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## Exclusion Clauses in Public Procurement: ...And Fairness for All

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## 1 INTRODUCTION

For nearly 30 years, procurement law has been a source of tension between freedom of contract and commercial certainty. A tender issuer<sup>1</sup> will often seek to exclude obligations of fairness by using cleverly-drafted exclusion and discretion clauses. A contractor, having agreed to such a clause, might bring a claim where it believes that a breach falls outside the scope of the clause, or to argue that the clause should not be applied. When the Supreme Court of Canada (the “SCC”) heard the appeal in *Tercon Contractors Ltd v British Columbia (Transportation and Highways)*,<sup>2</sup> it endeavoured to provide a clear test for determining when a court should refuse to apply an exclusion clause. It is argued that this framework did not provide sufficient guidance and certainty to parties in the tendering process. It risks eroding the protections established by the SCC over the past few decades.

This paper focuses on public procurement, and examines whether government sponsors should be permitted to exclude the implied obligation of fairness. Stated otherwise, should there be a minimum standard of fairness in public procurement? The paper begins by providing a brief overview of the jurisprudence concerning exclusion clauses and procurement law. Second, it examines and offers criticisms of the approach established in *Tercon*. And finally, it presents an argument for the recognition of a doctrine of fairness to govern the public tendering process. Due to the overwhelming public interest

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<sup>1</sup> The terms “issuer”, “owner” and “sponsor” are used interchangeably and intended to have the same meaning, i.e. the party who issues a request for proposals and conducts its own tendering process.

<sup>2</sup> 2010 SCC 4, [2010] 1 SCR 69 [*Tercon*].

in fair and transparent government conduct, government sponsors should be held to an unassailable baseline of fairness.

## 2 EXCLUSION CLAUSES IN CANADIAN PROCUREMENT LAW

Prior to advancing the argument for the recognition of a new doctrine, this paper will undertake to provide a synopsis of the current law in Canada regarding procurement and exclusion clauses. Since there are numerous challenges that continue to be addressed in the jurisprudence in either area, this overview is certainly not intended to be exhaustive. The scope is limited to issues that are relevant to the question of whether limits should be imposed on exclusion clauses in public procurement.

### 2.1 The Historical Treatment of Exclusion Clauses

The primary objective of contractual interpretation is to give effect to the intention of the parties at the time of contract formation. Exclusion clauses are an expression of the freedom of contract. Parties may wish to allocate the risk and liability between themselves, especially in commercial bargains. Before turning to the procurement context, it is necessary to take a brief look at the ways in which courts have placed limits on the exclusion of liability.

In *Bauer v the Bank of Montreal*,<sup>3</sup> the SCC adopted a framework for determining whether a clause is an exclusion clause. To be able to determine which principles of construction to apply, a court must determine whether it is an exclusion clause. Therefore,

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<sup>3</sup> [1980] 2 SCR 102 [*Bauer*].

it is necessary to first categorize the clause prior to interpreting it. Before ultimately finding that the relevant clause was not an exclusion clause, the Court identified the three types of exclusion clauses:

First, there are clauses which purport to exempt one party from a substantive obligation to which he would otherwise be subject under the contract, for example, by excluding express or implied terms[...]. Secondly, there are clauses which purport to relieve a party in default from the sanctions which would otherwise attach to his breach of contract, such as the liability to be sued for breach or to be liable in damages, or which take away from the other party the right to repudiate or rescind the agreement. Thirdly, there are clauses which purport to qualify the duty of the party in default to indemnify the other party, for example, by limiting the amount of damages recoverable against him, or by providing a time-limit within which claims must be made.<sup>4</sup>

The Court also specified that exemption clauses are subject to special rules of construction:

In construing such a clause, the court will see that the clause is expressed clearly and that it is limited in its effect to the narrow meaning of the words employed and it must clearly cover the exact circumstances which have arisen in order to afford protection to the party claiming benefit. It is generally to be construed against the party benefiting from the exemption[...].<sup>5</sup>

Prior to the SCC decision in *Hunter v Syncrude*,<sup>6</sup> the law regarding exclusion clauses was clouded by the doctrine of fundamental breach. This doctrine was quite problematic in that it tempted courts to engage in *ex post facto* reasoning where the operation of an exclusion clause would result in “extreme unfairness” (i.e. a fundamental breach).<sup>7</sup> Dickson

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<sup>4</sup> *Ibid* at 108 citing *Chitty on Contracts*, 24th ed, vol. 1 at 362.

<sup>5</sup> *Ibid*.

<sup>6</sup> *Hunter Engineering Co v Syncrude Canada Ltd*, [1989] 1 SCR 426 [*Hunter*].

<sup>7</sup> *Ibid* at 456.

C.J. recommended that the doctrine of fundamental breach should be laid to rest, explaining that it has been “confusing at the best of times”.<sup>8</sup> He held that the courts should not disturb the bargain of the parties and concluded: “I am inclined to replace the doctrine of fundamental breach with a rule that holds the parties to the terms of their agreement, provided the agreement is not *unconscionable*”.<sup>9</sup>

Wilson J. agreed that unconscionability must be considered, but maintained that courts should retain some residual power to refuse to apply an exemption clause where there is unfairness at the time of breach: “I believe, however, that there is some virtue in a residual power residing in the court to withhold its assistance on policy grounds in appropriate circumstances”.<sup>10</sup> Dickson C.J. and Wilson J. disagreed on whether the court should retain discretion to refuse to apply the clause when there has been a fundamental breach. The bench divided in its support of their judgments. McIntyre J. (as tiebreaker) sided with Wilson J. without adding to the analysis of how to construe exemption clauses.

The uncertainty surrounding the fate of fundamental breach continued after *Hunter*. The jurisprudence illustrates the confusion regarding whether courts should consider factors (at the time of breach) which are beyond the intention of the parties at contract formation. These issues came to a head in *Tercon*, which is discussed below under section III(c).

## 2.2 The Development of Canadian Procurement Law

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<sup>8</sup> *Ibid* at 462, 456.

<sup>9</sup> *Ibid* at 455-56 [emphasis added].

<sup>10</sup> *Ibid* at 517.

The tendering process is a special commercial context for which a distinctive approach to contract analysis has evolved. The commonly accepted starting point of the modern Canadian approach is *The Queen v Ron Engineering*.<sup>11</sup> In his analysis, Estey J. established that contractual relations *may* arise prior to the acceptance of a tender. This initial contract, which he called “Contract A”, “is brought into being automatically upon the submission of a tender”<sup>12</sup> and is independent of the actual construction contract. Contract A arises through interpretation of the terms of the tender call; it does not arise as a rule of law. The contract which later arises when a tender is accepted and the agreement is signed is called “Contract B”. The terms for the bidding process, as specified in the tender documents, become the terms of Contract A. This contract imposes the obligation to act fairly and equally toward all bidders. Therefore, an owner who violates its own bidding process is open to contractual liability to bidders.<sup>13</sup>

The SCC has recognized additional features of this legal construct throughout the jurisprudence. These developments have been aimed at providing commercial certainty to an integral commercial process of the Canadian economy. In *Naylor Group Inc. v Ellis-Don Construction Ltd.*,<sup>14</sup> the Court affirmed that “[t]he existence and content of Contract A will depend on the facts of the particular case”.<sup>15</sup> In *M.J.B. Enterprises Ltd v Defence Construction (1951) Ltd*,<sup>16</sup> the Court implied a term, based on the presumed intention of the parties, that only compliant bids were open to acceptance. The owner had included a privilege clause

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<sup>11</sup> *The Queen in right of Ontario v Ron Engineering & Construction (Eastern) Ltd*, [1981] 1 SCR 111 [*Ron Engineering*].

<sup>12</sup> *Ibid* at 119.

<sup>13</sup> *Ibid*.

<sup>14</sup> 2001 SCC 58, [2001] 2 SCR 943 [*Naylor Group*].

<sup>15</sup> *Ibid* at para 36.

<sup>16</sup> [1999] 1 SCR 619 [*M.J.B. Enterprises*].

stating that it was not obliged to accept the lowest or any tender, but the clause did not entitle the owner to select a non-compliant bid. Where consistent with the intention of the parties, there is an implied obligation of issuers to accept only compliant tenders.<sup>17</sup>

The duty to reject non-compliant tenders “falls within the broader umbrella of another implied duty in Contract A, the duty of the owner to treat all bidders fairly and equally in the assessment of bids, having regard to the terms of the call for tenders”.<sup>18</sup> This implied duty of fairness was recognized in *Martel Building Ltd v Canada*,<sup>19</sup> where the Court implied a term in Contract A obligating the owner to be fair and consistent in the assessment of tender bids. In *Double N Earthmovers Ltd v Edmonton (City)*,<sup>20</sup> the Court explained that “[t]he reciprocal obligations of owners implied in *M.J.B.* and *Martel* arose out [of] the expectation of bidders that if they undertook the significant time and expense involved in preparing a bid, their bids would each receive fair and equal consideration by owners during the evaluation of bids and the award of Contract B”.<sup>21</sup> In that case, the Court refused to imply a term requiring owners to investigate and determine if bidders will actually perform what they promised in their tender.

The protections established by the SCC will only be implied where it can be presumed that the parties have intended them. They cannot be implied where the parties clearly express a contrary intention. The ability of parties to the tendering process to exclude these implied terms has become a source of confusion and continuous litigation.

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<sup>17</sup> *Ibid* at paras 40-41.

<sup>18</sup> Jassmine Girgis, “Tercon Contractors: The Effect of Exclusion Clauses on the Tendering Process” (2010) 49:2 Can Bus LJ 187 [Girgis, “Tercon Contractors”].

<sup>19</sup> 2000 SCC 60, [2000] 2 SCR 860.

<sup>20</sup> 2007 SCC 3, [2007] 1 SCR 116 [*Double N Earthmovers*].

<sup>21</sup> *Ibid* at para 70.



### 2.3 Tercon: Exclusion Clauses in Canadian Procurement

*Tercon Contractors Ltd v British Columbia*<sup>22</sup> is the most recent SCC pronouncement on the interpretation and application of exclusion clauses. Prior to *Tercon*, the question of when a court would refuse to enforce an exclusion clause in a request for proposals (“RFP”) was unsettled. As stated by Binnie J., “[t]he important legal issue in [*Tercon*] is whether, and in what circumstances, a court will deny a defendant contract breaker the benefit of an exclusion of liability clause to which the innocent party, not being under any sort of disability, has agreed”.<sup>23</sup>

In 2000, the Ministry of Transportation and Highways (the “Province”) issued a request for expressions of interest to design and build a highway in northwestern British Columbia. Six teams made submissions, including Tercon Contractors Ltd. (“Tercon”) and Brentwood Enterprises Ltd. (“Brentwood”). The Province later decided that it would instead design the highway itself and issue an RFP for its construction.<sup>24</sup>

Under the terms of the RFP later issued by the Province, only the six original proponents were eligible to submit a proposal.<sup>25</sup> Tercon submitted a proposal, and so did Brentwood. Brentwood was unable to submit a competitive bid on its own. It teamed up with Emil Anderson Construction Co. (“EAC”), which was not a qualified bidder. Together, they submitted a bid in Brentwood’s name, which listed EAC as a “major member” of the

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<sup>22</sup> *Tercon*, *supra* note 2.

<sup>23</sup> *Ibid* at para 81.

<sup>24</sup> *Ibid* at para 9.

<sup>25</sup> *Ibid* at para 10 (“The obligation to consider only bids from eligible bidders was stated expressly in the tender documents” at para 23).

team.<sup>26</sup> It was determined that the Province was aware that the bid was on behalf of a joint venture and took active steps to conceal its status.<sup>27</sup>

The Court agreed with the conclusion of the lower courts that the Brentwood/EAC joint venture was an ineligible bidder and the Province therefore breached Contract A by accepting the bid. Cromwell J. wrote:

I find no fault with the trial judge's conclusion that the bid was in fact submitted on behalf of a joint venture of Brentwood and EAC which was an ineligible bidder under the terms of the RFP. This breached not only the express eligibility provisions of the tender documents, but also the implied duty to act fairly towards all bidders.<sup>28</sup>

The Court then had to determine whether compensation for the breach was barred under the following exclusion clause, contained in the RFP:

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.<sup>29</sup>

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<sup>26</sup> *Ibid* at paras 11, 46.

<sup>27</sup> *Ibid* at para 40. Brentwood attempted to advise the Province of a material change in its team's structure due to the intention to form a joint venture with EAC. The province did not respond in writing as it ought to have under the terms of its own RFP. The Court concluded that "although Brentwood submitted a bid in its own name, the proposal in substance was from the Brentwood/EAC joint venture and was evaluated as such" at para 39. The Court supported the trial judge's findings that the Province: (1) understood that the Brentwood bid was in fact on behalf of a joint venture; (2) thought that the bid was ineligible; and (3) took active steps to obscure the reality of the situation. See paras 37-40.

<sup>28</sup> *Ibid* at para 59 (minority also concluded that contracting with Brentwood was a breach of the Contract A at paras 86, 126).

<sup>29</sup> *Ibid* at para 60 [emphasis in original].

After more than two decades of uncertainty following Dickson C.J.'s statement that fundamental breach should be laid to rest,<sup>30</sup> the SCC in *Tercon* made a clear pronouncement that this doctrine is dead.<sup>31</sup> The Court unanimously adopted a new test to be applied where a party seeks to escape the effect of an exclusion clause.<sup>32</sup> Binnie J., who authored the minority judgment, articulated a three-part test for the applicability of exclusion clauses:

[122] The first issue, of course, is whether as a matter of interpretation the exclusion clause even *applies* to the circumstances established in evidence. This will depend on the Court's assessment of the intention of the parties as expressed in the contract. If the exclusion clause does not apply, there is obviously no need to proceed further with this analysis. If the exclusion clause applies, the second issue is whether the exclusion clause was unconscionable at the time the contract was made, "as might arise from situations of unequal bargaining power between the parties" (*Hunter*, at p. 462). This second issue has to do with contract formation, not breach.

[123] If the exclusion clause is held to be valid and applicable, the Court may undertake a third enquiry, namely whether the Court should nevertheless refuse to enforce the valid exclusion clause because of the existence of an overriding public policy, proof of which lies on the party seeking to avoid enforcement of the clause, that outweighs the very strong public interest in the enforcement of contracts.<sup>33</sup>

To summarize, the test asks three questions. First, as a matter of interpretation, does the exclusion clause apply to the circumstances? Second, was the clause unconscionable at

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<sup>30</sup> *Hunter*, *supra* note 6 at 462.

<sup>31</sup> *Tercon*, *supra* note 2 at paras 62, 82 (Cromwell J. wrote that the time has come to lay the doctrine to rest, while Binnie J. stated that the Court "should again attempt to shut the coffin on the jargon associated with 'fundamental breach'" at para 82).

<sup>32</sup> *Ibid* at para 121.

<sup>33</sup> *Ibid* at paras 122-23 [emphasis in original] citing *Hunter*, *supra* note \_\_ at 462.

the time of contract formation? And third, is there a public policy reason for refusing to enforce the clause? Professor Waddams summarizes the approach:

This decision marks a definitive preference for Dickson C.J.C.'s view in *Hunter*: the nature of a breach may be relevant to the interpretation of an exclusion clause, but, no matter how grave the breach, there is no rule of law that clauses limiting or excluding liability are invalid, provided that they are not grossly unfair (unconscionable) at the time of agreement, and that they do not contravene and overriding public policy.<sup>34</sup>

The bench split 5-4 on the application of the test to the factual circumstances. The source of disagreement was the proper interpretation of the clause under the first step. The majority, in a judgment written by Cromwell J., held that the exclusion clause did not protect the Province from Tercon's claim for damages resulting from the breach.<sup>35</sup> The majority interpreted the clause and concluded that Tercon's claim did not arise "as a result of participating in this RFP".<sup>36</sup> The clause must be read in light of the limit on eligibility to participate in the RFP.<sup>37</sup> The majority held that Tercon's claim arose as a result of an ineligible bidder's participation, as a process involving ineligible bidders was not the process called for by the RFP.<sup>38</sup> Cromwell J. indicated that "being part of that other process [was] not in any meaningful sense 'participating in this RFP'".<sup>39</sup> The majority held that the parties could not have intended to exclude a damages claim "resulting from the Province

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<sup>34</sup> Stephen Waddams, "Canadian Contract Law, 1970-2010" (2011) 50 Can Bus LJ 409 at 425.

<sup>35</sup> *Tercon*, *supra* note 2 at paras 7, 78. The majority held, in the alternative, that the language of the clause is ambiguous and should be interpreted against the Province under the principle *contra proferentem* at para 79. The result is the same: the clause does not apply.

<sup>36</sup> *Ibid* at paras 7, 74.

<sup>37</sup> *Ibid* at para 74.

<sup>38</sup> *Ibid*.

<sup>39</sup> *Ibid*.

unfairly permitting a bidder to participate who was not eligible to do so”.<sup>40</sup> Cromwell J. clarified that “[i]t is only when the defect in the Province’s adherence to the RFP process is such that it is completely outside that process that the exclusion clause cannot have been intended to operate”.<sup>41</sup>

The minority held that the Province’s conduct *did* fall within the exclusion clause.<sup>42</sup> Binnie J. disagreed with the majority’s conclusion that the process ceased to be the RFP process once an ineligible bid was accepted. He believed their conclusion to be a “strained and artificial interpretatio[n] in order, indirectly and obliquely, to avoid the impact of what seems *ex post facto* to have been an unfair and unreasonable clause”.<sup>43</sup> In the minority’s view, “participating in this RFP” began with “submitting a proposal” for consideration.<sup>44</sup> Therefore, the intention of the parties must have been for the clause to apply to this situation. The minority held that there was no imbalance of bargaining power (and therefore no unconscionability), nor a public policy ground to justify depriving the Province of the protection of the exclusion clause.<sup>45</sup>

The majority and minority judgments offered additional guidance on the analysis of exclusion clauses.<sup>46</sup> Regarding the proper interpretation of the clause, Cromwell J. noted that the key principle of contractual interpretation is that “the words of one provision must

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<sup>40</sup> *Ibid* at para 78.

<sup>41</sup> *Ibid* at para 76. Cromwell J. noted that “[i]t is also significant that the Province did not reserve to itself the right to accept a bid from an ineligible bidder or to unilaterally change the rules of eligibility” at para 77.

<sup>42</sup> *Ibid* at para 129.

<sup>43</sup> *Ibid* at para 128 citing *Hunter*, *supra* note 6 at 509.

<sup>44</sup> *Ibid* at para 127.

<sup>45</sup> *Ibid* at paras 131, 140.

<sup>46</sup> Binnie J. provided insight into each step of the newly articulated test. Cromwell J.’s comments, however, were mostly limited to the first step. Since the majority resolved the issue on the first step, it was not necessary to consider the other two.

not be read in isolation but should be considered in harmony with the rest of the contract and in light of its purposes and commercial context”.<sup>47</sup> That is, the clause must be given a purposive construction. Binnie J. indicated that the focus must be on the intentions of the actual parties, not the intentions of reasonable parties, in determining whether the implied terms have been excluded.<sup>48</sup> With respect to excluding the implied duty of fairness, Cromwell J. held that “**clear language** is necessary to exclude liability for breach of such a basic requirement of the tendering process, particularly in the case of public procurement”.<sup>49</sup>

Binnie J. appeared to signal that the starting point in the public policy analysis is the strong public interest in the freedom of contract. Binnie J. accepted that “there may be well-accepted public policy considerations that relate directly to the nature of the *breach*, and thus trigger the court’s narrow jurisdiction to give relief against an exclusion clause”.<sup>50</sup> The burden is on the party seeking to avoid the effect of an exclusion clause to identify the overriding public policy that outweighs the public interest in the enforcement of the contract.<sup>51</sup> Binnie J. did not opine on what considerations of public policy would have been sufficient in *these* circumstances to warrant intervention.

The test in *Tercon* provides an apparently clear set of principles to determine when a court should refuse to apply an exclusion clause. However, the exclusion clause drafted by the Province does not provide the ideal opportunity for testing the limits of exactly how

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<sup>47</sup> *Tercon*, *supra* note 2 at para 64 (Cromwell J. indicated that the approach adopted in *M.J.B. Enterprises*, *supra* note 16 is instructive).

<sup>48</sup> *Ibid* at para 94 (an implied term cannot be implied where either party expresses a contrary intention).

<sup>49</sup> *Ibid* at para 71 [emphasis added]

<sup>50</sup> *Ibid* at para 117 [emphasis in original].

<sup>51</sup> *Ibid* at para 120.

clear the clause must be to exclude the implied duty of fairness. The decision did leave the door open for exclusion clauses to preclude liability for accepting non-compliant bids.<sup>52</sup> As a result, lower courts are left to wrangle with the question of which exclusion clauses achieve this task.

### 3 SHORTCOMINGS OF THE *TERCON* APPROACH

At first glance, it appears that Binnie J. developed a clear and instructive test for determining where to refuse to apply an exclusion clause. However, as with all tests, problems may arise in both interpretation and application. This section critically analyzes the test and the challenges with discretion and uncertainty in its application. First, criticisms of the majority's application in *Tercon* are advanced. Second, problems are identified which have arisen in the subsequent application of the test by lower courts.

#### 3.1 The Majority's Application in *Tercon*

The majority interpreted the clause and concluded that it did not apply where the Province selected an ineligible bidder and attempted to conceal the ineligibility of the bidder. While the majority emphasizes interpretation of the clause and the presumed intentions of the parties, their reasoning appears to be coloured by considerations of public policy.

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<sup>52</sup> Girgis, "Tercon Contractors", *supra* note 18 at 204.

Binnie J. criticized and the majority's analysis under the first step as a "strained and artificial interpretation".<sup>53</sup> In *Hunter*, Wilson J. cautioned against interpreting in this manner:

[E]xclusion clauses, like all contractual provisions, should be given their natural and true construction. Great uncertainty and needless complications in the drafting of contracts will obviously result if courts give exclusion clauses strained and artificial interpretations in order, indirectly and obliquely, to avoid the impact of what seems to them *ex post facto* to have been an unfair and unreasonable clause.<sup>54</sup>

It is difficult to see, through a natural construction of the clause, how Tercon's claim arose from anything other than participating in the RFP. Binnie J. challenged the majority's view on this point, writing that "participating in this RFP" began with "submitting a proposal" for consideration.<sup>55</sup> Had Tercon not submitted a bid, it would have not have a claim. Its claim arose from the fact that it submitted a bid and participated in the RFP process. Binnie J. warned that denying that such participation occurred on the ground that the Province chose an ineligible bidder would "take the Court up the dead end identified by Wilson J. in *Hunter*".<sup>56</sup> As discussed below, it is suspected that the majority's interpretation of this clause was influenced by considerations beyond the intentions of the parties.

The majority's judgment places a strong emphasis on the special status of the tendering process. Cromwell J. wrote: "[I]t seems to me that *both the integrity and the business efficacy of the tendering process* support an interpretation that would allow the

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<sup>53</sup> *Tercon*, *supra* note 2 at para 128.

<sup>54</sup> *Hunter*, *supra* note 6 at 509.

<sup>55</sup> *Tercon*, *supra* note 2 at para 127.

<sup>56</sup> *Ibid* (the "dead end" in *Hunter* is the where the court refuses to apply an exclusion clause which seem unfair after the breaching event has occurred).



exclusion clause to operate compatibly with the eligibility limitations that were at the very root of the RFP”.<sup>57</sup> In determining the intention of the parties regarding the exclusion clause, he held: “I cannot conclude that the parties, through the words found in this exclusion clause, intended to waive compensation for conduct like that of the Province in this case that strikes at the heart of the integrity and business efficacy of the tendering process which it undertook”.<sup>58</sup> The majority interpreted the exclusion clause *in light of* the special context of tendering. The integrity of tendering was such a significant consideration that the majority kept it in mind throughout their interpretation. The analysis under the first step is intended to be a straightforward contractual interpretation to determine if the clause applies to the factual matrix. However, the majority’s decision alludes to the idea that special concerns for the tendering process might supersede the intention of the parties.

Arguably, the integrity and business efficacy of the tendering process are matters which could engage the public interest. However, the Court declined to make a decision on public policy grounds. It did not believe that these considerations rose to the level of a public interest which should limit the freedom of contract expressed through an exclusion clause.<sup>59</sup> Though the majority decided the case upon the interpretation step of the test, it is submitted that this interpretation was strained *because of* the public interest in fairness in the tendering process. This approach is problematic and does not aid in providing a sufficient level of commercial certainty.

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<sup>57</sup> *Ibid* at para 70 [emphasis added].

<sup>58</sup> *Ibid* at para 78.

<sup>59</sup> Writing for the minority, Binnie J. held that “[w]hile there is a public interest in a fair and transparent tendering process, it cannot be ratcheted up to defeat the enforcement of Contract A in this case” at para 135.

### 3.2 Hurdles in Subsequent Application of *Tercon*

As discussed above, there are several criticisms that may be offered regarding the majority's analysis in *Tercon*. It is important to remember that the Court closely split in the application of the test to the facts. The subsequent jurisprudence demonstrates that the confusion in the application of this framework has extended to the lower courts.

Very little instruction is provided in *Tercon* regarding the analysis to be used in determining the presence of unconscionability in contractual formation. The majority, having resolved the issue at the first stage, did not go on to address unconscionability. The dissent noted that *Tercon* is a major contractor, capable of protecting its interests, and therefore no imbalance of bargaining power existed.<sup>60</sup> However, the Court did not refer to a specific test for unconscionability, giving rise to some inconsistency in post-*Tercon* application. Some courts have held that the "usual test" for unconscionability continues to apply.<sup>61</sup> The confusion arises in that there is no consensus on what the "usual test" is. In British Columbia, courts have primarily applied a two-part test, which provides that unconscionability will not be established unless the following factors exist: "inequality in the position of the parties arising from the ignorance, need or distress of the weaker, which leaves him or her in the power of the stronger; and proof of substantial unfairness in the bargain".<sup>62</sup> In Alberta and Ontario, however, other courts have applied expanded tests

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<sup>60</sup> *Tercon*, *supra* note 2 at para 131.

<sup>61</sup> Matthew Nied & Shawn Erker, "The Ghosts of Fundamental Breach: New Developments in the Enforceability of Contractual Limitations of Liability Since *Tercon*" (2014) 72:5 Advocate 665 [Nied & Erker, "Ghosts of Fundamental Breach"] citing *Roy v 1216393 Ontario Inc.*, 2011 BCCA 500 at para 30 [Roy].

<sup>62</sup> Nied & Erker "Ghosts of Fundamental Breach", *supra* note 61 at 668-69. See e.g. *Loychuk v Cougar Mountain Adventures Ltd*, 2012 BCCA 122 at paras 29-31, leave to appeal to SCC refused, 34823 (27 September 2012)

requiring the presence of additional factors.<sup>63</sup> Though the standard for proving unconscionability is similarly high between these approaches, subtle differences remain. Since the unconscionability analysis is beyond the focus of this paper, no further analysis will be advanced. Unconscionability rarely arises in tendering due to the sophistication of the parties.

The public policy analysis under the third stage has also given rise to difficulties in application. The examples provided by Binnie J. of public policy considerations sufficient to trigger the court's jurisdiction to give relief against an exclusion clause are not helpful for the tendering context. His examples include: a milk supplier adulterating its baby formula with a toxic compound to increase profitability; selling toxic cooking oil to unsuspecting customers; and the situation in *Plas-Tex Canada Ltd*.<sup>64</sup> Binnie J. added that "[c]onduct approaching serious criminality or egregious fraud are but examples of well-accepted and 'substantially incontestable' considerations of public policy that may override the countervailing public policy that favours freedom of contract".<sup>65</sup> Some of these are examples of illegality, for which the law already provides protections. The examples do not properly illustrate what type of public interests in tendering might defeat the freedom of

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[*Loychuk*]; *Niedermeyer v Charlton*, 2012 BCSC 1668 at paras 82-89, rev'd on other grounds 2014 BCCA 165 [*Niedermeyer BCSC*].

<sup>63</sup> See Nied & Erker, "Ghosts of Fundamental Breach", *supra* note 61 at 669 for the full list of factors.

<sup>64</sup> *Tercon*, *supra* note 2 at paras 118-119; *Plas-Tex Canada Ltd v Dow Chemical of Canada Ltd*, 2004 ABCA 309, 245 DLR (4th) 650. The Alberta Court of Appeal refused to enforce an exclusion clause where the defendant Dow knowingly supplied defective plastic resin to a customer who used it to fabricate natural gas pipelines. Dow did not disclose the deficiency. The pipelines began to degrade and caused considerable damage to property and risk to human health. The Court concluded that "a party to a contract will not be permitted to engage in unconscionable conduct secure in the knowledge that no liability can be imposed upon it because of an exclusionary clause" at para 53.

<sup>65</sup> *Tercon*, *supra* note 2 at para 120.

contract. Lower courts have been left to interpret whether the public policy analysis is intended to be broader than, or restricted to, the traditional categories of public policy.

The doctrine of public policy has often been referred to as an “unruly horse”.<sup>66</sup> The traditional categories of public policy include: contracts injurious to the state, contracts injurious to the justice system, contracts involving immorality, contracts affecting marriage and contracts in restraint of trade.<sup>67</sup> Separate from these ‘heads’ of public policy are contracts which involve statutory illegality or common law illegality.<sup>68</sup> It is much simpler to determine where a contract contravenes statute or common law. However, “a contract that violates public policy is one which contravenes a value deemed so fundamental that it necessitates the intervention of the courts *in spite of the fact* that there has been no contravention of a legal obligation”.<sup>69</sup> In their article “The Doctrine of Public Policy in Canadian Contract Law”, Brandon Kain and Douglas Yoshida assert that “[i]n declining to enforce a contract which is contrary to a value of public policy”, the courts are “attempting to preserve values which are necessary preconditions of justice in a modern liberal democracy”.<sup>70</sup> Despite stressing the importance of balancing freedom of contract with the public interest in the integrity and business efficacy of the tendering process, *Tercon* does

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<sup>66</sup> *Richardson v Mellish* (1824) 2 Bing. 229 (Eng. C.P.) at 225, Burrough J. (this characterization as an unruly horse has been repeated throughout the jurisprudence and commentary on public policy).

<sup>67</sup> Brandon Kain & Douglas T. Yoshida, “The Doctrine of Public Policy in Canadian Contract Law” (2007) *Archibald AnnRev Civil* 1 [Kain & Yoshida, “Public Policy”].

<sup>68</sup> *Ibid* at 15.

<sup>69</sup> *Ibid* at 16 [emphasis in original].

<sup>70</sup> *Ibid* at 46.

not disclose which values could engage public policy in tendering. It is not clear “what must be shown, at a minimum, to trigger a court’s public-interest jurisdiction”.<sup>71</sup>

Matthew Nied and Shawn Erker highlight that “[m]ost early post-*Tercon* decisions seemed to indicate that a court must be satisfied that the defendant was seeking to use the limitation clause as a shield for deliberate deception or intentional misconduct. Mere or even gross negligence appeared to be insufficient”.<sup>72</sup> In *Loychuk v Cougar Mountain Adventures Ltd*, Frankel J. considered *Tercon* and concluded that a party must have “engaged in conduct that is so reprehensible that it would be contrary to the public interest to allow it to avoid liability”.<sup>73</sup>

This language sounds quite similar to the former analysis of fundamental breach. In *Niedermeyer v Charlton*,<sup>74</sup> Garson J.A. appeared to conclude that public policy considerations under *Tercon* are broader than the traditional categories.<sup>75</sup> In dissent, Hinkson J.A. (as he then was) stated that the *Tercon* public policy analysis should be limited to the traditional categories of public policy.<sup>76</sup> The exact nature of the public policy considerations under *Tercon* remains unclear.

The lack of guidance and restrictions on public policy discretion presents the risk that the analysis of exclusion clauses could fall back into the type of *ex post facto* reasoning that

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<sup>71</sup> Nied & Erker, “Ghosts of Fundamental Breach”, *supra* note 61 at 671.

<sup>72</sup> *Ibid* at 671. See e.g. *Roy*, *supra* note 61; *Loychuk*, *supra* note 62.

<sup>73</sup> *Loychuk*, *supra* note 62 at para 46.

<sup>74</sup> 2014 BCCA 165 [*Niedermeyer* BCCA].

<sup>75</sup> The situation in *Niedermeyer* did not fit within the category of statutory illegality. However, Garson J.A. held that the exclusion clause violated public policy because it frustrated the objects of the legislation (i.e. driver’s insurance).

<sup>76</sup> *Niedermeyer*, *supra* note 74 at para 44.

the Court sought to escape. It is argued that procurement requires a more stable approach to analyzing exclusion clauses, which can provide a consistent level of commercial certainty to meet the special needs of this process. As cautioned by Brandon Kain and Douglas Yoshida, the “courts must ensure that they do not unduly extend the reach of public policy, and in doing so undermine the continued march of the positive law”.<sup>77</sup> The failure to contain the public policy considerations to the existing categories obfuscates this stage of the analysis, allowing that unruly horse to rear its head again.

#### 4 THE CASE FOR A DOCTRINE OF FAIRNESS

When interpreting a contract, the role of the court is to give effect to the intention of the parties. In procurement, the parties are sophisticated and capable of drafting complex contracts and clauses to allocate and limit liability. The current test for exclusion clauses gives too much discretion to judges, resulting in inconsistent application. Judges may find ways to refuse to apply exclusion clauses (even well-drafted ones) where the result is manifestly unfair. The concerns of Dickson C.J. in *Hunter* are as relevant now as then. Nonetheless, this paper does not seek to contest that it is problematic to apply exclusion clauses even where an owner has acted entirely unfairly and disregarded its own process. Rather, it is contended that public procurement requires more reliable protections against government owners who fail to follow the terms set out in their own RFPs. Government sponsors should not be permitted to escape liability for choosing non-compliant tenders by

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<sup>77</sup> Kain & Yoshida, “Public Policy”, *supra* note 67 at 46.

implementing broad exclusion clauses. The creation of a common law duty of fairness could ensure minimum standards of fairness in public procurement.

#### 4.1 Public vs. Private Procurement

Prior to advancing the argument for the recognition of a new doctrine, it is necessary to set out why public procurement warrants additional protections. The holding in *Tercon* threatens to erode the protections developed for the tendering process, which exist only where there is a Contract A and the parties have not excluded them. Following *Tercon*, owners have learned that any exclusion clause must be clearly worded in order to protect from liability for selecting an ineligible bidder (and by extension, a non-compliant bid).

The ability to exclude both of the implied terms wreaks havoc on the *Ron Engineering* construct. In *Ron Engineering* and *Naylor Group Inc*, the SCC emphasized that Contract A may arise upon the submission of a tender. Whether Contract A arises depends upon the intention of the parties, including the terms of the RFP. If, under *Tercon*, the parties are free to exclude the implied duty of good faith, then it is doubtful whether Contract A arises. Parties have already excluded the obligation to select the lowest compliant bidder for some time by employing privilege clauses. Under *Tercon*, issuers might be free to exclude the *Ron Engineering* construct completely, thereby avoiding the protections put in place by the SCC.<sup>78</sup> The alternate view is that Contract A still arises where an owner issues an RFP excluding the implied terms. However, it is difficult to see what consideration is provided by the sponsor when it has eliminated substantially all of its obligations to tenderers. What

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<sup>78</sup> See Girgis, “*Tercon Contractors*” *supra* note 18: “[S]ince there is no freestanding duty of fairness absent contractual relationships, owners will have no obligations to a tenderer in the absence of Contract A” at 204.

exactly would the tenderer be bargaining for when Contract A lacks any guarantees? Significant barriers to the Contract A and Contract B construct arise when it is stripped of the implied obligations.

An argument is frequently offered that if government sponsors reduce or eliminate their potential liability through overbroad exclusion clauses, contractors will choose not to submit tenders.<sup>79</sup> It is expensive to prepare submissions, and having no guarantees of fair treatment, contractors will choose not to participate. In this sense, the system would self-regulate. After experiencing reductions in qualified and attractive bids, owners would be forced to soften their exclusions of liability to make bidding on their projects more worthwhile. This paper takes the position that it is insufficient, in the context of public procurement, to leave it to contractors to regulate the behaviour of government owners. Allowing the industry to self-regulate might be sufficient in private procurement, but it does not ensure the level of integrity that should be expected of government functions.

In *Tercon*, the bench expressed doubt that the public interest in the integrity and business efficacy of public procurement was sufficient to warrant restrictions on the government's ability to draft exclusion clauses. But if it is a "special commercial context",<sup>80</sup> how can its protections be guaranteed when the parties are free to exclude them? In her article discussing the impact of *Tercon* and the tendering process, Professor Girgis contends that "[a]lthough some courts have been inclined to refer to the tendering process as a special process in need of protection, the reality is that the tendering process is a series

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<sup>79</sup> See *Tercon*, *supra* note 2 at para 141, where Binnie J. concludes that if enough bidders are dissatisfied with the terms of the tender call and therefore do not bid, the issuer will be "forced to change its approach".

<sup>80</sup> *Ibid* at para 67.



of contracts, adhering to basic contract law principles”.<sup>81</sup> She adds that “the only way to preclude issuers from excluding liability for accepting non-compliant tenders in a tendering process would be to attribute to the tendering process a special characteristic under public policy, one that would allow the tendering process to bypass the contract law principles pertaining to exclusion clauses”.<sup>82</sup> Professor Girgis takes the position that the courts should not impose protections independent of the parties’ intentions. This paper takes the opposite view. The recognition that tendering requires protection appears throughout the case law from *Ron Engineering* through to *Tercon*. Public procurement in particular warrants protection beyond what is currently offered.

Professor Girgis notes that the Court in *Tercon* did not analyze the issue on the basis that public funds had been used. She asks whether, in the future, the use of public funds could elevate the issue to one public policy.<sup>83</sup> It is surprising that this factor has not been afforded sufficient consideration. There is a strong public interest in the government (including its agencies, ministries, etc.) acting fairly. In a country with significant levels of taxation, citizens are invested in the responsible, transparent and efficient use of public funds. In the tendering context, it is shocking when government owners act in contravention of their own standards, such as in *Tercon*. They owe a higher level of accountability to the parties that they contract with as well as to the public. Government issuers should not be free to excuse their own misbehaviour with a bulletproof exclusion clause.

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<sup>81</sup> Girgis, “*Tercon Contractors*”, *supra* note 18 at 198.

<sup>82</sup> *Ibid* at 199.

<sup>83</sup> *Ibid* at 209.

For these reasons, it is argued that a distinction should be made between public and private procurement. This position is not immune to criticism in respect of asymmetrical treatment. Some might argue that private and public procurement should be subject to the same set of rules. This view does not appreciate the need for good faith government performance as well as responsible, transparent and fair use of public funds. These interests elevate the concerns for the public process over its private counterpart. While the self-regulation of exclusion clauses might be sufficient in the private context, it is unsatisfactory as a standard for public procurement.

Professor Girgis believes that if the *Ron Engineering* analysis is to be saved, “the preferred approach would be to impose certain obligations in public procurement processes or restrict the use of broad exclusion clauses that exclude liability for failing to adhere to fundamental obligations through legislation”.<sup>84</sup> It is agreed that legislation is one possible solution. However, contracts are the domain of the provinces, which could result in different standards across the country. A more consistent approach could be developed at common law under the umbrella of the organizing principle of good faith contractual performance.

#### 4.2 Bhasin: The Organizing Principle of Good Faith

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<sup>84</sup> *Ibid* at 212.

In the recent and seminal case *Bhasin v Hrynew*,<sup>85</sup> the SCC articulated an organizing principle of good faith contractual performance. It also created a doctrine of honest contractual performance:

[I]t is time to take two incremental steps in order to make the common law less unsettled and piecemeal, more coherent and more just. The first step is to acknowledge that good faith contractual performance is a general organizing principle of the common law of contract which underpins and informs the various rules in which the common law, in various situations and types of relationships, recognizes obligations of good faith contractual performance. The second is to realize, as a further manifestation of this organizing principle of good faith, that there is a common law duty which applies to all contracts to act honestly in the performance of contractual obligations.<sup>86</sup>

The organizing principle of good faith is not a legal doctrine. It “states in general terms a requirement of justice from which more specific legal doctrines may be derived”.<sup>87</sup> Cromwell J., who authored the judgment, outlined the parameters of the organizing principle of good faith:

The organizing principle of good faith exemplifies the notion 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. While “appropriate regard” for the other party’s interests will vary depending on the context of the contractual relationship, it does not require acting to serve those interests in all cases. It merely requires that a party not seek to undermine those interests in bad faith.<sup>88</sup>

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<sup>85</sup> 2014 SCC 71, [2014] 3 SCR 494 [*Bhasin*].

<sup>86</sup> *Ibid* at para 33.

<sup>87</sup> *Ibid* at para 64.

<sup>88</sup> *Ibid* at para 65.

The newly-created general duty of honesty in contractual performance “means simply that parties must not lie or knowingly mislead each other about matters directly linked to the performance of the contract”.<sup>89</sup> This duty operates “irrespective of the intentions of the parties”.<sup>90</sup> It is not, therefore, an implied term but rather a general doctrine of contract law. It imposes a minimum standard of honesty which applies to all contracts; the parties are not free to exclude it.<sup>91</sup> The Court in *Bhasin* held that the entire agreement clause in the contract did not impede the operation of the duty; it did not protect from liability.<sup>92</sup>

It is arguable that the actions of the Province in *Tercon* would have violated this duty of honest contractual performance, had it been in existence. The Province acted dishonestly in its attempt to conceal the true status of the ineligible bid. However, where an owner clearly gives itself the ability to select non-compliant bids, this duty would not apply. The duty of honest contractual performance, though a necessary development of the law, is not sufficient in itself to maintain the integrity of the tendering process.

#### 4.3 The Case for a New Doctrine under *Bhasin*

The list of doctrines which fall under the organizing principle of good faith in *Bhasin* is not closed.<sup>93</sup> New doctrines may be recognized under this umbrella where it would be an

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<sup>89</sup> *Ibid* at para 73.

<sup>90</sup> *Ibid* at para 74.

<sup>91</sup> *Ibid* at paras 74-75, 86.

<sup>92</sup> *Ibid* at paras 75, 103. An entire agreement clause is similar to an exclusion clause. It expresses the parties' intention to limit the agreement to the terms contained in the written contract, seeking to prevent the implication of any other terms.

<sup>93</sup> *Bhasin*, *supra* note 85. “The application of the organizing principle of good faith to particular situations should be developed where the existing law is found to be wanting and where the development may occur incrementally in a way that is consistent with the structure of the common law of contract and gives due weight to the importance of private ordering and certainty in commercial affairs” at para 66.

incremental development of the law. In discussing situations and relationships which fall under the organizing principle, Cromwell J. specifically referred to the tendering process:

This Court has also recognized that a duty of good faith, in the sense of fair dealing, will generally be implied in fact in the tendering context. When a company tenders a contract, it comes under a duty of fairness in considering bids submitted under the tendering process, as a result of the expense incurred by parties submitting these bids.<sup>94</sup>

However, the implied terms which have developed in tendering case law are only implied under Contract A when consistent with the intention of the parties. As discussed above, careful, clearly-worded drafting can avoid the implication of the terms developed to safeguard the tendering process.

To achieve a minimum standard of fairness and commercial certainty, it is submitted that a **general duty of fairness** should be adopted in respect of public procurement. This doctrine, operating independently of the intention of the parties, would prevent a government sponsor from escaping liability for violating its own process through the selection of a non-compliant bid or ineligible bidder. The parties would not be free to exclude it. As with the duty of honest contractual performance, the exact requirements of this duty will vary with the context. However, the elevation of the duty of fairness from an implied term to a rule of law achieves a minimum standard of fairness: a government owner will be obliged to follow its own terms regarding compliance and eligibility as set out in its RFP. In submitting a bid, tenderers would be afforded the protection of a fair and

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<sup>94</sup> *Ibid* at para 56.

transparent process. These characteristics ought to be expected of functions performed by government agencies and supported by public funds.

Government owners would continue to be able to employ privilege clauses imposing no requirement to select the lowest or any bidder (thereby excluding the implied obligation to select the lowest compliant bidder). Whereas there may be benefits to selecting a bid which is not the lowest in cost,<sup>95</sup> permitting government owners to sidestep their own processes gives rise to a sense of impropriety which should not exist in public procurement. The protections of the Contract A system can be maintained through the recognition of a contractual duty of fairness.

An obvious question of interpretation arises in determining when a departure from the RFP terms contravenes the proposed rule. Which types of non-compliance<sup>96</sup> are government owners prevented from accepting? A non-compliant bid is that which does not comply with the terms or process set out by the RFP. Therefore, the determination of whether a bid is non-compliant will depend on the facts of each case. The standard for evaluating compliance which has been recognized through the case law would continue to apply. The test for determining compliance is “substantial compliance” rather than strict compliance: “Substantial compliance requires that all material conditions of a tender, determined on an objective standard, be complied with[...]. A bid is substantially compliant

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<sup>95</sup> Examples: attractive innovations, reputation of contractor, former positive business relationship, better selection of materials, etc. Owners might also wish to reserve the right not to select any submission in case they are unsatisfied with the submissions or circumstances surrounding the project change.

<sup>96</sup> The term “non-compliance” will be used to refer to both non-compliant bids and submissions by ineligible bidders.

if any departures from the tender call concern mere irregularities.<sup>97</sup> Where a substantially compliant bid is accepted, there is no breach of the implied term that only compliant bids would be accepted.<sup>98</sup> An owner may also waive compliance of an “informality”.<sup>99</sup>

Maintaining this standard, it is argued that only the acceptance of *substantially* non-compliant tenders ought to give rise to liability under this duty of fairness. It is the acceptance of substantially non-compliant tenders which calls into question the integrity and business efficacy of the tendering process. Importantly, however, this distinction still permits the acceptance of bids that contain trivial inconsistencies. For example, a minor error which can be corrected does not sink an entire submission. Though an owner is not *required* to accept a revised bid,<sup>100</sup> it should not be prevented from doing so when it does not impact the legitimacy of the process.

In *Bhasin*, Cromwell J. contended that recognizing the duty of honest contractual performance poses no risk to commercial certainty in the law of contract: “A reasonable commercial person would expect, at least, that the other party to a contract would not be dishonest about his or her performance”.<sup>101</sup> Similarly, a reasonable contractor would expect a government sponsor to be honest, transparent and fair in carrying out their own tender process.

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<sup>97</sup> *Double N Earthmovers*, *supra* note 20 at paras 109-110, Charron J, dissenting citing *Silex Restorations Ltd. v Strata Plan VR 2096*, 2004 BCCA 376 at paras 24, 29; *Graham Industrial Services Ltd. v Greater Vancouver Water District*, 2004 BCCA 5 at para 15.

<sup>98</sup> *Double N Earthmovers*, *supra* note 20 at paras 109-110 (the intention is to separate bids which fail to comply with the RFP in substance from those that are non-compliant as the result of oversight).

<sup>99</sup> *Ibid* at para 41 (an informality is “something that did not materially affect the price or performance of Contract B” at para 41).

<sup>100</sup> *Calgary (City) v Northern Construction Company Division*, 1985 ABCA 285; *aff’d* [1987] 2 SCR 757 (C.A.).

<sup>101</sup> *Bhasin*, *supra* note 85 at para 80.

As the party initiating the tendering process, the owner has the option to give the tenderers flexibility to propose innovations or variations on the design. However, when the government asks for a specific design, and the bidder suggests something different altogether, the owner has prevented itself from being able to accept that bid. It would not reasonably have been within the expectation of the other parties, who observed the terms of the RFP, that the owner would accept a bid for something different than what it requested. A government owner should instead utilize discretion clauses indicating that it is not required to accept the lowest or any bid. The owner might realize, through the submission of a non-compliant bid, that there are benefits to proceeding in another direction. The owner should be required to cancel the RFP and issue another with different terms. Although there would be added costs to this method, it is worth the benefit gained in procedural fairness. If an owner requests “A”, it should not be able to accept “B” to the surprise of all compliant bidders. As a bottom line, a government owner should be held to its bargain.

## 5 CONCLUSION

It is very difficult to reconcile the proposition that tendering is a “special commercial context”<sup>102</sup> with the ability of parties to exclude the implied terms through clearly-worded exclusion clauses. It is doubtful that the confusion surrounding exclusion clauses has been resolved. There are a few directions that the law could develop in the future. First, standards could be adopted through legislation. However, this poses the challenge of

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<sup>102</sup> *Tercon*, *supra* note 2 at para 67.



inconsistency across the various provinces. Second, the law could continue to develop on a case-by-case basis, exploring the scope of the *Tercon* framework. This path will likely result in the over-application of the public policy analysis, risking the reincarnation of fundamental breach under a different label. Finally, there is the possibility of judicial recognition of a common law duty of fairness in respect of public procurement. This incremental development of the law could resolve much of the uncertainty that remains in the tendering process.

Government owners should be held to the terms of the RFPs which they issue. The rule proposed in this paper can help achieve the level of integrity and business efficacy contemplated by Cromwell J. in *Tercon* by establishing a minimum standard of fair, transparent conduct. So what will it be: the unruly horse, or fairness for all?