

## Do lenders still have a duty of good faith? Supreme Court decides in Wastech

MARCH 30, 2021 4 MIN READ

### Related Expertise

- [Financial Services](#)

Authors: [Joyce M. Bernasek](#), [Tearney Johnston-Jones](#), Ryan Hayes

The decision of the Supreme Court of Canada (the SCC) in *Wastech Services Ltd. v. Greater Vancouver Sewerage District* (2021 SCC 7), reaffirming the duty of good faith in the context of contractual discretionary rights, has important implications for lenders in the context of lending practices.

In both the *Wastech* decision and the SCC's parallel companion case, *C.M. Callow Inc. v. Zollinger*, on which Osler has previously commented, the Court acknowledged the need for greater clarity with respect to the scope of contractual discretion. The standards set out in *Wastech* have further defined the nature and limitations of this duty to exercise discretionary contractual powers in good faith dealings. In summary, the SCC majority held that

- The duty to exercise contractual discretion in good faith is an implied term in every contract. Parties cannot contract out of the obligation to act reasonably and even discretionary powers that appear unrestricted must be exercised within the scope of the purpose for which the power was granted.
- Discretionary powers must be exercised reasonably and in a manner that relates to the purpose for which the discretion was granted and cannot be exercised dishonestly.
- An unreasonable use of a party's discretion is one that falls beyond the scope of the range of choices connected to the underlying contractual purpose and is one that breaches the duty of good faith (as previously recognized in *Bhasin v. Hrynew* (2014 SCC 71)).
- Where an agreement does not define the circumstances or purpose for which a party may aptly employ its discretionary powers, such purpose may be interpreted based on the contract itself, read as a whole.
- In the context of discretionary powers, "reasonable" may still include "for one party's exclusive economic benefit." Even where discretion is used to eradicate the other party's expected benefits under a contract, such discretion may be reasonable in the context of the parties' agreement.

Please also refer to Osler's [recent case comment](#) for a more detailed summary of the facts informing the *Wastech* decision. Below is a summary of our key takeaways for lenders.

### A duty to exercise discretion in good faith

A lender has a duty to exercise its discretion in good faith. When applying this duty of good faith to the lending environment, lenders must understand that they are to act reasonably

while carrying out their contractual obligations and any discretionary decision taken on their part must be connected to the purpose for which the lender is permitted to employ this power under the contract. Practically speaking, this reaffirms the longstanding principle that a contracting party cannot rely on its discretionary powers to act dishonestly or arbitrarily in any manner.

As noted in *Bhasin*, the general organizing principle of good faith dealings applies to all contracts regardless of the parties' intentions or attempts to contract out of this obligation. Nevertheless, this does not mean to suggest that parties should subordinate their own interests to those of the opposing party or be unnecessarily benevolent in their consideration of the other party's interests. Rather, reasonableness principles should be used to guide a party's behaviour and inform them of when discretionary powers may be appropriately employed.

## The (un)enforceability of discretionary provisions and the potential breach of contract

Provisions that state or suggest that a lender's acknowledgement or consent may be unreasonably withheld are not enforceable. Any such unreasonable exercise of a party's discretion may constitute a breach of contract, even where discretion has been granted without limitations or is expressly absolute.

It remains to be seen how this application of good faith dealings will be applied to contractual interpretations that expressly authorize a party to exercise discretion without constraint. Future decisions may inform the standard of what constitutes the duty of good faith in situations where there is a clear contractual purpose for unconstrained discretion to be afforded to a contracting party.

When exercising discretion, lenders should use "reasonableness" as a guiding principle to inform them of how their actions may be assessed by a court should an exercise of contractual interpretation take place.

## The impact of discretionary provisions in contracts

Discretionary provisions must be drafted with diligence and care, as parties will be reliant on these clauses when determining the scope of reasonableness in future dealings governed by the contract. Lenders should consider including express statements that define the purpose of each discretionary power that is granted to mitigate future ambiguities and uncertainty.

## The duty of good faith does not hinder an "aggressive pursuit of self-interest"

The need to incorporate the duty of good faith and the concept of reasonableness when entering into a contract does not prevent a lender (or any party) from putting its needs first, even where it is at the other party's expense. The common law continues to recognize that transactional dealings require parties to promote their own self-interests, even where it is disadvantageous to others. The SCC reconciled this approach to contractual negotiations with the need for reasonable discretionary powers by stressing that discretion should only be criticized where it is used capriciously or arbitrarily and outside of the reasonable expectations of the parties.