in Canada as to whether the well-established implied obligation of fairness (and the corresponding predisposition of the courts to protect the integrity of public procurement processes in Canada) will or will not withstand the principle that the court has no discretion to refuse to enforce a valid and applicable contractual term.

Indeed, the five-to-four split of the SCC on the matter of the application of the RFP's exclusion clause centred on this issue and illustrates the two possible arguments in this regard. The majority of the court, also concerned with the ambiguity of the exclusion clause, focused on the "egregious conduct of the Province" and held that the conduct of the Province breached the express and implied terms of the contract and it did so in a manner that was an affront to the integrity and business efficacy of the tendering process. The majority of the court was "careful to consider the special commercial context of tendering and noted that one aspect of tendering that is generally seen as contributing to the integrity and business efficacy of the tendering process is the requirement that only compliant bids be considered".

In contrast, the minority would impose a higher standard for overriding contractual terms in procurement processes. The minority decision states that, "...a plaintiff who seeks to avoid the effect of an exclusion clause must identify the overriding public policy that it says outweighs the public interest in the enforcement of the contract" and held that the appellant did not meet this standard. The minority decision went on to state: "So long as contractors are willing to bid on such terms, I do not think it is the court's job to rescue them from the consequences of their decision to do so".

### **Other Procurement Issues Raised**

The SCC also canvassed a number of important procurement issues in the decision. A brief summary is as follows:

- the SCC canvassed the "hallmarks" of the formation of Contract A (irrevocability of the bid/proposal, existence of bid security, revisions to the proposal to be made in writing before closing, detailed evaluation criteria explicitly set out in the procurement documents, detailed provisions about pricing that are fixed and non-negotiable, form of agreement attached, submission of a signed proposal form, agreement to execute the contract in substantially the same form as attached);
- the SCC case highlights the importance of ensuring that the same entities that are prequalified or short-listed must be the entities that bid; and

CONT'D ON PAGE 3

CONT'D FROM PAGE 2

- negotiation may be permitted even in a circumstance where Contract A comes into existence as long as “the negotiation was constrained and did not go to the fundamental details of either the procurement process or the ultimate contract”.

### CONCLUSIONS AND IMPLICATIONS

As indicated by the five-to-four split on the SCC as to the application of the exclusion clause in this case, and the difference of opinion between the trial judge and the B.C. Court of Appeal, this remains an area ripe for disagreement. In the commercial context, the SCC’s establishment of a new analytical framework may encourage courts to give greater effect to the intentions of parties as reflected in exclusion clauses, by eliminating the question of whether a contract breach is “fundamental”. Nevertheless, the courts will not enforce bargains which are “unconscionable” or sanction conduct that is contrary to vaguely-defined “public policy”. As such, this case adds new jargon but little certainty to this area of the law. In the public procurement context, the conclusion in this case reinforces the courts’ commitment to integrity in the bidding process, and their reluctance to apply exclusion clauses to protect government parties from liability for conduct in breach of their obligations in that process. However, the strong minority position reminds us that Contract A is still a contract and the possibility remains that carefully drafted provisions may withstand a claim similar to the *Tercon* claim.

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