Talkin' Tercon

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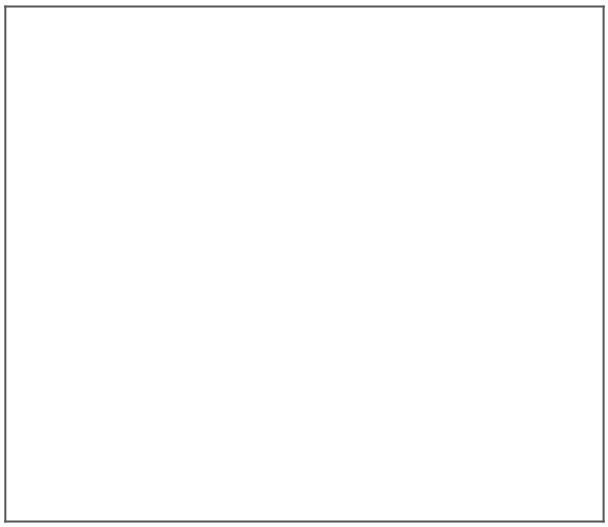
A little over a month ago (Feb. 12, 2010), the Supreme Court of Canada issued its decision in the case of **Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)**. Since the decision was released, it has garnered much attention and comment from construction lawyers nationwide.



Briefly stated, the facts of the case are as follows:

The Province of B.C. issued a RFEI (Request for Expression of Interest) for the design/construction of a highway in Northern B.C. There were six responses to the RFEI. B.C. subsequently decided that it would design the highway itself, and issued a RFP (Request for Proposals) for the construction of the highway. The RFP was only open to the six parties which had responded to the RFEI.

Tercon Contractors Ltd. and Brentwood Enterprises Ltd. both submitted responses to the RFEI. In order to perform the work contemplated under the RFP, Brentwood entered into a joint venture agreement with another contractor, Emil Anderson Construction Co. ("EAC"). In order to comply with the terms of the RFP, the joint venture submitted a bid in Brentwood's name, with EAC listed as a "major member" of its proposed team. Brentwood was awarded the contract and Tercon sued the Province claiming that it had awarded the contract to an ineligible party as the joint venture (Brentwood/EAC) was not one of the six entities which had bid on the RFEI.

In its defence, the Province argued that: (a) The Brentwood bid was compliant with the terms of the RFP; and (b) even if the the bid was materially non-compliant, the RFP contained an exclusion clause which prevented Tercon from advancing a claim against the Province. The operative portion of the exclusion clause read as follows:

> "… Except as expressly and specifically permitted in these Instructions to Proponents, no Proponent shall have any claim for 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."

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The trial judge in this case held that the Brentwood bid was ineligible and that the Province had acted unfairly in considering and ultimately awarding the contract to what was essentially a new entity, the Brentwood/EAC joint venture. The trial judge further held that the exclusion clause was ambiguous and did not apply in these circumstances. The B.C. Court of Appeal did not consider the eligibility of the bid, but overturned the decision of the trial judge on the basis that the exclusion clause was applicable and barred any claim by Tercon.

The case was then appealed to the Supreme Court of Canada. In a split 5-4 decision, the Court allowed the appeal and restored finding of the trial judge.

The split decision is a little misleading in the sense that the Court was unanimous in finding that the Province of B.C. acted improperly in accepting the Brentwood bid. The split on the Court came when determining whether the exclusion clause prevented Tercon from bringing its claim.

The question of whether B.C. could rely on the exclusion clause required the Supreme Court to revisit the "doctrine of fundamental breach". As set out by Justice Binnie in paragraph 106 of the decision, the doctrine of fundamental breach refers to a rule of contract law which comes into operation where a party "egregiously" breaches a contract. In such a case, the innocent party is released from further performance under the contract, while the offending party will still be held liable for the consequences of the breach.

The obvious difficulty with the doctrine of fundamental breach is determining how substantial a breach must be before it is considered "fundamental".

The Supreme Court in Tercon sought to provide some clarity on this point by "laying to rest" the doctrine of fundamental breach (at least as it relates to exclusion clauses) and imposed a three step test to determine whether a party can rely on an exclusion clause in a contract. The Court held that the following inquiries are to be made:

1. Does the exclusion clause apply to the circumstances established in the evidence?

This may seem like an obvious point, but it is important to consider the exclusion clause in relation to the entire contract and determine on its particular wording if it applies to the subject matter of a claim. If the exclusion clause does not apply to the claim, then there is no need to consider the next two steps.

2. If the exclusion clause does apply, was it unconscionable at

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the time the time the contract was made?

This step allows a Court to look into issues like inequality in bargaining power and the sophistication of the parties. It should be emphasized that this inquiry will be directed at the circumstances that exist when the contract is made – not the circumstances existing at the time of the breach.

3. Should the Court refuse to uphold the exclusion clause because of an overriding public policy?

The Court recognized that there are instances in which exclusion clauses simply should not apply – the Court cited as examples cases where a supplier has provided products which are dangerous or defective and have caused illness or death, or threats to public or environmental safety.

The Court was unanimous in endorsing this three-step test, but disagreed with its application in this case. 5 of the judges held that the exclusion clause in this case did not apply in the circumstances of the claim (i.e. it failed the first step of the test). The majority found that the exclusion clause was not intended "to gut the RFP's eligibility requirements".

So – What can we take away from Tercon?

1. The pre-eminent message from Tercon, and the one which has attracted the most comment is the new criteria to determine whether an exclusion clause may be relied upon. By establishing the three step process instead of continuing to rely on the doctrine of fundamental breach, the Court has clarified the law and provided additional certainty for contractors and owners as well as those of us tasked with preparing exclusion clauses.

2. An element of the case which hasn't received as much attention is the universal condemnation of the way in which the RFP was handled by the Province of B.C. To get the full facts you have to refer to the trial decision, which you can find **here.** While it's a lengthy read, it's a good cautionary tale for owners who may be tempted to stray from the criteria they establish in RFPs and tender documents.

3. The Court left open the issue of whether it is possible to craft an exclusion clause that would protect an owner who breaches its duty of fairness to bidders in the tendering process. The majority based their decision on the ambiguous nature and the particular wording of the exclusion clause in this case. In other words, they stopped at step one of the three step test. They did not go on to consider whether a more carefully drafted clause would have been unconscionable or against public policy.

In his dissent, Justice Binnie worked his way through the three step test and found that there

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was nothing unconscionable about a sophisticated contractor such as Tercon entering into a contract with the Province which featured a broad exclusion clause prohibiting claims arising from “participation” in the RFP.

The most interesting portion of the decision (in my humble view) is the determination by Justice Binnie and the other dissenting members of the Court that the exclusion clause – which purports to protect an owner who breaches its duty of fairness to bidders – would not be void for reasons of public policy. This finding seems a little at odds with the repeated decisions of the Supreme Court which emphasize the importance of fairness in the tendering process. As a fair and transparent tendering process is essential to both the construction industry and for public procurement generally, it would seem that an exclusion clause that allows an owner to subvert the system with impunity would be against public policy.

As noted above, the 5 judges in the majority did not have to consider the public policy issue. Given the majority’s emphasis on the “integrity and business efficacy of the tendering process” in its decision, it’s interesting to speculate how these 5 judges would rule on the public policy issue should a similar case come back before the Court.

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