SCC File Number: 38601

IN THE SUPREME COURT OF CANADA
(ON APPEAL FROM THE COURT OF APPEAL FOR BRITISH COLUMBIA)

BETWEEN:

WASTECH SERVICES LTD.

APPELLANT
(APPELLANT)

and

GREATER VANCOUVER SEWERAGE AND DRAINAGE DISTRICT

RESPONDENT
(RESPONDENT)

FACTUM OF THE APPELLANT
WASTECH SERVICES LTD.

(Pursuant to Rule 42 of *the Rules of the Supreme Court of Canada*)

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PART I -OVERVIEW AND STATEMENT OF FACTS

A. Overview

1. The parties spent months negotiating a 20-year contract about the management of waste disposal. During negotiations, they deliberately did not provide a contractual term for the possibility that the respondent Greater Vancouver Sewerage and Drainage District ("Metro") would exercise its discretion to allocate waste disposal volumes in a way that prevented the appellant Wastech Services Ltd. ("Wastech") from achieving its express contractual objective to earn a target operating margin. The parties agreed not to include a term that dealt with this eventuality as they thought that Metro allocating waste disposal volumes in a way that nullified Wastech's fundamental contractual benefit was very unlikely to occur because it did not appear that alternative waste disposal sites would be available and because the parties could not reach agreement on how it might be addressed in the agreement. As a result, Wastech was left to depend on Metro's good faith.

2. Fifteen years into the contract, in order to reduce its costs, the unexpected occurred: Metro materially reallocated waste volumes, which made it impossible for Wastech to earn its target margin despite ably performing its work. The arbitrator properly found this was a breach of Metro's duty to exercise its contractual discretion in good faith.

3. Based on the contract and the factual matrix of its formation, the arbitrator found that the parties recognised at the time of contract formation that they could not capture all of the eventualities that might arise over the course of the relational, 20-year agreement. Wastech's legitimate contractual expectation, which was known to both parties, was that Metro would not exercise its discretion to implement a material change in the volume of waste allocation that had the effect of depriving Wastech of the opportunity, if it performed its own obligations, to achieve the bargained for margin. This was because the costs of performing the agreement could not be adjusted to cope with a material reduction in the higher paid portion of the work. The arbitrator concluded that his finding a breach of the duty of good faith was not precluded by his finding that there was no implied term requiring a specific compensatory mechanism if Metro reallocated large volumes of waste.

4. The Court of Appeal overturned the award. Its reasoning fails to apply the principle of good faith in the exercise of a contractual discretion that was well-established law prior to *Bhasin v. Hrynew*[1], is inconsistent with the organizing principle of good faith described in *Bhasin* and prevents the rational development of the law. The Court of Appeal's analysis treats good faith as confined by the agreed terms of the contract rather than asking whether there has been a good faith exercise of the contractual discretion. The court in effect denied that the unilateral exercise of a contractual discretion is subject to the obligation of good faith, which operates to prevent the self-interested destruction of fundamental, mutual contractual expectations.

5. Good faith, at its core, is the exercise of contractual powers in a fashion that is consistent with the mutual goals of the relationship. Here that meant recognising that the exercise of discretion was inconsistent with the parties' mutual goal of performance-based regulation of costs and profits, which provided the opportunity for the identified margin to be earned by the applicant throughout the 20-year term of the agreement through capable management.

6. This appeal also demonstrates again that despite *Sattva Capital Corp. v. Creston Moly Corp.*[2] and *Teal Cedar Products Ltd. v. British Columbia*,[3] lower courts continue to issue confusing judgments when reviewing arbitral awards. The court below overturned the arbitrator's interpretation of the contract on the ground that he failed to address whether Wastech had a legitimate expectation founded in the contract. The court also overturned the arbitrator's finding that the reasonable contractual expectations of Wastech had been defeated. The arbitrator's conclusions on these issues were, according to *Teal Cedar* and *Sattva*, questions of mixed fact and law and thus were not reviewable. The decision below fails to exercise the vigilance called for by this Court against finding extricable questions of law when in reality the objection is about how the arbitrator applied the law to the facts.

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[1] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494.

[2] *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, [2014] 2 SCR 633.

[3] *Teal Cedar Products Ltd. v. British Columbia*, 2017 SCC 32, [2017] 1 SCR 688.

B. The nature of the claim, the parties and their contract

7. Wastech is a company that had a 20-year contract ("Comprehensive Agreement" or "CA") with Metro for the transportation of solid waste.[4]

8. Metro is a corporate body exercising regulatory authority over waste disposal facilities in the Greater Vancouver Regional District ("GVRD").[5]

9. The CA was entered into in 1996 and provided for an integrated waste management system that shared the benefits that could be obtained through efficiencies and superior performance. The CA replaced and superseded four separate agreements between Metro and Wastech or its predecessors dating back to 1986.[6] Metro wanted to control the costs of trucking and disposal of waste and Wastech wanted an assurance it would earn a fair profit if it performed well.[7] Disposal rates were set at the beginning of the CA and, once set, only adjusted by inflation or other defined mechanisms in the CA.

10. The CA provided that solid municipal waste would be delivered to various transfer stations managed by Wastech in the Lower Mainland and transported by, or on behalf of, Wastech to the Cache Creek Landfill ("CCLF"), the Vancouver Landfill ("VLF") and the Burnaby Waste to Energy Facility ("Burnaby Incinerator").[8] The CA also provided for different payment scales reflecting the different costs of transportation. A Long Haul Rate ("LHR") was payable for the transfer, transport and disposal of municipal solid waste to the CCLF. A Short Haul Rate ("SHR") was payable for the transfer and transport of municipal solid waste to the VLF and the Burnaby Incinerator.

11. The cost of running Lower Mainland transfer stations was significant and apportioned between the LHR and SHR based on shipped tonnage.[9] Any radical shift in volumes between long-haul and short-haul significantly affected Wastech's compensation. At the outset of the CA,

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[4] Award of Arbitrator Ghikas, Q.C. ("Award"), para. 1; Reasons for Judgment of McEwan J. ("BCSC Reasons"), para. 5.

[5] Award, para. 2; BCSC Reasons, para. 6.

[6] Reasons for Judgment of Newbury, Stromberg-Stein and Fisher JJ.A. ("BCCA Reasons"), para. 20.

[7] Award, paras. 3, 42; BCSC Reasons, para. 7-8.

[8] Award, paras. 4, 49; BCSC Reasons, paras. 9-10.

[9] Award, para. 6; BCSC Reasons, para. 10.

the bulk of the transfer stations costs were apportioned to the LHR and this was still the case in the disputed reallocation year.

12. Although the CCLF was a more expensive facility, the parties understood that, because of the limited availability of alternatives, for the duration of the CA Metro needed Wastech to plan and operate on the basis that would maximize the volumes going to the CCLF.[10] This was expressly reflected in Recital C(6), which provided that the CA "*will, in relation to the operation of the comprehensive municipal solid waste transfer system…provide for the maximization of the municipal solid waste disposal capacity of the Cache Creek Landfill…*"

13. In order to make the CA cost effective for Metro (another objective set out in Recital C) while still providing Wastech with a predictable income, Wastech's payment for services was not on a cost-plus basis. Instead, using a concept similar to performance-based regulation of utilities, the payments to Wastech were predicated on a specified operating margin: the agreement provided for a "target operating ratio" of 0.89 ("Target OR"), based on operating costs being 89% of total revenues.[11] The Target OR, agreed on the basis of the financial performance under previous contracts between the parties, meant that Wastech's target profit margin would be approximately 12%. The complex formulae in the CA meant that Wastech had an incentive to control costs, since cost savings would in the result be shared between the parties.

14. One of the variables impacting total revenues and costs (and thus Wastech's ability and opportunity to achieve the Target OR) was the volume of waste allocated for disposal to each of the CCLF, the VLF and the Burnaby Incinerator.[12] When the CA was made, both parties knew that if the Target OR was to be achieved, rates, costs and total volumes allocated to each disposal site had to be in an appropriate balance. In large measure, this was due to the contractual formula which allocated the cost of running the transfer stations between the LHR and the SHR.

15. Metro, however, had the contractual discretion to allocate waste annually between the CCLF, VLF and Burnaby Incinerator.[13] Section 12.7 required Metro to provide to Wastech, by no later than August 15 of each year, a "*detailed forecast*" for the following operating year of the

[10] Award, paras. 52, 56, 58, 62; BCSC Reasons, para. 22.
[11] Award, para. 5; BCSC Reasons, para. 11.
[12] Award, paras. 6, 43; BCSC Reasons, para. 12.
[13] Award, para. 44; BCSC Reasons, para. 13.

allocation of all the waste expected to be handled in the system during the following operating year (an "Annual Waste Allocation Plan").

16. Wastech planned its operations and managed its costs with the view to maximizing operating efficiencies in accordance with the Annual Waste Allocation Plans.[14] As a result, Wastech's ability to earn its specified profit margin (the Target OR) was affected by Metro's exercise of discretion as to the portion of long-haul or short-haul volumes. This was particularly so if the discretion was exercised at a time or in a manner that made it impossible to adjust the costs relating to the operation of the transfer stations in the Lower Mainland. The maximization of the CCLF exercised a control over this risk since it meant that portion of the volume was reasonably predictable and hence Wastech could predict one aspect of the operations.

C. Decision of Arbitrator Ghikas (February 13, 2015)

17. The issue before the arbitrator was whether Metro's discretionary waste allocation in 2011 made it impossible for Wastech to achieve the Target OR and whether in that result: (1) Metro breached an implied term of the CA requiring a retroactive rate adjustment and compensatory payment; or (2) Metro breached a duty to perform the CA in good faith by allocating waste volumes in such a way as to deprive Wastech of the opportunity to earn the Target OR.[15]

18. The arbitrator made several findings central to his Award.

19. First, Metro made a conscious decision in 2010 to significantly redirect waste flow volume from the CCLF to the VLF. Metro's allocation decision for 2011 ("2011 Waste Allocation Plan") caused volumes delivered to the CCLF to drop precipitously by 123,328 tonnes, or 31%, relative to 2010.[16] Metro made its decision to redirect waste from the CCLF to the VLF because it would be better off financially, even though it knew that the decision was likely to cause significant operational issues for Wastech such as layoffs and lower royalty payments.[17]

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[14] Award, para. 44; BCSC Reasons, para. 14.
[15] Award, paras. 28, 32.
[16] Award, paras. 47, 52, 54, 89; BCSC Reasons, para. 16.
[17] Award, paras. 53, 87-88; BCCA Reasons, para. 32.

20. Second, as a result of Metro's 2011 Waste Allocation Plan, it was impossible for Wastech to achieve the Target OR for the 2011 operating year as the radical shift from long-haul to short-haul left no means of recovering the costs to operate the transfer stations that were allocated to the long-haul. Wastech could not adjust the rates to levels that would compensate for the reallocation.

21. Third, the Comprehensive Agreement did not expressly address a radical re-distribution of waste away from the CCLF. At the arbitration, witnesses for both parties said that the mutual expectation of the parties at the time the CA was made was that the CCLF would be used to maximum advantage, and that waste volumes allocated to the CCLF would approximate the maximum annual amounts of waste that the site was permitted to accept.[18] When the CA was made, Wastech understood that the City of Vancouver, which owned and operated the VLF, was resistant to any increase in waste volumes to the VLF.[19] Metro's witness said that the reason there was no express provision to compensate Wastech for losses arising from Metro radically re-directing waste flow away from the CCLF in any given year was simply because no one directly involved in developing the terms of the CA considered it realistically possible that Metro would ever do so.[20] The topic was raised during negotiations, but the parties decided not add any term for it because the express premise in the Recital—that the CCLF would be used to its maximum annual capacity during the term of the agreement—made it not worth adding further complexity to an already complex document and compensation formulae to address something that was considered highly likely to ever arise.[21]

22. The arbitrator summed up his findings as follows:

> Based on the entirety of the evidence (and without deciding at this stage that the evidence is relevant or admissible in the context of the specific claims made by Wastech in this arbitration) I find that when the CA was being negotiated:
>
> 1. Both parties were aware of the possibility that waste flows to CCLF might reduce and that one possible reason for a volume reduction would be the direction of waste to VLF rather than CCLF;

[18] Award, para. 56.
[19] Award, para. 57.
[20] Award, para. 58.
[21] Award, para. 58.

> 2. Both parties were aware that a possible consequence of a reduction in waste volumes delivered to CCLF would be that Wastech would not achieve the Target OR;
>
> 3. Both parties thought that it was highly unlikely that there actually would be a substantial reallocation of waste away from CCLF to VLF;
>
> 4. As a consequence, and because of a mutual desire to simplify the CA, both parties agreed that no provision dealing with that eventuality should be included in the CA.[22]

23. Fourth, the opportunity for Wastech to achieve the Target OR was a central concept underpinning the CA.[23] It balanced the interest of Wastech in receiving appropriate compensation over the life of the agreement with the interest of Metro in not being obliged to make payments that might over time be considered excessive.[24] The fundamental bargain underlying the CA was the assurance of cost control to Metro and the assurance of an operating margin to Wastech. The chance to achieve the annual Target OR was the fundamental benefit for which Wastech bargained.[25]

24. The arbitrator noted that "*Metro does not seriously dispute that the Target OR was a central concept underpinning the CA*", and he found that the Target OR "*balanced the interest of Wastech in receiving appropriate compensation over the life of the CA with the interest of Metro in not being obliged to make payments that might over time be considered excessive.*"[26]

25. The arbitrator first addressed the question of whether there was an implied term that Wastech would have the annual opportunity to meet the Target OR. Wastech argued that the CA had the following implied term, which incorporated a specific contractual mechanism:

> Should Wastech demonstrate that, as a consequence of [Metro]'s re-direction of waste flow volume in the immediately preceding Operating Year, whether pursuant to an Annual Waste Allocation Plan or otherwise, it was impossible for Wastech to achieve the target Operating Ratio in that Operating Year based on the actual volume of waste handled, the parties shall retroactively reset the rates and payments for and from that Operating Year in accordance with section 14.17, and the Lump Sum

[22] Award, para. 63.

[23] Award, paras. 42, 84, 94.

[24] Award, para. 42.

[25] Award, para. 94.

[26] Award, paras. 42, 84; BCCA Reasons, para. 42.

> Payment payable by [Metro] pursuant to section 14.3(c) shall include an amount equal to 100% of the resultant Carry-over Variance.[27]

26. The arbitrator held that he could not imply this term into the CA because the parties had decided not to include such a term (since it was highly unlikely to be an issue) and because the parties were aware that there were various contractual mechanisms that could have applied but they had not agreed on any of them.[28]

27. The arbitrator next considered the duty of good faith. He found that Metro breached its good faith obligation by exercising its discretion under the CA and unreasonably deprived Wastech of its bargained-for benefit.[29] This legal duty was not excluded because the parties had decided not to negotiate a term to address the circumstance.[30] The CA was a "*long term relational agreement that depends upon an element of trust and confidence if the mutual expectations of the parties are to be achieved*" and that it "*falls within the types of situations and relationships in which the existing doctrines require Metro have 'appropriate regard' for the legitimate contractual interests of Wastech when exercising its discretionary contractual power*."[31]

28. The arbitrator's conclusion as to the breach of a duty of good faith was based on the well-established good faith doctrine that for long-term, relational contracts, which involve elements of trust and confidence, a party to a contract may not unilaterally exercise its discretionary contractual power in such a way as to substantially nullify the bargained benefit or objective to the other party.[32] He quoted extensively from case law that describes the specific doctrine that he found governed contractual performance.[33]

29. While routine changes to waste allocations, even if they had a negative impact on Wastech, were not breaches of Metro's good faith obligation, the 2011 material reduction in

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[27] Award, para. 31.
[28] Award, paras. 31, 74, 75.
[29] Award, paras. 78-97.
[30] Award, para. 91.
[31] Award, para. 85.
[32] Award, paras. 78-97.
[33] Award, paras. 80-82; *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, paras. 65-66.

waste allocated to CCLF and material increase in waste allocated to VLF, which had significant financial implications, was a breach of the duty of good faith.[34]

30. The unfairness of Metro's allocation arose from the fact that Metro reduced its waste allocations to reduce its own costs knowing that this would make it impossible for Wastech to earn its Target OR in 2011.[35] There was no means for Wastech to recover the transfer station cost allocated to the long-haul when this volume was radically shifted to short-haul. At the time of the 2011 allocation in 2010, Metro did not actually have the ability to implement its projected allocation. Metro only gained the ability to do this in the middle of 2011. Therefore, while Metro estimated its 2011 allocation would likely change dramatically, this outcome was not certain until well into 2011. As a result, Wastech had to maintain LHR transfer station capacity, although the volume of waste ultimately shipped to the CCLF in 2011 made this an economically untenable situation.

31. The arbitrator accepted that Metro's decisions about waste allocations in 2011 were subjectively reasonable and in furtherance of its own business objectives.[36] But he recognised that the existing doctrines of the duty of good faith do not require evidence of dishonesty in all cases.[37] The specific category of the good faith doctrine in issue characterised the exercise of an acknowledged, bargained for contractual right as "dishonest" (in the sense of not being in good faith) where it was wholly at odds with the legitimate contractual expectations of the other party.

32. The arbitrator found that the findings which precluded an implied term did not preclude the application of the good faith doctrine. He held that:

> …If the doctrine can operate to constrain or limit the exercise of an express contractual power, the fact that the parties considered and rejected including express limits on the power does not seem to me to add anything to the good faith analysis. In most situations it will be the case that the parties "could have" incorporated express restraints, but actually or presumptively chose not to do so. Although in some cases the good faith obligation is described as an implied contractual term, *Bhasin*, and the other jurisprudence defining the good faith doctrine do not require that the

[34] Award, para. 86.

[35] Award, paras. 54, 63, 86-89.

[36] Award, paras. 87-88.

[37] Award, para. 90.

> officious bystander be applied. It is significant, in my view, that after observing that "the jurisprudence is not always very clear about the source of the good faith obligations found in these cases", when describing the organizing principle Cromwell J. did not import the requirements of the officious bystander test for implying a term.[38]

33. Wastech had a legitimate contractual expectation that Metro would not exercise its discretion to implement a material change in the volume of waste allocated to the CCLF that had the effect of depriving Wastech of the opportunity, if it performed its own obligations, to achieve the Target OR.[39] In the exercise of its discretion under the CA for 2011, Metro failed, contrary to its duty of good faith contractual performance, to act with appropriate regard for this legitimate contractual expectation.[40]

34. The arbitrator noted that whether particular conduct evidences a lack of "appropriate regard" is inherently a question of degree and requires an assessment of the importance of the affected expectation and the nature of the adverse effect on that expectation.[41] He considered whether Wastech must have shown that Metro's conduct "gutted" the CA by immediately depriving Wastech of all or substantially all of the benefit for which it bargained. According to the arbitrator, conduct that eviscerates the contract from the perspective of one party has been an important consideration, but the overarching principle stated in *Bhasin* did not include this requirement. *Bhasin* made clear that what constitutes inappropriate disregard for a counter-party's legitimate expectations must be determined on a case-by-case basis and thus Metro's conduct had to be viewed in the context of the CA and the commercial relationship as a whole. His assessment was as follows:

> Unless constrained by a duty of good faith, under the CA, Metro theoretically has the discretion to reduce the volume of waste directed to CCLF to zero. Having the opportunity to earn the Target OR in every year of the term is the fundamental benefit for which Wastech bargained. In my view it is artificial to assess the importance of that legitimate interest to Wastech, or the adverse implications of Metro's conduct, as if this were a contract for a single year. I find that in the circumstances Metro's conduct shows a lack of appropriate regard for Wastech's legitimate expectations

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[38] Award, para. 91.

[39] Award, para. 92.

[40] Award, paras. 93-97.

[41] Award, para. 93.

> sufficient to justify its characterization as a breach of the duty of good faith.[42]

35. The arbitrator awarded damages for breach of Metro's duty of good faith in the amount of Wastech's actual lost earnings for 2011 ($2,888,162).[43]

D. Judgment of McEwan J. (2018 BCSC 605)

36. The questions stated for appeal of the award and decided by the chambers judge were as follows:

> (a) Did the Arbitrator err in law in failing to apply proper principles in holding that the exercise of a bargained-for right could be "dishonest" and an act undertaken in bad faith simply because it was wholly at odds with the expectations of the counter-party, which expectations were not embodied in the contract?
>
> (b) Did the Arbitrator err in law by confusing the "organizing principle" stated in *Bhasin* with a free-standing obligation of contractual good faith, disregarding the applicable principles of good faith as found in the authorities?

37. The Court of Appeal addressed the two questions afresh and reversed the award for its own reasons, and so, with respect, the chambers judge's reasons are largely overtaken.[44]

38. The chambers judge found the arbitrator erred in his treatment of the duty of good faith in two ways.[45] First, he concluded the Award was based on a general duty of good faith as an extension of *Bhasin*. Second, he concluded that the arbitrator's dismissal of the claim of an implied term raised a "*problem*" for the claim of a breach of good faith. Because the contract did not have an express or implied term regarding the rights and obligations of the parties should Metro exercise its discretion to substantially reduce the volumes allocated to the CCLF, there could be no duty to exercise that discretion in good faith. The finding of no implied term excluded the availability of both avenues of relief.

E. Judgment of the British Columbia Court of Appeal (Newbury, Stromberg-Stein and Fisher JJ.A., 2019 BCCA 66)

39. The Court of Appeal for British Columbia dismissed Wastech's appeal.

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[42] Award, para. 94.

[43] Award, paras. 64, 97.

[44] BCCA Reasons, paras. 65, 74.

[45] BCSC Reasons, paras. 41-42, 49, 56-57, 59-61, 63.

40. After reviewing the discussion of good faith in *Bhasin*, the court summarized the arbitrator's findings regarding the Comprehensive Agreement, noting the parties' intentions set out in the Recitals and each party's obligations under the contract and key terms such as the Target OR, Annual Waste Allocation Plan and hauling rate adjustment formulas.[46] The court highlighted the arbitrator's conclusion, based on all the evidence, that when the CA was negotiated both parties thought it highly unlikely that there actually would be a substantial reallocation of waste away from the CCLF to the VLF and as a consequence and because of a mutual desire to simplify the agreement, both parties agreed that no provision dealing with that eventuality should be included.[47]

41. Regarding Metro's decision to reallocate large volumes of waste away from the CCLF in 2011 and its effect on Wastech, the court said the arbitrator's key findings were that the substantial increase in the Target Operating Ratio was caused by Metro's decision and this made it impossible for Wastech to achieve the Target OR for 2011.[48]

42. The court noted that Metro did not seriously dispute that the Target OR was a "*central concept*" underpinning the CA[49] and that the arbitrator's analysis was grounded in the proposition that as a complex, long-term contract involving mutual cooperation the CA fell within one of the types of relationships in which existing doctrines of contract law required Metro to have "*appropriate regard*" for Wastech's "*legitimate contractual interests*" or "*legitimate expectations*" in the exercise of Metro's discretionary power.[50]

43. Before beginning its analysis, the court re-stated the two questions brought by Metro for consideration by the chambers judge:

> (a) Did the Arbitrator err in law in failing to apply proper principles in holding that the exercise of a bargained-for right could be "dishonest" and an act undertaken in bad faith simply because it was wholly at odds with the expectations of the counter-party, which expectations were not embodied in the contract?

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[46] BCCA Reasons, paras. 20-47.

[47] BCCA Reasons, para. 30.

[48] BCCA Reasons, para. 33.

[49] BCCA Reasons, para. 42.

[50] BCCA Reasons, paras. 43, 45.

(b) Did the Arbitrator err in law by confusing the "organizing principle" stated in *Bhasin* with a free-standing obligation of contractual good faith, disregarding the applicable principle of good faith as found in the authorities?[51]

44. The court said it was dealing with both questions concurrently but did so on different terms.[52]

45. The court accepted the arbitrator's findings that the Comprehensive Agreement was a complex, relational contract that came within an existing category to which the duty of the good faith applied: a party who has discretion under a contract may not exercise it so as to substantially nullify the bargained objective or to cause significant harm to the other.[53]

46. Madame Justice Newbury stated that the case law, including *Bhasin*, describing the specific doctrine of good faith applicable in this case referred to the legitimate contractual expectations or interests of the other party.[54] She said that the second part of the first question in issue was whether it was open to the arbitrator to find a breach of the duty of good faith by Metro by virtue of expectations that were not founded in the contract.

47. The court held that if Wastech had a legitimate contractual expectation that Metro would not redirect or re-allocate waste "*to an extent that deprives Wastech of the* possibility *of achieving the Target OR*" [emphasis in original], this could only come from the Comprehensive Agreement.[55] Because the arbitrator concluded that there was no implied term in the Agreement to this effect the court held that the duty of good faith did not apply. The court said that there could be no legitimate contractual expectation that Wastech would be allowed the chance to achieve the Target OR because to be legitimate the contractual expectation or interest had to be in the Comprehensive Agreement.[56]

48. The court also held that the arbitrator erred in law because he found it unnecessary to decide whether to come within the specific contractual good faith doctrine Wastech had to show that the impugned conduct had "nullified" or "eviscerated" the CA in the sense that it

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[51] BCCA Reasons, para. 65.
[52] BCCA Reasons, para. 65.
[53] BCCA Reasons, paras. 62, 66-73.
[54] BCCA Reasons, para. 67.
[55] BCCA Reasons, para. 67-69.
[56] BCCA Reasons, paras. 67-69.

immediately deprived Wastech of all or substantially all of the benefit for which it bargained.[57] In the court's opinion, by doing so the arbitrator essentially created a new duty of "*disregard of contractual interests*" because it meant that a duty of good faith would as a matter of law be breached whenever a party exercising a contractual discretion fails to have "*appropriate regard*" for the other party's contractual interests and that this is not what *Bhasin* intended.[58]

49. Madame Justice Newbury also held that there must be subjective bad faith (a "stench") as in other areas of the law such as fraud and the arbitrator erred in finding otherwise.[59]

50. Madame Justice Newbury for the court concluded that the arbitrator erred in law in:

> (1) failing to address whether Wastech had a legitimate expectation, *founded in the Agreement*, that if Metro exercised its discretion as it did, it would compensate Wastech over and above the adjustments provided for in the Agreement;
>
> (2) failing to consider the effect of his rejection of an implied term in his analysis of the duty of good faith;
>
> (3) effectively concluding that the duty of good faith is breached whenever a contracting party fails to have "appropriate regard" for the other, in circumstances where the agreement has not been found to have been "nullified" or "eviscerated"; and
>
> (4) finding "dishonesty" and thus a breach of the duty of good faith on Metro's part without any subjective element of dishonesty, improper motive (under which I would include "seeking to undermine" the interests of the other party) or bad faith as understood in existing law [emphasis in original].[60]

51. Based on the two questions for appeal, which were formulated by counsel for Metro in the original request for judicial review, the court found that the appeal raised extricable issues of law.[61] While noting that the standard of review of reasonableness applies to all questions of law on appeal in commercial arbitrations, Newbury J.A. held that the correctness standard applied in this case because she found the questions were errors of law that were of importance to the

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[57] BCCA Reasons, para. 70.

[58] BCCA Reasons, para. 70.

[59] BCCA Reasons, paras. 71-73.

[60] BCCA Reasons, para. 74.

[61] BCCA Reasons, para. 74.

parties and the legal system as a whole.[62] They involved the scope and meaning of good faith in contract, as newly explained in *Bhasin*.[63] However, even if the reasonableness standard applied, she would have reached the same conclusions.

PART II -QUESTIONS IN ISSUE

52. Did the Arbitrator err in law in concluding that:

(a) the duty of good faith in issue can be implied by law;

(b) Wastech had a legitimate expectation that if Metro exercised its discretion as it did, it would compensate Wastech over and above the adjustments provided for in the Comprehensive Agreement;

(c) a breach of the duty of good faith in issue did not require a finding that the Comprehensive Agreement was nullified or eviscerated; and

(d) a breach of the duty of good faith in issue did not require proof of subjective dishonesty?

53. Were the arbitrator's conclusions about a breach of the duty of good faith reviewable?

PART III -STATEMENT OF ARGUMENT

A. Overview

54. The arbitrator in this case applied the established law that when exercising a contractual discretion, particularly in a long-term relational agreement, a party must do so in good faith. The arbitrator noted the discussion of the organizing principle of good faith in *Bhasin* and properly found that it both preserved and supported the existing law of good faith. The Court of Appeal, however, relied on the organizing principle to impose restrictions on the duty of good faith in issue. The errors of law found by the Court of Appeal did not address those stated for the appeal, were contradicted by the existing law and in effect turned *Bhasin* on its head to give life to the concern that "*a general duty of good faith that would permit courts to interfere with the express terms of a contract*" would "*create commercial uncertainty and undermine freedom of contract.*"[64]

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[62] BCCA Reasons, paras. 4, 74.

[63] BCCA Reasons, para. 74.

[64] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para 39.

55. The arbitrator relied on a long-recognized category of good faith and committed no error of law in stating that law or in its application. As affirmed by *Bhasin*, the law concerning contractual discretion does not require a term to be implied on the officious bystander or business efficacy test. Contrary to the finding of the court below, its application depends only on identifying the reasonable expectations of the other contracting party, not on an express contractual provision; it requires only a significant impact on the other contracting party that is contrary to the original contractual expectations or purposes; and does not require that animus or dishonesty be proven. To the extent that the Court of Appeal purports to apply pre-*Bhasin* principles it is in error as to those principles; to the extent it advocates changes in the law of good faith in order to prefer contractual provisions over a duty of good faith implied by law, it is wrong in principle and flatly contradicted by *Bhasin*. Further, the entire history of the treatment of the award demonstrates again the need to restrain the review of arbitration awards to addressing extricable questions of law alone, and on a standard of reasonableness; neither restraint was observed in the courts below.

B. The duty of good faith in issue: exercise of a contractual discretion

56. The arbitrator found that the Comprehensive Agreement was a long-term relational agreement that depended on an element of trust and confidence if the mutual expectations of the parties were to be achieved.[65] The arbitrator found that the Target Operating Ratio—effectively, the level of profit to be earned by Wastech in each Operating Year—was a central concept underpinning the Agreement.[66] Metro had a discretion to allocate waste between the Cache Creek Land Fill—the long-haul site—and the various short-haul sites in the Metro Vancouver area. The parties recognized that it was possible that a reduction in waste volumes allocated to the CCLF would prevent Wastech from achieving the Target OR, no matter how capably it performed the work. The parties discussed adding a contractual term to address this possibility, but decided not to since such a reduction was mutually considered to be highly unlikely, and a contractual term would add yet more complexity to the already complex compensation formula.[67] Indeed, the parties discussed several potential contractual mechanisms without

[65] Award, para. 85.

[66] Award, paras. 83, 84.

[67] Award, paras. 58, 63.

reaching agreement.[68] The 2011 allocation decision by Metro was made consciously and made it impossible for Wastech to achieve the Target OR in 2011.[69]

57. The arbitrator, relying on the discussion of the law in *Bhasin*, identified the relevant pre-existing situation in which a duty of good faith has been imposed: "*where contracts expressly confer discretion upon a party, the courts have held that the discretion must be exercised in good faith*."[70] The issue is whether the arbitrator fell into error as to any principles of that pre-existing law, or any change in the law as a result of the decision in *Bhasin*.

58. This court in *Bhasin* did three things: (1) it identified situations and relationships that the existing law recognized as giving rise to some kind of duty of good faith; (2) it set out a new organizing principle of good faith, "*without displacing the existing specific doctrines*"[71]; and (3) it set out a new duty of honest contractual performance. The principle that applies in this appeal and that was applied by the arbitrator was recognized and discussed in *Bhasin* as an existing category of good faith.

59. The Court in *Bhasin* adopted the analysis by Professor McCamus as to the situations and relationships where the courts have recognized a duty of good faith: (1) where the parties must cooperate in order to achieve the objects of the contract; (2) where one party exercises a discretionary power under the contract; and (3) where one party seeks to evade contractual duties.[72] The example given by the Court of a case falling within the second situation was *Mitsui & Co. (Canada) Ltd. v. Royal Bank of Canada*.[73]

60. McCamus described the relevant category as follows:

> Canadian judges have referred to a duty of good faith in a series of recent cases involving what one might refer to as abuse of a discretionary power

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[68] Award, para 75.

[69] Award, paras. 52, 54.

[70] Award, para. 81.

[71] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para 68.

[72] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para 47; John D. McCamus, *The Law of Contracts*, 2d ed. (Toronto: Irwin Law, 2012), pp. 839-856.

[73] *Mitsui & Co. (Canada) Ltd. v. Royal Bank of Canada*, 1995 CanLII 87 (SCC), [1995] 2 SCR 187.

> conferred by contract. In each case, the defendant was required to exercise the power in question in a reasonable fashion…[74]

G.R. Hall, *Canadian Contractual Interpretation Law,* analyzes the pre-*Bhasin* law as covering six, or possibly seven situations. He describes the first category as being that "[a] *discretionary power must be exercised in good faith.*"[75] In a leading case, *Greenberg v. Meffert,* the Ontario Court of Appeal said:

> In my opinion, the company's discretion in this matter is not unbridled, firstly, because the nature of this contract and the subject-matter of the discretion are such that the company's decision should be construed as being controlled by objective standards; and secondly, because the exercise of the discretion, whether measured by subjective or objective standards, is subject to a requirement of honesty and good faith.[76]

61. In applying this rule, courts look to the nature of the contract, the commercial context and the significance of the exercise of the discretion. In particular, courts have required the party exercising the discretion to give effect to the reasonable expectations of the other party where the contract is long-term and relational and the exercise of the discretion would cause significant harm to the other party. For example, in *Mesa Operating Limited Partnership*, the Alberta appeal court said:

> The rule that governs here can, therefore, be expressed much more narrowly than to speak of good faith, although I suspect it is in reality the sort of thing some judges have in mind when they speak of good faith. As the trial judge said, a party cannot exercise a power granted in a contract in a way that "substantially nullifies the contractual objectives *or causes significant harm to the other contrary to the original purposes or expectations of the parties.*"[77] [Emphasis added.]

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[74] J.D. McCamus, *The Law of Contracts*, 2d ed. (Toronto: Irwin Law, 2012), p. 844.

[75] G.R. Hall, *Canadian Contractual Interpretation Law*, 3d ed. (Markham, ON: LexisNexis, 2016), p. 39

[76] *Greenberg v. Meffert*, [1985] O.J. No. 2539, 18 DLR (4th) 548 (C.A.), para 18. See also *Mesa Operating Limited Partnership v. Amoco Canada Resources Ltd.*, 1994 ABCA 94, paras. 14-15, 22; *Schluessel v. Maier*, 2001 BCSC 60, paras. 130-132, 85 B.C.L.R. (3d) 239; *Canadian National Railway Co. v. Inglis*, [1997] O.J. No. 4278, 36 O.R. (3d) 410 (C.A.), pp. 3-6; *Imperial Oil Ltd. v. Young*, 1998 CanLII 18026 (NL CA) para. 161; *Transamerica Life Canada Inc. v. ING*, 2003 CanLII 9923 (ON CA), 68 OR (3d) 457, paras. 45, 53; *Sherry v. CIBC Mortgages Inc.*, 2016 BCCA 240, paras. 12, 18, 64, 66. See also e.g. *Data & Scientific Inc. v. Oracle Corp.*, 2015 ONSC 4178, paras. 7, 10-11; A. Swan, J. Adamski and A.Y. Na, *Canadian Contract Law*, 4th ed. (Toronto: LexisNexis, 2018), p. 1020; G.R. Hall, *Canadian Contractual Interpretation Law*, 3d ed. (Markham, ON: LexisNexis, 2016), pp. 36-49.

[77] *Mesa Operating Limited Partnership v. Amoco Canada Resources Ltd.*, 1994 ABCA 94, para 22.

62. The court below accepted the arbitrator's findings that the Comprehensive Agreement was a complex, relational contract that came within an existing category to which the duty of the good faith applied: a party who has discretion under a contract may not exercise it so as to substantially nullify the bargained objective or to cause significant harm to the other party.[78]

63. Based on the Comprehensive Agreement and the factual matrix of its formation, the arbitrator found that Wastech's legitimate contractual expectation, which was known to both parties, was that Metro would not exercise its discretion to implement a material change in the volume of waste allocated to the CCLF that had the effect of depriving Wastech of the opportunity, if it performed its own obligations, to achieve the Target OR. This was because the costs of performing the agreement could not be adjusted to cope with a material reduction in the higher paid portion of the work. The arbitrator found that achieving the Target OR throughout the term of the agreement was a "*central concept*" underpinning the CA.[79] (The Court of Appeal accepted this finding.) In the result, Metro acted unreasonably in exercising its contractual discretion in 2011 and thus breached its duty of good faith to Wastech. The arbitrator concluded that his finding a breach of the duty of good faith was not precluded because he found there was no implied term requiring a specific compensatory mechanism if Metro redirected large volumes of waste away from the CCLF.

64. The Court of Appeal found four errors of law in the arbitrator's findings. In the order in which this factum will address them, the court found:

(a) the arbitrator failed to consider the effect of his rejection of an implied term in his analysis of the duty of good faith;

(b) the arbitrator failed to address whether Wastech had a legitimate expectation, founded in the Agreement, that if Metro exercised its discretion as it did, it would compensate Wastech over and above the adjustments provided for in the Comprehensive Agreement;

(c) the arbitrator effectively concluded that the duty of good faith is breached whenever a contracting party fails to have "*appropriate regard*" for the other, in circumstances where the agreement has not been found to have been nullified or eviscerated; and

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[78] BCCA Reasons, paras. 62, 66-73.

[79] BCCA Reasons, paras. 25, 42.

(d) the arbitrator found dishonesty and a breach of the duty of good faith on Metro's part without any subjective element of dishonesty, improper motive or bad faith as understood in existing law.[80]

C. The rejection of an implied term on the basis of business efficacy does not preclude the imposition of a duty of good faith as a matter of law

65. The court below found it was an error of law for the arbitrator not to consider the effect of his rejection of the implied term in his analysis of the good faith duty.[81] In fact, the arbitrator expressly considered this very point, as set out below. It is evident from the court's reasons that the real issue was that it disagreed with the arbitrator's conclusion. It was the arbitrator's role to consider the full contractual and commercial context in deciding whether a duty of good faith existed, and that in itself created no extricable issue of law. The only possible relevant extricable issue of law, although not stated in these terms by the Court of Appeal, is whether a finding that a term cannot be implied in the contract on the officious bystander or business efficacy test means, as a matter of law, that no duty of good faith arises in the situation of the exercise of a contractual discretion.

66. The content of the term that the arbitrator was asked to imply into the contract was different from the content of the duty of good faith found by the arbitrator. The implied term rejected by the arbitrator incorporated a particular mechanism for addressing the situation where it was impossible for Wastech to achieve the Target OR: it required a retroactive reset of the rates and payments for the year in question in accordance with section 14.17 of the CA and a requirement that the defined Lump Sum Payment should include an amount equal to the resulting Carry-over Variance.[82] The arbitrator rejected this on the application of the business efficacy test, which requires a determination, among other things, that the missing term is an obvious oversight that the parties intended to include. The arbitrator noted that there were a number of possible mechanisms to address an unexpected imbalance in the allocation of waste, and that some of these had been discussed, but no agreement had been reached. In light of this, the arbitrator held this belied the suggestion that it was obvious that the parties would have readily

[80] BCCA Reasons, para. 74.

[81] BCCA Reasons, paras. 67 and 74.

[82] Award, para. 31.

agreed to the specific term put forward in the arbitration. While the parties had recognized there was an omission they had decided not to include a provision to address it.[83]

67. The good faith duty found by the arbitrator did not include the specific contractual mechanism proposed for the implied term. Instead, the arbitrator founded the good faith duty on a full consideration of the commercial relationship and held that, in circumstances where the waste allocated to CCLF was reduced because of a redirection on waste to the Vancouver Landfill, and that reduction deprived Wastech of the opportunity to achieve the Target OR, Metro was under a good faith duty to provide compensation to Wastech for the lost opportunity.[84]

68. The arbitrator expressly and carefully considered the question of whether the rejection of the proposed implied term precluded the recognition of a duty of good faith:

> I have also considered the relevance of my findings that the parties made a conscious decision not to include an express provision constraining Metro's allocation decisions or requiring compensation for their adverse effects and that a term to that effect cannot be implied. I conclude that these findings do not preclude the application of the good faith doctrine. If the doctrine can operate to constrain or limit the exercise of an express contractual power, the fact that the parties considered and rejected including express limits on the power does not seem to me to add anything to the good faith analysis. In most situations it will be the case that the parties "could have" incorporated express restraints, but actually or presumptively chose not to do so. Although in some cases the good faith obligation is described as an implied contractual term, *Bhasin* and the other jurisprudence defining the good faith doctrine do not require that the officious bystander test be applied.[85]

69. As the arbitrator correctly identified, this Court in *Bhasin* rejected the notion that a contractual duty of good faith, and specifically the duty in question here, could only arise where a term could be implied on the business efficacy rule. This Court accepted that good faith obligations could arise as terms implied as a matter of law, terms implied as a matter of intention

[83] Award, paras 74, 75.

[84] Award, paras 85, 92-96.

[85] Award, para 91.

and terms arising as a matter of interpretation, and did not restrict the sources of the obligation in any way.[86]

70. Although courts have on occasion used the law on implied terms as a mechanism to introduce a good faith obligation, it would be contrary to the whole direction of the law of good faith to suggest that good faith can only be grounded in a contractual term, either express or implied. As a matter of logic, if the parties are found to have specifically provided for the obligation, there is no need for the wider good faith obligation. *Bhasin* emphasized the necessary and important role of good faith obligations implied as a matter of law:

> Good faith also plays a role in the law of implied terms, particularly with respect to terms implied by law. Terms implied by law redress power imbalances in certain classes of contracts such as employment, landlord-lessee, and insurance contracts: *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, 1992 CanLII 41 (SCC), [1992] 3 S.C.R. 299, at p. 457, *per* McLachlin J.; see also *Machtinger v. HOJ Industries Ltd.*, 1992 CanLII 102 (SCC), [1992] 1 S.C.R. 986, per McLachlin J., concurring. The implication of terms plays a functionally similar role in common law contract law to the doctrine of good faith in civil law jurisdictions by filling in gaps in the written agreement of the parties: *Chitty on Contracts*, at para. 1-051. In *Mesa Operating*, the Alberta Court of Appeal implied a term that a power of pooling properties for the purpose of determining royalty payments be exercised reasonably. The court implied this term in order to give effect to the intentions of the parties rather than as a requirement of good faith, but Kerans J.A. stated that "[t]he rule that governs here can, therefore, be expressed much more narrowly than to speak of good faith, although I suspect it is in reality the sort of thing some judges have in mind when they speak of good faith": para. 22. Many other examples may be found in Waddams, *The Law of Contracts*, at paras. 499-506.[87]

71. This Court in *Bhasin* cited with approval Professor McCamus' conclusion that particularly in the category of cases at issue here—abuse of contractual discretion—it was more realistic to view the duty as arising from the reasonable expectations of the parties than from terms implied on the basis of business efficacy :

> Although the line between the two types of implication is difficult to draw, it may be realistic to assume that implied duties of good faith are likely, on

[86] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para. 52.

[87] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para. 44.

> occasion at least, to slide into the category of legal incidents rather than mere presumed intentions. Certainly, it would be difficult to defend the implication of terms on each of the cases considered here on the basis of the traditional business efficiency or officious bystander test. In the control of contractual discretion cases, for example, it may be more realistic to suggest that the implied limitation on the exercise of the discretion is intended to give effect to the "reasonable expectations of the parties.[88]

72. *Bhasin* itself was an example where the duty of good faith could not be implied in fact into the agreement, yet this Court found that the circumstances were covered by a new common law duty under the broad umbrella of the organising principle of good faith.[89] The duty of honest contractual performance in *Bhasin* was not an implied term of the contract.[90] The duty operated irrespective of the intentions of the parties. Cromwell J. rejected characterisation of good faith as an implied term and described the principle as "*inhering in the parties' relationship*".[91]

73. There are many cases where a duty of good faith has been implied as a matter of law. In *Machtinger v. HOJ Industries Ltd.*, this Court held that the requirements for reasonable notice in employment contracts were not terms implied in fact.[92] While the majority judgment preferred to describe the requirements for reasonable notice as a presumption, Justice McLachlin (as she then was) said that such terms were implied as a matter of law and as such the parties' intentions were not relevant.[93] Following *Bhasin*, appellate courts in British Columbia, Ontario and Nova Scotia have held that the good faith obligation is implied by law.[94] For example, in *Industrial Alliance Insurance and Financial Services Inc. v. Brine*, unfettered, explicit contractual discretion did not prevent enforcement of the insurer's contractual duty of good faith.[95] The court held that

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[88] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para 48.

[89] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para. 72.

[90] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para. 72.

[91] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para. 45; see also A. Swan, "The Obligation to Perform in Good Faith: Comment on *Bhasin v. Hrynew*", (2015) 56 Can. Bus. L.J. 395, p. 402; A. Swan, J. Adamski and A.Y. Na, *Canadian Contract Law*, 4th ed. (Toronto: LexisNexis, 2018), pp. 810-811.

[92] *Machtinger v. HOJ Industries Ltd.*, 1992 CanLII 102 (SCC), [1992] 1 SCR 986, pp. 997-998.

[93] *Machtinger v. HOJ Industries Ltd.*, 1992 CanLII 102 (SCC), [1992] 1 SCR 986, pp. 1008-1009.

[94] *Moulton Contracting Ltd. v. British Columbia*, 2015 BCCA 89, para. 68; *High Tower Homes Corporation v. Stevens*, 2014 ONCA 911, para. 36; *Industrial Alliance Insurance and Financial Services Inc. v. Brine*, 2015 NSCA 104, para. 101.

[95] *Industrial Alliance Insurance and Financial Services Inc. v. Brine*, 2015 NSCA 104.

manifestations of the duty of good faith discussed (including the new duty of honest contractual performance) in *Bhasin* were not just executive summaries of a contract's written terms.[96]

74. This appeal is another example of where the duty of good faith operates as a matter of law. The parties did not include a term regarding substantial reallocation of waste from the CCLF because they did not think the facts would arise in the circumstances and did not want to unduly complicate the Comprehensive Agreement. In other words, they expected that it would not arise and that Wastech would not be deprived of the chance to achieve the Target OR in every year of the CA.

75. The error of law identified by the Court of Appeal—the imposition of a good faith duty as a matter of law in circumstances where the traditional business efficacy test would not support a contractual implied term—is not an error of law at all. As Professor McCamus pointed out in the passage cited with approval in *Bhasin*, this is commonly the case. This is itself sufficient for this appeal.

76. However, for the purpose of the development of good faith law, it may be helpful to go further and identify the deeper error that underlies the Court of Appeal's decision. From its discussion of the implied term and the concept of legitimate contractual expectations the court below was concerned to re-establish the primacy of defined contractual obligations (whether express or implied as a matter of business efficacy) over the imposition of good faith duties as a matter of law that are based on a broader view of the commercial and contractual relationship and the reasonable expectations of the parties. In effect, the court below was concerned to uphold a narrow view of the contract relationship and limit the application of duties to act in good faith. *Bhasin*, on the other hand, recognized the need for good faith obligations to be founded on law and that an inquiry confined to a narrow view of contract obligations can be too narrow. *Bhasin* considered that anchoring this approach in the existing law would alleviate any concerns about undermining certainty in commercial contracts and that it represented an appropriate balance between flexibility and predictability.[97]

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[96] *Industrial Alliance Insurance and Financial Services Inc. v. Brine*, 2015 NSCA 104, para. 101.

[97] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para. 41.

77. Professor Gray has discussed how the approach taken in *Bhasin* better reflects the underlying values in issue. He considers that implying good faith obligations as a matter of fact seems particularly unsuitable because what is being reflected by notions of good faith is not that these individual parties necessarily would have included such a doctrine if they had considered it, but that the doctrine reflects general societal values and general observations about the ways in which parties in our society typically deal and some aspiration as to how we want people to behave.[98]

78. When parties enter into contracts, they assume or expect that the other party will act in accordance with notions of good faith: "*Parties may generally be assumed to intend certain minimum standards of conduct.*"[99] This assumption or expectation is made because of the high degree of trust underlying contractual relationships, and their (typically) relational nature; one party to a contract is entitled to expect and assume that the other will act in accordance with good faith.[100] When parties contract, they understand that the other expects this of them, as they can expect it from the other. It is contrary to the true nature of contracts to assume otherwise and Professor Gray argues that this was captured by this Court in its rejection of the past antipathy towards good faith on the basis that such antipathy "*produces results that are not consistent with the reasonable expectations of commercial parties.*"[101] As Professor Gray puts it:

> The advantages of considering good faith as an assumption under which the parties acted in making their bargain include that, in my mind, it better reflects the true nature of good faith doctrine, as reflecting a societal expectation and public policy justified principle rather than an imputed intention to the particular parties; further it obviates the need to consider difficult issues in relation to implication of terms which are themselves a source of confusion and uncertainty, including "necessity", "business efficacy", "officious bystander", classes of different contracts, and the need to assess individual contracts (in the case of suggested implication of fact) to ascertain an intention to incorporate good faith.[102]

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[98] A. Gray, "Development of Good Faith in Canada, Australia and Great Britain", (2015) 57 Can. Bus. L.J. 84, p. 116.

[99] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para. 45; A. Swan, J. Adamski and A.Y. Na, *Canadian Contract Law*, 4th ed. (Toronto: LexisNexis, 2018), p. 253.

[100] A. Gray, "Development of Good Faith in Canada, Australia and Great Britain", (2015) 57 Can. Bus. L.J. 84, p. 118.

[101] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para. 32.

[102] A. Gray, "Development of Good Faith in Canada, Australia and Great Britain", (2015) 57 Can. Bus. L.J. 84, p. 118.

79. The Court in *Bhasin* considered not just the existing law but empirical evidence in assessing the expectations of commercial parties, particularly parties to longer term, relational contracts. The Court satisfied itself that its approach would reflect and facilitate the way that commercial parties actually expect contractual relationships to operate and would supplement rather than undermine the traditional emphasis on explicit contractual obligations. This approach would bring Canada closer to the practice in the United States, and bring the common law closer to the civil law approach in Quebec. The narrow focus of the Court of Appeal is at odds with this perspective.[103]

D. Legitimate contractual expectations are not limited to explicit contractual terms

80. The Court of Appeal essentially found that the arbitrator should have restricted his good faith analysis to express contractual terms, or terms implied in the contract under the business efficacy rule, and that it is an error of law to take any broader view of the reasonable expectations of the parties. This appears to be what the court meant by saying that legitimate contractual interests or expectations could only be those "*arising out of the Agreement.*" Since the arbitrator rejected the proposed implied term incorporating a specific contractual mechanism, as a matter of law Wastech could have no contractual expectations regarding Metro's exercise of its discretion. In the context of this case, the court below clearly meant that the obligation of good faith did not arise as a matter of law unless there was an explicit contractual term giving Wastech an opportunity to achieve the Target OR. On this basis, the Court of Appeal set aside the arbitrator's findings as to Wastech's contractual interests and expectations, which it could only do if this represented an extricable question of law, not simply a difference on what those reasonable contractual interests and expectations were.

81. If the Court of Appeal is correct, then as a matter of logic and principle this leaves effectively no room for the operation of a duty of good faith. The Court of Appeal would only have been satisfied by a contractual term that expressly gave Wastech the opportunity to achieve the Target OR in each year of the contract. If the contract had in fact contained this clause, there would be no need to involve the duty of good faith at all; instead of a good faith obligation on

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[103] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, paras 32, 34, 60, 61. See also J.T. Robertson, "Good Faith As An Organizing Principle in Contract Law: *Bhasin v. Hrynew* - Two Steps Forward and One Look Back", (2015) 93 Can. B. Rev. 809, p. 818

Metro to give appropriate regard to Wastech's reasonable expectations when exercising the contractual discretion, it would have been a breach of contract to act as it did.

82. The Court of Appeal's finding is inconsistent with the organizing principle as set out in *Bhasin*; the pre-*Bhasin* law on the abuse of contractual discretion; and with modern norms of contractual analysis and interpretation.

83. The Court of Appeal based its finding on the statement of the organizing principle in *Bhasin* rather than on the pre-existing law and gave the organizing principle the narrowest possible reading—that the reference to contractual interests or expectations limited the context for good faith in the contractual area to actual contract terms. The court again evidenced a concern that the ambit for good faith in contracts should be tightly circumscribed and primacy given to bargained obligations. *Bhasin* never intended the organizing principle to be used to limit the law of good faith in this way.

84. This Court in *Bhasin* did not intend that the "*legitimate contractual interests*" or "*expectations*" to which it refers could only be identified on the narrow basis allowed by the Court of Appeal. This Court repeatedly referred to the reasonable expectations of commercial parties, and went as far as to cite empirical research on those expectations. Similarly, this Court referred to legitimate contractual interests, which in context must refer to the benefits expected under a contract. Further, this Court considered the significance of the nature of the relationship created by a contract, approved the view that good faith inheres in the parties' relationship and said that the legitimate interests likely had different implications in long term contracts of mutual cooperation.[104] The good faith obligation arises out of the commercial expectations and relationship, regardless of whether the contract recognizes such a right. In the case of the new duty of honest performance, this Court expressly found that the duty was imposed by law and operates irrespective of the intentions of the parties.[105] The Court clearly intended the references to contractual interests and expectations to include a broad, real world view of the commercial relationship created by a contract, and not be limited to an examination of the explicit contract obligations.

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[104] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, paras 1, 34, 39, 45, 61, 62, 65, 69.

[105] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para. 74.

85. Although *Bhasin* did not need to go this far, its approach to legitimate expectations is congruent with modern academic thinking that contracts can be cooperative and mutually beneficial undertakings, not always just vehicles of purely self-interested actors.[106] For long-term, complex agreements, the transaction costs of allocating risk at the outset are often prohibitively high and require parties to operate with narrowly-bounded rationality.[107] Where risk is uncertain or cannot be properly accounted for at the outset, good faith can ensure that the parties are held to a bargain which includes the parties' reasonable expectations. In this way, good faith helps reflect the true nature of the parties' relationship, including mutual trust and an understanding that neither party will resort to opportunistic behaviour based on an exploitation of contractual rights at the expense of mutual benefits and the parties' relationship.[108] Good faith promotes efficient outcomes by providing outcomes the parties would have contracted for in a world of "*zero transaction costs and unlimited foresight*". [109]

86. *Bhasin*'s approach is in accord with the pre-*Bhasin* law on abuse of contractual discretion. Professor McCamus summarized the cases on good faith as a remedy for the abuse of contractual discretion as follows:

> In sum, these cases establish the proposition that where discretionary powers are conferred by agreement, it is implicitly understood that the powers are to be exercised reasonably. The concept of reasonableness in this context implies a duty to exercise the discretion honestly and in light of the purposes for which it was conferred.[110]

87. The case law contemplates that a party exercising a contractual discretion may be expected to give good faith recognition to contractual concerns of the counterparty identified through a process much broader than a simple reading of the four corners of the contract. The

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[106] J. Young, "Justice Beneath the Palms: *Bhasin v. Hrynew* and the Role of Good Faith in Canadian Contract Law", (2016) 79 Sask. L. Rev. 79, p. 99, 107-108, 111.

[107] J. Young, "Justice Beneath the Palms: *Bhasin v. Hrynew* and the Role of Good Faith in Canadian Contract Law", (2016) 79 Sask. L. Rev. 79, p. 103; David Stack, "Two Standards of Good Faith in Canadian Contract Law", (1999) 62 Sask L. Rev 201, p. 203.

[108] A. Gray, "Development of Good Faith in Canada, Australia and Great Britain", (2015) 57 Can. Bus. L.J. 84, p. 101.

[109] J. Young, "Justice Beneath the Palms: *Bhasin v. Hrynew* and the Role of Good Faith in Canadian Contract Law", (2016) 79 Sask. L. Rev. 79, pp. 103-104.

[110] J.D. McCamus, *The Law of Contracts*, 2d ed. (Toronto: Irwin Law, 2012), p. 849.

cases refer to expectations, objectives, purposes and benefits intended under the contract and to the nature of the relationship created by the contract. For example:

(a) In *Mesa Operating Limited Partnership*, Kerans J.A. agreed with the trial judge that acting in bad faith means to act "*in a manner that substantially nullifies the contractual objectives or causes significant harm to the other contrary to the original purposes or expectations of the parties.*" He went on to say that the contract must be performed in accordance with the reasonable expectations created by it; to be reasonable, they must be "*consistent with the express terms*". In saying this, he recognized that expectations are different from, although connected to, the express terms.[111]

(b) In *Imperial Oil v. Young*, the Newfoundland Court of Appeal said that even where the language of an agreement appears to give an unfettered discretion, an obligation of good faith may apply once the language is construed "in the context of the relationship of the parties."[112]

(c) In *Mannpar*, the court said that a discretion may not be exercised so as to "nullify the benefits reasonably expected to be obtained from the contract." This contemplates an inquiry as to the commercial benefits to be expected, not just express contractual rights.[113]

(d) In *Schluessel*, the court referred to the "bargained objective or benefit".[114]

88. Contractual expectations and interests relate to the purpose and objective of a contract. Contractual terms, on the other hand, express the obligations of the parties. The process of inquiry into purposes and objectives involves an examination of the factual matrix and in particular the recitals in the contract, which typically represent the mutually agreed account of the genesis and objectives of a contract. If a duty of good faith could only be found by looking to the terms of the agreement, then expectations are conflated with contractual terms and the role of good faith is effectively excluded. Acting in good faith cannot be reduced to "not breaching a contract term". As put by the Nova Scotia Court of Appeal, manifestations of the duty of good faith discussed in *Bhasin* are not just equivalent to executive summaries of a contract's written terms.[115]

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[111] *Mesa Operating Limited Partnership v. Amoco Canada Resources Ltd.*, 1994 ABCA 94, para. 14.

[112] *Imperial Oil Ltd. v. Young*, 1998 CanLII 18026 (NL CA), para 161.

[113] *Mannpar Enterprises v. H.M.T.Q*, 1999 BCCA 239, para 51.

[114] *Schluessel v. Maier*, 2001 BCSC 60, para. 130, 85 B.C.L.R. (3d) 239.

[115] *Industrial Alliance Insurance and Financial Services Inc. v. Brine*, 2015 NSCA 104, para. 101.

89. The extremely narrow approach taken by the court below is not only inconsistent with the relevant good faith law but also with the modern approach to contract law and interpretation. As explained in *Sattva,* the modern approach to contract interpretation requires a practical, common-sense approach with the overriding concern being to determine the intent of the parties.[116] *Sattva* approved the well-known passage from *Reardon Smith Line* where Lord Wilberforce said that in a commercial contract the court should know the commercial purpose of the contract and that this in turn presupposes knowledge of the genesis of the transaction, the background, the context, and the market where the parties are operating.[117] This enquiry is not dependent on finding a contractual ambiguity. Given that this broad enquiry is mandated even for the purpose of identifying contractual obligations, it is not surprising that the identification of the reasonable commercial interests and expectations of the parties requires at least as broad an enquiry. The enquires are generally similar; the difference is the use to which the conclusions are put—in one case, to define contractual obligations, in the other to found a duty of good faith.[118]

90. The narrowness of the Court of Appeal's approach in this case is illustrated by its sharp distinction between contractual recitals and contract terms. The court regarded it as erroneous to elevate contract recitals to contractual terms and that recitals are generally only referred to for the purpose of clarifying ambiguities.[119] This represents, with respect, an old-fashioned view of the role of recitals. Following *Sattva,* it cannot be correct to say that recourse to the recitals is limited to cases of ambiguity.[120] Indeed, Hall says:

> The modern approach to the use of recitals in the interpretation of contracts is demonstrated by several cases. These cases suggest that recitals should be considered as part of a contract as a whole and interpreted in accordance with the rules of construction and interpreted in accordance with the rules of construction which apply generally.[121]

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[116] *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, [2014] 2 SCR 633.

[117] *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, [2014] 2 SCR 633, para. 47.

[118] See the discussion in J.T. Robertson, "Good Faith As An Organizing Principle in Contract Law: *Bhasin v. Hrynew* - Two Steps Forward and One Look Back", (2015) 93 Can. B. Rev. 809, p. 820.

[119] BCCA Reasons, para 53.

[120] See the discussion of *Sattva* in *British Columbia (Minister of Technology Innovation and Citizens' Services) v. Columbus Real Estate Inc.,* 2016 BCCA 283, paras. 41-42.

[121] G.R. Hall, *Canadian Contractual Interpretation Law*, 3d ed. (Markham, ON: LexisNexis, 2016), p. 363.

91. The question of the role of recitals in contract interpretation does not need to be settled on this appeal. The recitals, however, cannot be excluded on any principled basis from the process of identification of interests and expectations for the purpose of the duty of good faith. The recitals to the Comprehensive Agreement include clearly relevant material relating to those interests and expectations. For example, the recitals refer to the incentives for efficiency and the minimization of costs and the sharing of risks and benefits between the parties. Recital C(6) specifically says the intention of the parties was to "*provide for the maximization of municipal solid waste disposal capacity of the Cache Creek Land Fill*." (It was not, of course, within the appeal court's mandate to examine the recitals itself and second guess the conclusions of the arbitrator.) In downgrading the use of recitals, the Court of Appeal was implicitly saying that no finding as to legitimate expectations of interests could take into account the recitals, because then they would not be "*founded on the contract*" since recitals are not part of the contract. Whether or not there is any validity to this in the context of contract interpretation, in the good faith context it is an artificial and formalistic view that excludes the intended examination of commercial interests and expectations.

92. Parties in long-term, relational contracts which rely on the parties' mutual trust and confidence will rarely, if at all, expect that either their fundamental contractual objectives and benefits could be significantly undermined by the other contracting party. In these cases, the question is whether the good faith protection invoked is inconsistent with the provisions of the contract, not whether it is contained in the contract provisions.[122]

E. The arbitrator was not required to find that the exercise of the discretion "nullified" or "eviscerated" the Comprehensive Agreement

93. The Court of Appeal found that it was an error of law for the arbitrator not to consider whether the impugned conduct had "*nullified*" or "*eviscerated*" the CA in the sense that it immediately deprived Wastech of all or substantially all of the benefit of the contract.[123] The court viewed this as creating a stand-alone wrong of "*disregard of contractual interests*."

94. The arbitrator did not purport to create a new wrong and his reasoning is consistent with both the pre-existing law and the organizing principle as set out in *Bhasin*. He correctly

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[122] *Styles v. Alberta Investment Management Corporation*, 2017 ABCA 1, para. 64.

[123] BCCA Reasons, para 70.

recognized that a context-specific analysis was required and he carefully explained the significant impact of the impugned conduct on Wastech. He said that the implications of Metro's conduct "*must be viewed in the context of the CA and the commercial relationship as a whole*." Although the arbitration concerned compensation for a single year, Metro could repeat the allocation decision in subsequent years, possibly with even larger reductions in the volumes to be delivered to the Cache Creek Land Fill. He found:

> Unless constrained by a duty of good faith, under the CA, Metro theoretically has the discretion to reduce the volume of waste directed to CCLF to zero. Having the opportunity to earn the Target OR in every year of the term is the fundamental benefit for which Wastech bargained. It is artificial to assess the importance of that legitimate interest to Wastech, or the adverse implications of Metro's conduct, as if this were a contract for a single year.[124]

The arbitrator's findings, which are not subject to review, are conclusive as to the significance of the impact on Wastech. Metro's conduct deprived Wastech of the fundamental benefit of the contract for 2011 and potentially for every year thereafter, if no duty of good faith applied. Although the arbitrator considered he did not need to make an express finding on nullification or evisceration, his realistic assessment of the effect on Wastech was equivalent to such a finding.

95. The arbitrator's consideration of the ongoing nature of the contract is precisely what was expected by *Bhasin*, where Cromwell J. said:

> For example, the general organizing principle of good faith would likely have different implications in the context of a long-term contract of mutual cooperation than it would in a more transactional exchange: Swan and Adamski, at § 1.24; B. Dixon, "Common law obligations of good faith in Australian commercial contracts — a relational recipe" (2005), 33 *A.B.L.R.* 87.[125]

96. The pre-existing law on abuse of a contractual discretion does not establish that as a matter of law a contract must be nullified or eviscerated before there is a breach of a good faith duty. The leading cases recognize that there needs to be a case-by-case analysis of the nature of

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[124] Award, paras 93, 94. See also paras. 84, 90.

[125] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para. 69.

the contract discretion and the degree of impact on the other party.[126] The case law reasonably suggests that the applicable duty of good faith is not breached unless the impact is significant, but there is no principled reason why complete loss of the benefit of the contract should be required. The references in some cases to "nullification" or evisceration" do not raise a hard boundary to good faith as a matter of law. As set out above, the principle stated in *Mesa Operating Limited Partnership* is that a party cannot exercise a power granted in a contract in a way that "*substantially nullifies the contractual objectives or causes significant harm to the other contrary to the original purposes or expectations of the parties.*"[127]

97. The arbitrator was correct in law in saying that the issue of a duty of good faith requires a case-by-case determination, and the arbitrator appropriately addressed the specific context of this long term, relational contract. The guiding principle of good faith is context-specific. *Bhasin* recognized that the widely varying contexts in which good faith may be invoked "*calls for a highly context-specific understanding of what honesty and reasonableness require so as to give appropriate consideration to the legitimate interests of both contracting parties*."[128] As put by one commentator, good faith's contextual application is its "*central and distinguishing feature*".[129]

98. The Court of Appeal test of nullification or evisceration of the entire contract is not supported as a principle of law by the pre-existing law on abuse of contractual discretion or by the organizing principle stated in *Bhasin*. Further, the court failed to acknowledge that the arbitrator's findings as to the nature of the impact on Wastech would indeed satisfy any requirement of nullification or evisceration.

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[126] *Gateway Realty Ltd. v. Arton Holdings Ltd.*, 1991 CanLII 2707 (NS SC), aff'd 1992 NSCA 2620; *Mannpar Enterprises v. H.M.T.Q*, 1999 BCCA 239, para. 51; *Mesa Operating Limited Partnership v. Amoco Canada Resources Ltd.*, 1994 ABCA 94, para. 22; *Schluessel v. Maier*, 2001 BCSC 60, para. 130, 85 B.C.L.R. (3d) 239; *Transamerica Life Canada Inc. v. ING*, 2003 CanLII 9923 (ON CA), 68 O.R. (3d) 457 (C.A.), para. 53; *Barclay's Bank PLC v. Devonshire Trust*, 2013 ONCA 494, para. 134; *Northrock Resources v. ExxonMobil Canada Energy*, 2017 SKCA 60, para. 31; *Benfield Corporate Risk Canada Ltd. v. Beaufort International Insurance Inc.*, 2013 ABCA 200, para. 120.

[127] *Mesa Operating Limited Partnership v. Amoco Canada Resources Ltd.*, 1994 ABCA 94, para 22.

[128] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para 69.

[129] J. Young, "Justice Beneath the Palms: *Bhasin v. Hrynew* and the Role of Good Faith in Canadian Contract Law", (2016) 79 Sask. L. Rev. 79, p. 104. See also N. Effendi, H. Pessione and O.V. Nguyen, "*Bhasin v. Hrynew*: Towards Clarity and Coherence with respect to Good Faith in Contract Performance", (2016) 46 Adv. Q. 94, p. 102; P.R. Cotton-O'Brien, "Unpacking the Meaning of Good Faith in *Bhasin v. Hrynew*", (2018) 48 Adv. Q. 473, p. 488.

F. The duty of good faith in issue does not require subjective dishonesty

99. The Court of Appeal also found that the arbitrator committed an error of law in concluding that good faith in this context did not require a finding of dishonesty in the sense of dishonest contractual performance in the form of half-truths, lies or deceits. The Court of Appeal understood the phrasing used in *Bhasin* of "*honestly and reasonably*" to mean that there had to be a finding of subjective dishonesty amounting to unscrupulous conduct, untruthfulness, ulterior motive or other intentional conduct equivalent to fraud.[130]

100. The court below erred in holding that subjective dishonesty was required. It ignored the pre-existing law on the requirement of good faith in the exercise of a contractual discretion, where the governing test is reasonableness. The Court of Appeal instead referred to good faith in other areas of the law. Further, the Court of Appeal misread and misapplied the discussion in *Bhasin* as to the organizing principle of law and inappropriately used it to narrow the scope of the pre-existing law. The proper test here is the objective standard of reasonableness: this is consistent with the relevant case law, with *Bhasin*, and is supported by commentary.[131]

101. Professor McCamus, in discussing the application of good faith in the situation relevant to this case, abuse of a contract discretion, says the cases impose an objective standard:

> In each case, the defendant was required to exercise the power in question in a reasonable way.

102. This is fully supported by the relevant cases. The passage from *Mesa Operating Limited Partnership* cited above expresses a purely objective approach to the control of the contractual discretion. Similarly, the court in *Greenberg* concluded that the discretion was subject to an objective standard and its exercise had to be "reasonable".[132] Further, the case selected by the court in *Bhasin* to illustrate the operation of good faith in the exercise of contractual discretion

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[130] BCCA Reasons, paras. 71-73; Award, para 90.

[131] P.R. Cotton-O'Brien, "Unpacking the Meaning of Good Faith in *Bhasin v. Hrynew*", (2018) 48 Adv. Q. 473, p. 473.

[132] See the discussion of both cases in J.D. McCamus, *The Law of Contracts*, 2d ed. (Toronto: Irwin Law, 2012), pp. 845-846.

was *Mitsui & Co. (Canada) Ltd. v. Royal Bank of Canada*, where the court imposed a reasonableness requirement on the discretion in question.[133]

103. The Court of Appeal ignored the specific discussion in *Bhasin* of why it was inappropriate in this context to inquire into the subjective motivations of the party exercising the contractual power:

> The principle of good faith must be applied in a manner that is consistent with the fundamental commitments of the common law of contract which generally places great weight on the freedom of contracting parties to pursue their individual self-interest. … The development of the principle of good faith must be clear not to veer into a form of ad hoc judicial moralism or "palm tree" justice. *In particular, the organizing principle of good faith should not be used as a pretext for scrutinizing the motives of contracting parties.*[134] [Emphasis added.]

104. The starting point of the discussion in *Bhasin* was that the judiciary's traditional resistance to recognising a general and independent doctrine of good faith in contractual performance in Canadian law had produced outcomes that were inconsistent with the reasonable expectations of commercial parties.[135] From there, Cromwell J. went on to say that the establishment of the good faith organizing principle aims to bring Canadian law in line with commercial parties' expectations.[136] Interpreting the meaning of good faith in terms of objective commercial standards of reasonableness fulfills this objective by using the actual expectations of commercial actors to inform the content of one's legal obligations in contractual performance.[137]

105. The discussion in *Bhasin* of the organizing principle was not intended to narrow the application of the pre-existing law by importing a requirement of subjective dishonesty. Indeed, one of the recurring themes in *Bhasin* identified in commentary is that parties must exercise a contractual discretion on the objective standard of reasonableness.[138] The Court avoided any

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[133] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para 50; *Mitsui & Co. (Canada) Ltd. v. Royal Bank of Canada*, 1995 CanLII 87 (SCC), [1995] 2 SCR 187.

[134] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para. 70.

[135] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para. 32.

[136] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para. 41.

[137] P.R. Cotton-O'Brien, "Unpacking the Meaning of Good Faith in *Bhasin v. Hrynew*", (2018) 48 Adv. Q. 473, p. 488.

[138] J.T. Robertson, "Good Faith As An Organizing Principle in Contract Law: *Bhasin v. Hrynew* - Two Steps Forward and One Look Back", (2015) 93 Can. B. Rev. 809, p. 835.

general definition of good faith. Cromwell J. said that "*parties must generally perform their contractual duties honestly and reasonably and not capriciously or arbitrarily.*"[139] This simply states that while honest and reasonable conduct is in line with good faith performance, capricious and arbitrary conduct is not. It does not impose a subjective dishonesty threshold in all situations. *Bhasin* emphasized that good faith may be invoked in widely varying contexts and this calls for a "*highly context-specific understanding of what honesty and reasonableness in performance may require*."[140] Hall says:

> *Bhasin* makes no attempt to provide a definition of a good faith, aside from the highly abstract and minimally instructive edict that the "organizing principle is simply that parties generally must perform their contract duties honestly and reasonably and not capriciously or arbitrarily" and that contracting parties must have "appropriate regard … not to undermine [the other party's] interests in bad faith." The omission of a clearer and more comprehensive definition - no doubt a deliberate one to allow development of the law as the new organizing principle is applied to varying fact patterns - leaves much scope, since there are numerous possible and competing definitions of good faith.[141]

106. *Bhasin* therefore does not support the approach taken by the Court of Appeal, which effectively homogenized the content of good faith over widely varying circumstances and displaced the existing law that applied to the exercise of a contractual discretion.

107. Also, the Court of Appeal's importation of a requirement of subjective dishonesty is wholly inconsistent with the need for recognition of the new duty of honest contract performance, which requires a contracting party not to lie or mislead the other party. The Court of Appeal's requirement of subjective dishonesty would effectively collapse the pre-existing law on the exercise of contractual discretion into the new duty.

G. The Court of Appeal erred in reviewing the Arbitrator's finding of a breach of the duty of good faith

108. *Sattva* and *Teal Cedar* stress the need to confine appeals from commercial arbitrations to extricable questions of law; questions of contractual interpretation are mixed questions of fact and law and not reviewable. Furthermore, only questions of law of central importance to the

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[139] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para 63.

[140] *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, para 69.

[141] G.R. Hall, *Canadian Contractual Interpretation Law*, 3d ed. (Markham, ON: LexisNexis, 2016), p. 48-49.

legal system as a whole are to be reviewed on a correctness standard; on other questions of law, an arbitrator is to be reviewed on a reasonableness standard.

109. As submitted above the arbitrator committed no reviewable errors of law, even on a correctness standard.

110. The history of this appeal illustrates the ongoing confusion in the lower courts as to the proper approach to extricable questions of law on appeals from commercial arbitration awards and the need for further guidance from this Court. The British Columbia courts stated two questions of law, neither of which accurately identified what the arbitrator had in fact decided. For example, the arbitrator had not found that exercise of a contractual right was dishonest "*simply because it was wholly at odds with the expectation of the counter-party*", and the arbitrator correctly referenced the relevant pre-existing law and did not ignore it.

111. The Court of Appeal implicitly recognized this problem by identifying its own four errors of law, which were significantly different from the stated questions. For example, the original questions did not suggest that it was an error of law for the arbitrator to fail to consider the effect of his decision to reject the proposed implied term, or raise the issue of nullification or evisceration, and the errors as re-stated by the Court of Appeal did not address whether the arbitrator had confused the organizing principle with the pre-existing law. In the result, the courts below failed to heed the warning in *Sattva* that courts must be careful to ensure that the proposed grounds of appeal are properly characterized.[142]

112. With respect, the Court of Appeal acted on its own views on matters that properly fell to the arbitrator for final determination. The arbitrator did not fail to consider the impact of his decision to reject the implied term (the identified error of law) but carefully considered it. The Court of Appeal clearly wished to revisit that decision and substitute its own conclusion as to the relationship between the implied term in question and the particular duty of good faith imposed by law. (The danger of doing so at a practical level, as well at a level of principle, is illustrated by the fact that the court below incorrectly concluded that the content of both was "*exactly the same*".[143]) Similarly the Court of Appeal did not accept or give effect to the arbitrator's finding

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[142] *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, [2014] 2 SCR 633, para 54.

[143] BCCA Reasons, para. 67.

that it was a central concept underpinning the contract that Wastech should have the opportunity to achieve the Target OR throughout the term of the CA. The Court of Appeal revisited the interpretation of the contract to argue that there was no legitimate expectation arising out of the contract.[144] And, although it said it was a matter of law, the Court of Appeal was in fact addressing the application of the law to the facts when it doubted that *Bhasin* would have attributed dishonesty "*to a party in the circumstances of Metro in this case.*"[145]

113. The context of this case is an application of a particular good faith requirement. This Court has emphasized that this is a highly context-specific exercise. On any fair reading, the British Columbia courts went beyond their appellate role and did not properly act on extricable errors of law. Furthermore, the review should have been on a reasonableness basis. Even if correctly determined, the errors identified by the Court of Appeal are not errors that were central to the legal system as a whole and not within the expertise of the arbitrator.[146] Although the Court of Appeal said it would have come to the same conclusion on a reasonableness standard, it did not explain this or engage in a reasonableness exercise. The arbitrator's identification and application of the relevant principles of good faith were reasonable and the appellate inquiry should have not proceeded further.

PART IV -SUBMISSIONS ON COSTS

114. In Wastech's submission the Court should award costs of proceedings in this Court and in the courts below to the successful party.

PART V -ORDER SOUGHT

115. That the appeal be allowed, with costs.

All of which is respectfully submitted.

Dated at the City of Vancouver, Province of British Columbia, this 1st day of October, 2019.

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[144] BCCA Reasons, para 68.

[145] BCCA Reasons, para 73.

[146] *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, [2014] 2 SCR 633, para 106.

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