

Supreme Court Expands Obligations of Good Faith and Honesty in Contract Performance

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In *Bhasin v. Hrynew (Bhasin)*, a decision released on November 13, 2014, the Supreme Court of Canada (the Court) significantly changed contract law in Canada by expanding the reach of good faith as a source of contract obligations. Specifically, the Court held that the “organizing principle” of good faith in contract law gave rise to a specific duty of honesty in contractual performance that generally applied to contracts, including commercial contracts.

Good Faith and the “Duty of Honest Performance”

The Court found that an obligation of good faith in contractual performance is a general organizing principle, which underpins the various common law rules which apply specifically in “various situations and types of relationships.” The obligation of good faith requires that parties “perform their contractual duties honestly and reasonably and not capriciously or arbitrarily.”

The “duty of honest performance” exists so that a party to a contract can “rely on a minimum standard of honesty from their contracting partner in relation to performing the contract,” wrote Justice Cromwell for a unanimous Court.

Honest performance, wrote Justice Cromwell, is a “manifestation of this organizing principle of good faith.” Honest performance requires that parties “not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract.” It operates “irrespective of the intentions of the parties.”

This development is necessary, according to the Court, to keep the common law “in step with the ‘dynamic and evolving fabric of our society.’” The Court arrived at this conclusion after reviewing the current state of the law in Canada, noting that courts to date had identified duties of good faith in certain circumstances (i.e., “sole discretion” clauses) and particular relationships (i.e., employment), but had refrained from declaring an across-the-board obligation of good faith.

Factual Background

The appellant, Harish Bhasin, through his business, was a highly successful “enrolment director” for the

Cassels

respondent Canadian American Financial Corporation (Can-Am). As an enrolment director, Bhasin marketed Can-Am's education savings plans to investors. The commercial relationship between Bhasin and Can-Am was governed by a three-year enrolment director's agreement, renewable automatically, unless one of the parties gave six months written notice to the contrary.

<The respondent Larry Hrynew was also an enrolment director for Can-Am and accordingly, was Bhasin's competitor. Bhasin had declined numerous proposals by Hrynew to merge their two agencies.

Subsequently, Hrynew was appointed Can-Am's provincial trading officer, responsible for a review of Can-Am's enrolment directors, in response to compliance concerns by the Alberta Securities Commission. In response to those concerns, Can-Am outlined restructuring plans to the ASC in June 2000, which included Bhasin working for Hrynew, unbeknownst to Bhasin. Can-Am repeatedly misled Bhasin about the nature of Hrynew's role as PTO and "responded equivocally when [Bhasin] asked ... whether the merger [of Bhasin and Hrynew's agencies] was a 'done deal.'"

Ultimately, Can-Am exercised its notice of non-renewal in Bhasin's enrolment director's agreement, following Bhasin's continued refusal to permit Hrynew to audit his records. As a result, "Bhasin lost the value in his business in his assembled workforce," which was substantially solicited by Hrynew.

Proceedings at Trial and on Appeal

Justice Moen in the Alberta Court of Queen's Bench found that Can-Am had breached "an implied term of the contract that decisions about whether to renew the contract would be made in good faith" by misleading Bhasin "throughout the events leading up to the non-renewal." The Alberta Court of Appeal allowed the respondents' appeal and dismissed the action.

Application of Honest Performance Duty

The Supreme Court found Can-Am's dishonest actions were directly and intimately connected to its performance of the agreement with Bhasin and its exercise of the notice of non-renewal. Accordingly, "Can-Am's breach of contract consisted of its failure to be honest with [Bhasin] about its contractual performance and, in particular, with respect to its settled intentions with respect to renewal."

The Court awarded damages of \$87,000 to Bhasin, "calculated on the basis of what [his] economic position would have been had Can-Am fulfilled [its duty of Honest Performance]."

Implications

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This case will have a significant impact on contract law going forward.

The immediate impact will be to make lying or misleading conduct in contractual performance the basis for an action for damages.

The Court expressly suggested that the scope of honest performance could be influenced by an agreement of the parties in a particular context. That said, according to Justice Cromwell, “any modification of the duty of honest performance would need to be in express terms.”

There are a number of unanswered questions about honest performance. The Court made it clear that the duty did not create an obligation of disclosure in contractual performance. However, the dividing line between dishonesty and non-disclosure will often be difficult to discern in practice.

The other problem is one of remedy. The cause of Bhasin's loss was Can-Am's exercise of its contractual right of non-renewal. The Court explicitly held that it would be a “stretch” to use the duty to constrain the exercise of a right of non-renewal and effectively create a contract of indefinite duration. However, the award of damages equal to the value of the business at point of termination is explained only by the Supreme Court's reliance on the trial judge's vague finding that if Bhasin had not been lied to, he could have “retained the value of his business.”

Another issue will be the future use of the “organizing principle” of good faith to create additional contractual duties. The Court said very little about what those duties may entail, leaving them to be developed on a case-by-case basis.

Ultimately, while purporting to regularize and clarify the law of good faith in contractual performance, the Supreme Court has introduced new uncertainties for businesses into Canadian contract law.

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