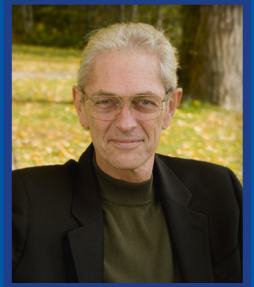


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A SERIES OF UNFORTUNATE EVENTS – THE LAW OF EXCLUSION CLAUSES AFTER *TERCON CONTRACTORS*

By now, most of our clients will have heard that the Supreme Court of Canada has finally released their decision in *Tercon Contractors v. B.C. (MOT)*. The decision is both complex and controversial. It is also critically important for all involved in competitive bid procurement, Owners and Bidders alike.

THE CASE: The facts of the case were fairly straight forward. The Court's decision, however, was not.

In 2001, the *B.C. Government* issued a Request for Expression of Interest (RFEI) for the design and construction of a highway. The *Province* prequalified six Contractors and ranked them. *Tercon* was ranked first. The *Province* then issued an RFP for the construction contract. The RFP allowed only the six prequalified Contractors to bid and contained an exclusion of all liability clause in favour of the *Province*. At award, the *Province* awarded the contract to a joint venture bid (a combination of the sixth ranked prequalified Bidder and a non-prequalified Contractor). When *Tercon* complained about the allowance of a joint venture bid, the *Province* sought to hide the fact that the winning bid was a joint venture bid. When *Tercon* sued, alleging unfairness, the *Province* defended; arguing the competition was not legally binding as it was an RFP; the successful Bidder was not a joint venture; and, in any event, the *Province's* exclusion clause barred *Tercon* from suing for compensation.

At trial, the Trial Court found that the RFP was a binding form of competitive bidding, that *B.C.* had indeed allowed a joint venture bid contrary to the express terms of both the RFEI and the RFP, which did in law breach the Bid Contract A the *Province* had with *Tercon*, and, that the exclusion of liability was not effective to exclude *B.C.'s* liability. The Court held that, firstly, the wording of the exclusion clause did not cover *B.C.* acting totally outside the parameters of the declared process in the RFP and, secondly, that even if the exclusion clause was applicable to the situation, because *B.C.* had fundamentally breached its obligations under competitive bidding law, the Court would refuse to enforce the clause. (Continued to page 6...)

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The *Province* appealed and in a somewhat surprising and unanimous decision, the B.C. Court of Appeal overturned the Trial decision. To the Court of Appeal, even if *B.C.* had breached the Bid Contract A, *Tercon* was an experienced Bidder and must be deemed to have accepted the exclusion clause when it bid. To the Court of Appeal, the exclusion clause did effectively cover what occurred and was a complete answer to *Tercon's* claim.

Tercon appealed to the SCC, who heard the case and reserved its decision for almost 10 months. The SCC decision was a deeply divided pronouncement, with a bare majority of five Justices siding with *Tercon* and restoring the Trial decision, awarding *Tercon* over \$3 million in compensation. The four dissenting Justices completely disagreed with the majority on the issue of the effectiveness of the exclusion clause and would have denied *Tercon's* claim.

However split the SCC was on whether the exclusion clause was effective or not in *this* case, all of the Justices did agree that there should be a new test applied to the effectiveness of exclusion clauses in contracts generally. Thus, while the Court was divided on whether *this* exclusion of liability clause was effective, they were unanimous on changing the Canadian law regarding exclusion clauses generally.

Within this complex decision, there are several issues of importance to Owners, Bidders, and, more generally, anyone who makes a contract for goods or services. Unfortunately, with such a divided decision, there are also a number of statements (from both the majority and the minority decisions) which are – to say the least – open to multiple interpretations. As a result, the SCC decision in *Tercon*, while it clarified some parts of the law, added more confusion to other parts of the law.

To date, this author has read seven articles purporting to describe what the SCC was trying to say in *Tercon*, and not surprisingly, the authors' opinions are as divided in interpretation as the SCC was in its decision. Some writers believe it is simply a matter of time and Owner drafting skill before the "perfect exclusion clause" will eliminate all claims by Bidders arising out of the competitive bidding process. Others seem to suggest that Owners will now stop trying to exclude all liability in competitive bidding. And, one source suggested that the *Tercon* decision endorses the idea that RFPs can be a non-binding method of competitive bidding. While we at Worthington and Associates could spill more ink on each of these opinions (we dedicated our March 2010 Fine Print newsletter to the *Tercon* decision), we will decline to do so and instead offer more on what we think the SCC was trying to say.

THE MAJORITY DECISION: The majority decision at the SCC focused its discussion on the behaviour of *B.C.*, the Owner, and emphasized the facts that both the RFEI and the RFP had expressly prohibited non-prequalified Bidders in any form from participating in the RFP, that *B.C.* had known the successful Bidder was joint venturing with a non-prequalified Bidder and especially that *B.C.* had taken steps to hide the fact that it was awarding the contract to a non-prequalified joint venturer. Noting the Trial Judge had found *B.C.'s* conduct to be egregious (remarkably bad) and deserving of condemnation, the majority at the SCC found that the exclusion clause wording did not cover the Owner acting completely outside the declared competitive process.

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In effect, the majority read the exclusion clause narrowly and expressed concern for the integrity and fairness of the competitive process.

THE MINORITY DECISION: The four Justices in dissent in the *Tercon* decision paid some heed to the need for the competitive process to have integrity, but emphasized primarily that *Tercon* was an experienced Bidder, that parties use exclusion clauses all the time in contracting and that the Courts ought not to interfere in freely made contracts between experienced and knowledgeable parties, unless there was a severe imbalance in bargaining power or some form of serious abuse by the party seeking to avoid liability (eg. such as selling a product known to be dangerous, pretending it isn't dangerous, then trying to escape liability via the exclusion clause when the buyer is harmed).

In effect, the minority read the exclusion clause widely (while construing the Owner's behaviour as unfortunate) and expressed concern for the parties being free to make whatever deal they wish (i.e., freedom of contract) without risk of Court interference.

THE NET RESULT: The net result of *Tercon Contractors v. B.C. (MOT) 2010 (SCC)* for the parties was that *B.C.*'s exclusion of liability clause in the RFP was not effective to avoid liability for acting unfairly in a competition and for seeking after the competition to hide the fact that it had acted unfairly. *B.C.* became liable to pay *Tercon*'s lost profit from the highway contract *Tercon* would have won had *B.C.* had acted according to the declared rules in the RFP (over \$3 million, according to the trial judgment).

The net result of *Tercon* on the law governing exclusion of liability clauses in contracts is a major change in direction, law and prominence for exclusion clauses. An old test has been discarded and a new test has been formulated, the effects of which are uncertain from our present vantage point. And, both Owners and Bidders (indeed, all contracting parties of any type, in any contract) will and must pay closer attention to the issue of exclusion of liability in all contracts.

THE NEW RULES FOR EXCLUSION CLAUSES: Where all nine of the Justices agreed in the *Tercon* case was that a new set of rules was required for Court interpretation of exclusion clauses in contracts generally (including competitive bid contracts). In the past, an exclusion of liability clause could be declared invalid or unenforceable (despite having been at least initially agreed to by the parties to the contract) if the party relying upon the exclusion clause had fundamentally breached the contract. "Fundamental breach" was loosely defined as a complete failure of a contracting party to honour their major obligations in a contract. Fundamental breach of a major term of the contract was not simply breach of contract but *serious* breach of contract (i.e., concerning the very reason the contract was made). It was unevenly applied by the Courts in Canadian cases in ways which are difficult to reconcile.

With the *Tercon* decision, the entire concept of Fundamental Breach has been, to quote the Court, "laid to rest" in Canadian Contract law. In its place, the SCC unanimously created a three-part test to be applied by a Court considering an exclusion clause in a contract.

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The new test for the enforceability of an exclusion of liability clause in a contract (apparently of any type) starts with the general premise that the exclusion clause, if it passes the test, will be enforceable to protect the named party from liability, according to the terms of the exclusion clause.

The new test also presumes there was clear and knowing agreement to the contract and to the clause by the parties. If there was not, there would be no agreement at all or the clause would not be part of the contract.

If a Court is satisfied that the parties chose to clearly and knowingly agree to the exclusion clause in the contract, at least when they made the contract, then the Court is to answer three questions to determine if the exclusion applies:

1. Does the exclusion clause as worded apply to the situation which has occurred?
2. Is the exclusion clause unconscionable and unenforceable?, and
3. Is the exclusion clause contrary to public policy and unenforceable?

If the answers are ... “yes, it does apply;” ... “no, it is not unconscionable” (grossly unfair); and ... “no, it is not contrary to public policy,” then the exclusion of liability clause will be enforceable according to its terms.

This test and the general tenor of the *Tercon* decision stand in support of Freedom of Contract governing over Fairness of Process in competitive bidding. Yet the decision itself (whereby *Tercon* won and the exclusion clause was unsuccessful) and some of the language used by the majority are both endorsements of fairness and integrity of the competitive process being paramount.

Such a “mixed message” from the SCC on such an important issue as exclusion of liability in contracts in Canada is unusual but this has occurred before in Canadian law. The SCC does reflect all Canadian points of view and the *Tercon* decision does in fact mirror the two conflicting views in Canada as to how to interpret contracts. The debate on which concept or principle should take precedence – Freedom of Contract or Fairness of Contract, has been ongoing for the last sixty years in Canadian legal circles and in Parliament. That debate will undoubtedly continue and may never be resolved except in individual cases as they occur.

What the SCC decision in *Tercon* will ultimately mean to the existing laws of contract, of exclusion clauses and of competitive bidding can not be seen from our present vantage point. As is intended by our legal system, especially when a new test is created by the highest Court of the land, it will now be up to the lower Courts (and especially the Appellate Courts) to interpret the Supreme Court of Canada’s words. What these Courts in other cases find to be important will be what they will emphasize in their decisions. Over time, we will then know

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which words from which Justice (majority or minority) have been settled upon as representing what the *Tercon* decision stands for. This may take some time to occur (or not) depending upon what cases are brought to trial or appeal and when.

THE MEANING OF *TERCON*: In the meantime, what is the effect of *Tercon* today on Canadian competitive bidding? Well, the answer to that question depends upon your position – Owner or Bidder?

Owners: If you are an Owner who has an exclusion or limitation of liability clause in your RFP or Invitation to Tender, you would want that clause re-examined (and possibly redrafted by your lawyer) in light of the SCC's words in *Tercon*. As an Owner, you could also, based upon the language of all the Justices in *Tercon*, take greater comfort that carefully drafted exclusions of liability clauses in contracts can be enforceable and can succeed in deflecting liability. At the same time, Owners must recognize that exclusion clauses are not a complete answer to a breach of fairness claim by a Bidder. *B.C's* exclusion clause failed at the SCC. However slim the majority ruling was, it is still the Law and Courts will not easily allow an Owner to escape liability for acting unfairly and contrary to their own RFP, regardless of how well drafted the exclusion clause may be.

If you are an Owner who does not currently have an exclusion of liability clause in your competitive bid solicitation documents, the SCC decision in *Tercon* mandates that such Owners consider adding an exclusion of liability clause in some form to their documents. While *B.C's* exclusion clause as worded did not succeed, the words of both sides of the Court clearly indicate that such clauses, differently worded, could succeed in reducing an Owner's potential liability. There are also questions of public perception and of marketplace acceptance to be considered and these will likely be different for each Owner. So, deciding whether to include an exclusion or limitation clause in their competitive bid documents is a choice that must be made by each individual Owner.

Bidders: If you are a Bidder, the meaning of *Tercon* is more complicated. While the Bidder in *Tercon* was successful, this was more due to the conduct of the Owner than to the failure of exclusion clauses generally. In fact, in other words, both the majority and the minority support the enforceability of properly drafted exclusion of liability clauses, even in competitive bid contracts (i.e., Bid Contract A). This means that a Bidder faced with an RFP which contains an exclusion or limitation of liability clause has only two options – to decline to bid or to bid anyway, protecting themselves as best they can. The Bidder can not legally counter-offer different terms than are in the RFP (unless the RFP allows for that) without almost certain disqualification for non-compliance. With potentially significant risk shifted to the Bidders, Bidders will be forced to respond. Some will bid anyway, some will bid with higher pricing to offset the risk (a self-defeating strategy in competitive bidding where price is such an important element), some will choose not to bid. However, there is no doubt that all Bidders will be forced as a result of the decision in *Tercon* to make difficult choices and face more uncertain outcomes. To do otherwise could result in a series of unfortunate events. Now, as ever, competitive bidding is risky business for Bidders!

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- our 50+ page-per-issue, 3-issue-per volume newsletter, *The Fine Print – Procurement Law Review*, reports on important cases and issues in competitive bidding and procurement three times annually,
- our two one-day law courses, *Update on Competitive Bidding Law* and *Update on Public Procurement Law*, put recent developments together in an easy-to-understand, comprehensive package for both those new to procurement and those who are “old hands” who need to stay abreast of changes and updates in the laws that affect their day-to-day business affairs, and
- our twelve other training seminars are designed especially for procurement professionals, all focusing on the laws you need to know to do your procurement job excellently and with a keen awareness of the perils and pitfalls inherent in the profession.
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Kind Regards,
Robert Worthington
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