

# BRIEFING NOTE

## Supreme Court of Canada rules that Good Faith applies to the performance of all contracts in Canada

*“[I]t is one thing to say that you can exploit your superior knowledge of the market ... It is another thing to say that you can take deliberate advantage of an oversight by your contract partner concerning his rights under the contract. Such taking advantage is not the exploitation of superior knowledge ... it is sharp dealing.”<sup>1</sup>*

### I. Summary

Does Canadian common law impose a duty on parties to perform their contractual obligations in good faith? The Supreme Court of Canada addressed this question in its recently released decision in *Bhasin v. Hrynew*, [2014 SCC 71](#).

While the Court did not refer to Posner J.’s reasons for judgment quoted above, it came to a similar conclusion. In a unanimous decision, the Court established a duty of honest contractual performance under which contracting parties are required to be honest with each other in relation to the performance of their contractual obligations. Conduct falling below a “minimum standard of honesty” in carrying out one’s contractual obligations is now actionable. The precise content of honest performance will vary with context, however, and parties may “relax the requirements of the doctrine.”<sup>2</sup>

The Court also held that there is an organizing principle of good faith underlying contract law, although the limits of the principle were left to be determined. It is not a standalone cause of action, however. Where a breach of a duty of good faith is alleged, the plaintiff must base his or her claim on “the existing doctrines about the types of situations and relationships in which the law requires, in certain respects, honest, candid, forthright or reasonable contractual performance.”<sup>3</sup> But the list of doctrines is not closed, and this principle should be used as a gap-filler where the existing law “is found to be wanting.”<sup>4</sup> How the courts will apply this principle is uncertain.

Although the Court asserts it has brought more certainty to Canadian contract law, it could be argued that it has filled in one hole whilst digging another. That is, while the Court confirmed there is a duty of honest performance of contractual obligations, further and equally vexing questions arise from the decision – namely, what is the content of this new duty of honesty and what are the limits of the organizing principle of good faith?

### II. Background

The respondent, “Can-Am”, marketed education savings plans through dealers known as “Enrollment Directors.” The Plaintiff, Mr. Bhasin, was one such dealer.

<sup>1</sup> *Market Street Associates Ltd. Partnership v. Frey*, [941 F.2d 588](#) at pg 594 (7th Cir. 1991), *per* Posner J.

<sup>2</sup> [2014 SCC 71](#) at para. 77

<sup>3</sup> [2014 SCC 71](#) at para. 66

<sup>4</sup> [2014 SCC 71](#) at para. 66

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The parties' relationship was governed by an Enrollment Director's agreement, which had a 3-year term starting in 1998 (the "Agreement"). The provision at the centre of the dispute provided that the Agreement would automatically renew at the end of the 3-year term unless one of the parties gave 6 months' written notice to the contrary.

The respondent, Mr. Hrynew, was a competitor of the Plaintiff and a fellow Enrollment Director. Mr. Hrynew wanted Mr. Bhasin's lucrative niche clientele and proposed a merger of their agencies, which he actively encouraged Can-Am to leverage.

At issue in the litigation were two decisions made by Can-Am. First, by early 2000, Can-Am had plans to reorganize its activities in Alberta. It outlined its plans to the Alberta Securities Commission to merge Mr. Bhasin's agency under Mr. Hrynew's, but did not tell Mr. Bhasin. Second, Can-Am appointed Mr. Hrynew as a "Provincial Trading Officer" to conduct a compliance review under Alberta securities law. This included an audit of Mr. Bhasin's confidential business records.

In May 2001, Can-Am gave notice of non-renewal under the Agreement and the majority of Mr. Bhasin's sales agents were subsequently poached by Mr. Hrynew's agency. Mr. Bhasin then sued Can-Am and Mr. Hrynew.

At trial, the court held that there was an implied term of good faith performance of the Agreement. The trial judge further found that the implied term was breached when Can-Am required Mr. Bhasin to submit to an audit by Mr. Hrynew, and by exercising the non-renewal clause in a dishonest and misleading manner. The court noted that the non-renewal clause was not intended to permit Can-Am to force a merger of the two agencies. The Court of Appeal overturned this decision and dismissed Mr. Bhasin's lawsuit. Mr. Bhasin then appealed to the Supreme Court of Canada.

### III. The Supreme Court's Decision: Two "Incremental Steps"

The issue to be determined on appeal was whether Canadian common law imposed a duty on parties to perform their contractual obligations honestly.

The Court held that it was appropriate to take "two incremental steps" in order to make the common law "less unsettled and piecemeal, more coherent and more just". These are:

1. to acknowledge that good faith contractual performance is a general organizing principle of the common law of contract; and
2. to recognize that there is a common law duty, applicable to all contracts, to act honestly in the performance of contractual obligations.

#### A. Why the change?

The Court gave 3 reasons why it was necessary to change the common law: (i) it resolves an uncertain area of the common law; (ii) it brings coherence to the resolution of contractual disputes; and (iii) it upholds the reasonable expectations of commercial parties.<sup>5</sup>

With respect to the third ground, the Court emphasized that parties expect "a basic level of honest conduct [which] is necessary to the proper functioning of commerce", particularly with "longer term, relational contracts that depend on an element of trust and cooperation."<sup>6</sup> And even with transactional exchanges, misleading or deceitful

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<sup>5</sup> [2014 SCC 71](#) at para. 41

<sup>6</sup> [2014 SCC 71](#) at para. 60

conduct will fly in the face of the expectations of the parties.<sup>7</sup> This is consistent with American jurisprudence. As Posner J. stated in the aforementioned *Market Street* ruling, the “office of the doctrine of good faith is to forbid the kinds of opportunistic behavior that a mutually dependent, cooperative relationship might enable in the absence of the rule”<sup>8</sup>.

### B. What is the “organizing principle of good faith”?

The organizing principle, which is easy to state but may ultimately be difficult to apply, generally requires parties to “perform their contractual duties honestly and reasonably and not capriciously or arbitrarily.”<sup>9</sup> This is not a “free-standing rule”. Rather, it is a standard that “underpins and is manifested in more specific legal doctrines and may be given different weight in different situations.”<sup>10</sup>

But how is the organizing principle to be applied?

It appears the Court intends for the law to develop organically through the existing legal doctrines which require “honest, candid, forthright or reasonable contractual performance”, such as: the doctrine of unconscionability;<sup>11</sup> implied terms;<sup>12</sup> the principles of contractual interpretation, which require courts to give effect to the parties’ intentions at contract formation;<sup>13</sup> and the various circumstances where courts have required “good faith”, including where parties must cooperate in order to achieve the contract’s objectives.<sup>14</sup>

Thus, under this new framework, there is not yet a cause of action for breach of good faith. Instead, the claim should “fall within these existing doctrines.”<sup>15</sup> However, the list of doctrines which require good faith in the performance of contractual obligations is not closed, and courts may gap-fill where the existing law is “found to be wanting.”<sup>16</sup>

In further explaining how this new organizational principle should be applied, the Court is regrettably vague, stating that good faith may be invoked in “widely varying contexts”, thus requiring a “highly context-specific understanding of what honesty and reasonableness in performance require so as to give appropriate consideration to the legitimate interests of both contracting parties.”<sup>17</sup> Although this principle at first glance appears to be a moralistic approach to contract law, the Court states that:

1. it must be applied in a manner consistent with the fundamental commitments of the common law of contract (i.e. freedom to contract);
2. it does not preclude parties from intentionally causing loss to others;
3. it must not become *ad hoc* judicial moralism or “palm tree” justice; and
4. it must not be used as a pretext for scrutinizing contracting parties’ motives.

At the end of the day, the limits of the implications of the organizing principle of good faith are undefined and appear open for active exploration by counsel.<sup>18</sup>

<sup>7</sup> [2014 SCC 71](#) at para. 60

<sup>8</sup> *Market Street Associates Ltd. Partnership v. Frey*, [941 F.2d 588](#) at pg 595 (7th Cir. 1991), *per* Posner J.

<sup>9</sup> [2014 SCC 71](#) at para. 63

<sup>10</sup> [2014 SCC 71](#) at para. 64

<sup>11</sup> [2014 SCC 71](#) at para. 43

<sup>12</sup> [2014 SCC 71](#) at para. 44

<sup>13</sup> [2014 SCC 71](#) at para. 45

<sup>14</sup> [2014 SCC 71](#) at para. 47

<sup>15</sup> [2014 SCC 71](#) at para. 66

<sup>16</sup> [2014 SCC 71](#) at para. 66

<sup>17</sup> [2014 SCC 71](#) at para. 69

<sup>18</sup> [2014 SCC 71](#) at para. 90

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### C. What is the duty of honesty in contractual performance?

From the “broad umbrella of the organizing principle of good faith performance of contracts” flows a general duty of honesty in contractual performance.

The Court explained this new duty in the following manner:

[73] ... This means simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract. ... [I]t is a simple requirement not to lie or mislead the other party about one’s contractual performance.

The Court further explained the content of the duty by identifying its outer limits. On the one side, the duty of honest performance does not equate to a duty of disclosure or of fiduciary loyalty.<sup>19</sup> The Court does not wish to make every contract signatory his ‘brother’s keeper’. On the other side, conduct that does not constitute civil fraud may still violate the duty of honest performance.<sup>20</sup>

Finally, unlike in the United States, this duty is not treated as an implied term. Here, it is a general doctrine of contract law that varies with context.<sup>21</sup> Parties are therefore not entitled to contract out of the duty completely – although they may, in some contexts, be permitted to “relax the requirements”, as long as they do so expressly and they “respect its minimum core requirements.”<sup>22</sup> In that sense, the doctrine is intended to impose limits on the freedom of contract.<sup>23</sup>

It appears that in creating this duty of honesty, the Court was seeking to set a floor, in order to address unjust situations and to pressure commercial parties to specify their expectations up front, rather than to have them rely on courts afterward.

### IV. Concluding Remarks

This is a significant decision. It sets a minimum standard for contracting parties’ conduct, such that active dishonesty is now actionable, as long as it can be proved damages flowed from the dishonesty.

But does *Bhasin v. Hrynew* clarify the law surrounding good faith claims? The ruling gives rise to several vexing questions:

1. How will the organizing principle of “good faith” be utilized by counsel and judges alike to gap-fill where the law is “wanting”?
2. What are the limits of the organizing principle of good faith? If the principle of good faith is bounded on one side by fiduciary duties and on the other side by intentional tort obligations, a significant gap is left.
3. In light of the Court’s comments that parties may relax the requirements of the duty of honesty, what are the “minimum core requirements”?

Only in the fullness of time will the full ramifications of the decision be known. In the meantime, however, parties should be fully informed that they run the risk of being sued if they engage in deceitful conduct in performing their contractual obligations or if they take opportunistic advantage of the other contracting party in a way that could not have been contemplated at the time of drafting the contract.

<sup>19</sup> [2014 SCC 71](#) at para. 86

<sup>20</sup> [2014 SCC 71](#) at para. 88

<sup>21</sup> [2014 SCC 71](#) at paras. 72-74, 77

<sup>22</sup> [2014 SCC 71](#) at para. 77

<sup>23</sup> [2014 SCC 71](#) at para. 74



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