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Wastech Services Ltd v Greater Vancouver Sewerage and Drainage District: The SCC Drops the Other “Good Faith” Shoe

The Supreme Court of Canada released its long-anticipated decision in *Wastech Services Ltd v Greater Vancouver Sewerage and Drainage District* today, a major decision concerning the scope of the obligation to perform and enforce contracts in good faith. While it rejected any suggestion that it is the Court’s role to impose unbargained-for terms on a private agreement, the Court affirmed a general power—that cannot be excluded—to police the exercise of discretion under contracts where its exercise would undermine the purpose of the parties’ agreement.

The decision in *Wastech* had been under reserve since December 6, 2019, which was curious since it was argued at the same time as *C.M. Callow Inc v Zollinger* (“*CM Callow*”) (previously discussed here), the last major private law decision delivered by the Supreme Court of Canada in 2020. While *CM Callow* and *Wastech* both considered the organizing principle of good faith in Canadian contract law, the core issue in each case concerned a different dimension of the doctrine of good faith.

Background

CM Callow concerned the extent of the duty of honest performance recognized in *Bhasin v Hrynew* (“*Bhasin*”).

Wastech concerned a different aspect of the doctrine of good faith—one whose antecedents are much older—namely, the idea expressed in *Bhasin* that “in carrying out his or her own performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner.” After *Bhasin*, there was considerable uncertainty as to what this aspect of the doctrine of good faith means, how far it extends, and, most importantly, whether it can impose on parties obligations for which they did not explicitly bargain.

The facts in *Wastech* raised exactly this issue. The parties had entered into a long-term agreement for the removal and hauling of solid wastes by Wastech on behalf of the Greater Vancouver Sewerage and Drainage District (“Metro”). The profitability of

the contract to Wastech depended on the destination to which the waste was to be removed, with long-haul destinations being more profitable and short-haul destinations being less so. Wastech claimed compensation when Metro substantially re-allocated wastes in 2011 between short-haul and long-haul destinations, increasing Wastech's costs to the point that it could not meet an operating ratio defined in the Agreement. This ratio yielded an operating profit of 11%. The agreement provided for certain adjustments to protect the profitability of Wastech, but provided no guarantee of the 11% figure. Under these adjustments, Metro paid Wastech some \$2.8 million as a result of the re-allocation, but still left Wastech with a level of profitability far short of the 11% figure.

Wastech commenced an arbitration claim, arguing that a term should be implied or that a duty of good faith should apply to entitle it to a further \$2.8 million. The arbitrator declined to imply a term since the parties deliberately chose not to include such an adjustment. The arbitrator nevertheless found that although Metro's conduct had been honest and reasonable from its own point of view, it had failed to give "appropriate regard" to Wastech's interests or expectations, and hence could be regarded as "dishonest" within the meaning of *Bhasin*. This, the arbitrator found, breached Metro's obligations of good faith.

Both the British Columbia Supreme Court and the Court of Appeal set aside the arbitrator's decision. The Court of Appeal determined that the arbitrator erred in law by misapprehending how a party can be obligated under *Bhasin* to have "appropriate regard" for a counterparty's interests. The Court of Appeal held that "appropriate regard" had to be understood in the context of the good faith jurisprudence that preceded *Bhasin*. This notion, the Court held, looked back to earlier case law that saw the obligation of good faith as requiring parties to not engage in conduct calculated to undermine the other party's legitimate contractual interests by substantially nullifying the parties' bargain. Because the arbitrator found that Metro had acted honestly and failed to imply a term protecting Wastech's profit margin expectation, the doctrine of good faith was not available to entitle Wastech to any greater right.

The Supreme Court Weighs In

A majority of the Supreme Court of Canada unanimously dismissed the appeal, but in doing so departed from the Court of Appeal's apparent suggestion that the recognized requirement that a contractual discretion must be exercised in good faith is limited to circumstances where the impugned exercise of discretion would "eviscerate" or "nullify" the parties bargain.

The majority held that the duty to exercise contractual discretion in good faith requires the parties to exercise discretion reasonably, which the Court understood to mean as consistently with the purposes for which it was granted in the contract. A breach of this duty occurs only where the discretion is exercised unreasonably, in a manner unconnected to the purposes underlying the discretion. The majority regarded this control of discretion not as an imposition of terms on an agreement, but rather as a means of enforcing the parties' bargain.

The key criterion is whether the impugned exercise of discretion related to the purposes for which the discretion was provided for in the agreement. It is not necessary to demonstrate that the impugned exercise of discretion substantially eviscerated or nullified the bargain. All that must be demonstrated is that the exercise of discretion was made unreasonably in the sense of being extraneous to the parties' bargain. In language questioned by Brown and Rowe JJ. in concurring reasons, a court must "form a broad view of the purposes of the venture to which the contract gives effect, and of what loyalty to that venture might involve for a party to it, and to take those broad purposes as providing the inherent limits for the exercise of the power."

Significantly, the majority also observed that the principle that contractual discretion must be exercised in good faith is a "general doctrine of contract law", not a term implied into bargains. As a result—like the duty of honest performance in *Bhasin*—it cannot be disclaimed by parties to a contract. In principle, the majority stressed that prohibiting the parties from contracting out of the obligation to exercise discretion in good faith is not an interference with freedom of contract because the express parameters of the agreement define the scope of the parties' discretion, and therefore the scope of the Court's ability to police it.

Boundaries of the Principle

The facts of *Wastech* illustrate the limits of the principle enunciated in it. Because the arbitrator rejected the implication of a term that would protect Wastech's profit margin, and because the arbitrator found that Metro acted in a subjectively

honest way for legitimate commercial reasons in making its decision, to impose on Metro an extra-contractual obligation to protect Wastech's margins would be imposing unbargained-for terms on the party's relationship in the face of a deliberate decision not to include such an explicit term.

Concurring reasons of Brown and Rowe JJ., on behalf of themselves and Côté J., mirror Brown J.'s concurring reasons in *CM Callow*, particularly insofar as they caution against the importation into the common law of Civilian concepts, particularly of abuse of right. While the concurring judges express concern about the breadth (and source) of the majority's description of a court's power to police the exercise of discretion by parties to a contract, the disagreement more concerns the outer boundaries of the courts' power. It does not appear to have erupted into the major philosophical rift reflected in disagreement between Brown J. and Kasirer J. in *CM Callow*.

A Significant Development

Wastech is a significant development in Canadian contract law. Its principled exposition of the role of good faith in constraining parties' freedom to operate within the confines of a contractual relationship will seem like judicial moralizing to some.

Nevertheless, and perhaps because an effort seems to have been made to bridge some of the disagreements reflected in the companion decision in *CM Callow*, the majority's approach positions itself not as an imposition on private bargains, but as a means of facilitating their true purpose.

There is much to commend this perspective. 21st century life—and therefore contracts—are far removed from the world of discrete, one-off contractual relationships in which the modern law of contract was born in the late 19th and early 20th century. A generalized obligation of good faith that polices the exercise of contractual rights beyond mere identified breaches of express terms can facilitate private bargains by controlling transaction costs. It is difficult to control risk under an agreement if the only way to obtain protection from opportunistic behaviour that undermines a bargain is to include an express term prohibiting it.