

Case In Point

Supreme Court of Canada Clarifies Principle of Good Faith in Contracts

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On February 5, 2021, the Supreme Court of Canada released its decision [Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage District](#), in which it commented on and clarified the principle of good faith in contracts, a principle previously recognized by the Court in [Bhasin v. Hrynew](#).

Background

The case involved a contract between Wastech, a waste transportation and disposal company, and Metro, a statutory corporation responsible for the administration of waste disposal for the Metro Vancouver Regional District. The contract contemplated the removal and transportation of waste by Wastech to three disposal facilities. The contract did not guarantee that Wastech would achieve a certain profit in any given year and it gave Metro absolute discretion to allocate waste as it so chose.

In 2011, Wastech alleged that Metro had breached the contract by allocating waste among the facilities in a manner that deprived Wastech of the possibility of achieving its target profit for 2011. Wastech sought compensatory damages representing the amount the company would have earned in 2011 if Metro's allocation of waste had not deprived it of the opportunity to achieve its target profit.

The parties took their dispute to arbitration. The arbitrator ruled in favour of Wastech, finding that although Metro's decision to allocate waste in the manner it did was reasonable, this decision demonstrated a lack of appropriate regard for Wastech's legitimate expectations. It therefore was a breach of a duty of good faith. The arbitrator clarified that the breach was not in regard to Wastech's allocation decision, but rather Metro's failure to compensate Wastech for its lost opportunity to achieve its target profit.

Metro successfully appealed the arbitrator's decision to the British Columbia Supreme Court. That court ruled that the imposition of a duty to have appropriate regard for the interests of another contracting party must be based on the terms of the contract itself. In this case, the parties had considered and deliberately rejected including such a term, and therefore, no such duty existed.

The B.C. Court of Appeal upheld the lower court's decision, and dismissed Wastech's appeal.

At the Supreme Court of Canada

A six-member majority of the Supreme Court of Canada (three members concurring in the result) unanimously dismissed *Wastech's* appeal. It found that Metro reasonably exercised its discretion under the contract given the purposes for which the discretion was granted. Specifically, the majority found that Metro's exercise of discretion was guided by the legitimate objectives of maximizing efficiency and operating in the most cost-effective manner, and therefore it did not amount to a breach of the duty of good faith.

In making this finding, the majority held that the touchstone for determining the purpose of contractual discretion is based on what is reasonable according to the parties' own bargain, not what a court sees as fair according to its own view of the proper exercise of discretion. Further the majority noted that it is only by properly interpreting the contract between the parties to determine the purposes for which discretion was granted that the range of good faith behaviour can be enumerated and breaches can be identified.

The majority went on to find that the breach of the duty to exercise contractual discretion in good faith occurs where discretion is exercised in a manner that is unconnected to the purposes for which the discretion was granted. It is only where the exercise of discretion is arbitrary or capricious in light of the parties' purpose that courts are able to intervene. The majority clarified that this duty does not require a party to confer a benefit that was not a part of their original agreement on the other party, nor does it require a party to subordinate its interests to those of the other contracting party.

Finally, the majority held that the duty to exercise discretion in good faith is a general doctrine of contract law. The duty need not find its source in an implied term in the contract, but rather operates in every contract irrespective of the intentions of the parties. As a result, parties who provide for discretionary power in a contract cannot contract out of the implied duty that the power will be exercised in good faith, and in a manner consistent with the purposes for which the discretion was conferred.

Takeaways for Employers

In light of *Wastech*, employers should be mindful of this duty of good faith in drafting contracts that provide for discretionary decision-making power. Where such discretionary power exists in a contract, employers should consider explicitly clarifying the scope of the discretionary power, and the purpose for which it was granted, directly in the terms of the contract.