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Business Context Matters When Assessing Good Faith

By Marco P. Falco

Parties to a commercial contract owe one another a duty of good faith.

In the past few years, a trilogy of decisions from the Supreme Court of Canada has established that the good faith principle includes:

(i) A duty of honest contractual performance, in which parties cannot lie or otherwise mislead each other regarding matters relating to the performance of the contract: *Bhasin v. Hrynew*, 2014 SCC 71; *C.M. Callow v. Zollinger*, 2020 SCC 45; and

(ii) A duty to exercise any contractual discretion reasonably, in accordance with the purposes for which the discretion was granted under the contract: *Wastech Services Ltd. v. Greater Vancouver Sewage and Drainage District*, 2021 SCC 7.

When assessing this latter obligation, Canadian Courts are only now starting to establish what factors they will consider in determining whether a party has exercised their contractual discretion in good faith.

A recent decision of the Ontario Court of Appeal, *Stericycle ULC v. HealthPRO Procurement Services Inc.*, 2021 ONCA 878, holds that business considerations, including industry practice and commercial custom, will inform the Courts' analysis of whether the duty of good faith has been breached.

A Bidding War

Stericycle involved a Court application arising out of a tendering process. The applicant biomedical waste management service sought a declaration that it, and not its respondent competitor (the "Competitor"), was the "primary supplier" for a health authority in British Columbia.

The tendering process was managed by HealthPRO, an organization that oversaw the procurement and contract for the health authority.

Initially, HealthPRO awarded the applicant a contract for waste management services to the health authority (the “2013 Contract”).

The 2013 Contract expired on May 31, 2020, and included a provision requiring the applicant to provide services for an additional six months after the expiry date to allow for the implementation of a new contract with a different supplier (the “Six Month Extension”).

In 2019, HealthPRO issued a request for qualification (“RFQ”) and request for proposal (“RFP”) for a new national contract for waste management services. Both the applicant and the Competitor qualified to bid on the new project. Notably, the Competitor did not have waste management facilities in British Columbia when it participated in the RFQ and RFP processes.

Both the applicant and the Competitor were awarded contracts in 2020 (the “2020 Contracts”).

The 2020 Contracts had a start date of June 1, 2020.

The Competitor requested that the Six Month Extension in the applicant’s 2013 Contract be employed by the health authority to allow the Competitor time to develop infrastructure in British Columbia.

On June 2, 2020, the health authority chose the Competitor as its “primary supplier”, but did not advise the applicant whether it would become a secondary supplier. The health authority also exercised its option under the Six Month Extension to have the applicant provide waste services for the six months after the expiry of the 2013 Contract.

The Competitor provided services immediately following the expiry of the Six Month Extension, beginning on December 1, 2020, being six months from the start date of the 2020 Contracts, i.e., June 1, 2020.

Most of the Court application turned on the interpretation of the various contracts between the parties.

However, the applicant also argued that the health authority and HealthPRO breached their duty of good faith and duty to exercise their discretion reasonably under the contracts by not requiring the Competitor to provide services under its 2020 Contract on June 1, 2020.

The application judge dismissed the application, holding, among other things, that no duty of good faith was owed. The Court of Appeal upheld the application judge’s ruling, holding that there was no breach of good faith.

Industry Practice Can be Used to Determine Breach of Good Faith

The Court of Appeal dismissed the argument that the respondents had breached their duty to exercise their contractual discretion reasonably on the basis that the respondents excused the Competitor from starting to provide services on June 1, 2020 under the 2020 Contracts.

In so doing, the Court noted that, in the industry, there was a distinction between the date on which a waste management service contract started and the date in which the services under the contract would be implemented:

[The applicant] relies principally on the HealthPRO letters awarding the 2020 Contract to [the Competitor] and [the applicant], which stated that the term of the 2020 Contracts would run from June 1, 2020 ... The application judge acknowledged that the 2020 Contracts ran for a period that commenced on that date. However, she found that it was understood in the industry, and therefore by the parties, that there was a difference between the date on which the term of the 2020 Contracts began, being the start date, and the implementation date for the provision of services to individual HealthPRO members.

Moreover, the Court held that requiring a “transition period” through the Six Month Extension to shift to a new primary supplier was a “commercially reasonable” result:

...the application judge also referred to the complexity and resulting time to transition the provision of services from [the applicant] to a new supplier [i.e., the Competitor]. She observed that it would be commercially unreasonable to require a prospective new supplier to make the significant financial investment required to provide services in a province without a guarantee of being selected as a service provider. This reality reinforced the need for a transition period after the start date of a contract...

...

In summary...[the health authority] did not breach any obligation to [the applicant] in refraining from requiring [the Competitor] to begin providing services on June 1, 2020...[The health authority] did not breach any obligation to [the applicant] in requiring it to continue to supply under the Six Month Provision until December 1, 2020.

Why Business Considerations Matter

The *Stericycle* decision establishes that, in assessing whether discretion under a contract is exercised in good faith by a party, the business context in which the contract is executed and performed is key.

The conclusion that the respondents did not breach their duty of good faith to the applicants in *Stericycle* depends largely on: what the industry standards were; how biomedical waste management contracts operate; and whether it was commercially reasonable for the respondents to build in a “transition period” following the execution and commencement of the 2020 Contracts.

In other words, it is not only the intention of the parties that matters when assessing their behaviour under the contract. Commercial realities and custom may be equally significant.

How a particular industry operates in practice informs the Courts’ approach to scrutinizing the contractual parties’ behaviour.

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