Raising the Bar

Raising the Bar – Third Edition

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Dear Friends,

We are pleased to provide you with the third issue of Raising the Bar, just in time for your dockside or patio summer reading.

In this issue, we share with you some of the key cases from the Ontario courts in the past few months in the context of summary judgment motions. These decisions deal with a broad range of legal issues you need to know about, including breach of fiduciary duty, wrongful dismissal actions and mitigation as well as defamation claims in the context of internet blogging.

In this issue, we also shine a light on the so-called “duty of good faith”, a legal concept which is often incorrectly described and misunderstood. Claims for breach of the “duty of good faith” are appearing with increasing frequency in contract disputes, and you need to know the scope and boundaries of this legal principle to be able to properly defend against these claims or to consider whether you might have a potential claim.

You will also find information about a little-known but important issue: the impact that inquiries into settlement offers have on the enforceability of the agreement.

We thank Carolyn Cornford Greaves and Stephanie Jeronimo, whose efforts and contributions were integral to the publication of this issue.

We hope that you benefit from reading this issue of Raising the Bar and we look forward to being back in touch with you for our next issue in September!

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PART 1 – CASES YOU NEED TO KNOW ABOUT

Bomhof v. Eunoia Inc., 2012 ONSC 3191 (CanLII)

This is an important decision because it is the Ontario Superior Court's first application of the new "full appreciation" test for granting summary judgment, as articulated by the Ontario Court of Appeal in *Combined Air Mechanical Services Inc. v Flesch,* in the context of a wrongful dismissal action filed under the simplified rules. The Court found that if the only issue in dispute had been the reasonable notice period, then summary judgment would have been appropriate. However, the Court found that this was not an appropriate case for summary judgment because the plaintiff's mitigation efforts were also in dispute and the defendant bore the onus of establishing that those efforts were insufficient. In reaching this decision, the Court relied on *Combined Air* where it was stated that it may not be in the interests of justice to have a party respond to a summary judgment motion before productions are complete and that in the context of simplified procedure actions, it is generally better to proceed to trial than engage in a summary judgment motion that requires oral evidence.

Cooperative Investigative Services v. Steele, 2012 ONSC 3286 (CanLII)

In another important decision on summary judgment motions, the Ontario Superior Court applied, for the first time, the "full appreciation" test to an action claiming breach of contract, breach of fiduciary obligations, wrongful resignation and intentional interference with economic relations. In this case, almost all of the material facts were in dispute, including whether or not the former employee was subject to a non-solicitation obligation and what that meant in the context of an industry where clients frequently change service providers. As such, numerous findings of fact were required and credibility was a central issue. The Court found this was not an appropriate case for summary judgment.

Baglow v. Smith, 2012 ONCA 407 (CanLII)

In this case, the Court of Appeal commented on summary judgment motions in the context of a claim for defamation based on comments posted on political blogs. The Court disagreed with the motion judge and found this was not an appropriate case for summary judgment. This conclusion was based largely on the fact that the case raised a number of issues for the first time, including the legal considerations that should be applied to internet publications and what constitutes defamation in this context. The Court found it was inappropriate to dispose of these novel questions without a full trial and potentially the assistance of expert evidence. The matter was remitted for trial.

PART 2 – SHINE A LIGHT ON…THE DUTY OF GOOD FAITH

The existence and scope of a "duty of good faith" in Canadian contract law is often incorrectly described. Plaintiff's counsel asserting a claim for breach of "the duty of good faith" will often paint the claim as a broad one about whether the defendant has acted fairly or properly or in the best interests of the plaintiff. However, the law does not support this overly broad approach. In reality, Canadian courts have been cautious and conservative in recognizing a good faith obligation in the performance of contracts.

Whether you are a defendant facing a claim for breach of good faith or a plaintiff considering launching this kind of claim, it is crucial that you know the boundaries of the law. Below, we analyze the key judicial statements on this topic and highlight the issues to watch out for, whichever side of the case you are on.

IT'S NOT THE SAME AS "WALLACE/HONDA" DAMAGES

The first key thing to know about the duty of good faith in the contractual context is that it is not the same as an employer's obligation to avoid acting in bad faith in the manner of dismissing an employee.

Under the line of cases following the Supreme Court of Canada's decisions in *Wallace* and *Honda v. Keays,* the courts have held that an employer has an obligation of good faith and fair dealing in the manner of dismissal of an employee. If an employer acts in bad faith in the manner of dismissal and causes mental distress to the employee and the employee suffers

actual damages, the employee may be awarded damages.

This is a self-contained principle that applies in context of an employer – employee relationship, and is different than the duty of good faith in the contractual context.

THE ONTARIO COURT HAS SPOKEN ABOUT THE DUTY OF GOOD FAITH

The foundational case in Ontario on the duty of good faith is the decision of the Court of Appeal in *Transamerica Life Canada Inc. v. ING Canada Inc.* [1]

Transamerica claimed for damages for misrepresentation and breach of warranties and covenants contained in a share purchase agreement. In its defence, among other things, ING pleaded that Transamerica breached certain implied duties of good faith and fair dealing and was precluded from asserting certain claims. On a pleadings motion, the motion judge struck the allegations relating to the duty of good faith. The Court of Appeal reversed that decision and allowed the pleading to stand. This context is important because, as the Court noted, “a decision to strike the pleading must only be made when the applicable law is settled in the jurisprudence.” [2]

In *Transamerica*, Justice O’Connor’s decision on behalf of the Court made clear that there is no stand-alone duty of good faith in Ontario law. This paragraph from the Court’s reasons has become the classic and most frequently-cited statement of the law in Ontario:

I agree with Transamerica that Canadian courts have not recognized a stand-alone duty of good faith that is independent from the terms expressed in a contract or from the objectives that emerge from those provisions. The implication of a duty of good faith has not gone so far as to create new, unbargained-for, rights and obligations. Nor has it been used to alter the express terms of the contract reached by the parties. Rather, courts have implied a duty of good faith with a view to securing the performance and enforcement of the contract made by the parties, or as it is sometimes put, to ensure that parties do not act in a way that eviscerates or defeats the objectives of the agreement that they have entered into [.]

Three key themes emerge from this passage, and they all serve to anchor any analysis of the duty of good faith to the terms of the contract.

The first key theme is that the duty of good faith must be tied to the *terms of the contract:* there is no free-floating duty to act in good faith. This makes good sense because any such duty would be formless and devoid of any principle or content without being anchored in the terms of a contract. Rather, a party claiming the existence (and breach) of a duty of good faith must point to a specific term of the contract that it says has not been performed in good faith. In reality, this is no more than holding the other party to its bargain. Seen in this way, the terms of the contract are key both to a determination of the existence and scope of any duty of good faith, and to whether there has been a breach of the duty. The Court of Appeal recently confirmed this point in *Jaffer v. York University:* “In order for a claim for a breach of duty of good faith to survive, such a duty must be an express or implied term of the contract and there must be a tenable cause of action for breach of contract.” [3]

The second key theme in Justice O’Connor’s statement of the law is that the terms of the contract can be supplemented by the “objectives that emerge” from those terms. This is not much different than interpreting a contract in light of the “factual matrix” or “surrounding circumstances” underlying the contract, or favouring a contractual interpretation that produces a commercially reasonable rather than a commercially absurd result. As Justice Doherty of the Court of Appeal put it in a well-known 2007 decision: “Insofar as written agreements are concerned, the context, or as it is sometimes called the ‘factual matrix’, clearly extends to the genesis of the agreement, its purpose, and the commercial context in which the agreement was made.” [4] If the terms of a contract can be interpreted in accordance with its purpose (i.e. its objective), then it is consistent to also look to the purpose/objectives to determine whether a party’s conduct *in relation to a term of the contract* is in breach of those objectives. This also reinforces the first key theme that an analysis of the duty of good faith, including in relation to the parties’ objectives, must always be tied to the words to which the parties agreed.

The third key theme that emerges from *Transamerica* is that the duty of good faith does not create "new, unbargained-for, rights and obligations." This over-arching theme ties the others together. The duty of good faith does not stretch to impose an obligation on a party that is not firmly grounded in the terms of the contract. This is an important limiting principle in this area of law.

It is also noteworthy that the Court of Appeal upheld the motion judge's decision to strike the portion of the statement of defence in which ING pleaded a general duty that Transamerica would act fairly in all its dealings with ING. The Court noted that the defence provided no specifics about what is entailed in the general duty, that the pleading "is vague and is not tied to the performance or enforcement of the provisions in the agreement" and that the pleading was not "linked to any alleged actions by Transamerica that would defeat any of the contractual objectives." [5] These findings reinforce the principles of law set out in the decision that establish the boundaries of the good faith principle.

THE LAW IN ACTION: A CASE STUDY

A recent decision in the Ontario Superior Court of Justice provides a good example of how these principles take shape.

In *National Logistics v. American Eagle Outfitters Canada* [6], the defendant brought a motion for summary judgment to dismiss the plaintiff's claims, which included a claim for breach of the duty of good faith. The plaintiff provided logistics services to the defendant, which owned and operated retail clothing stores.

In the decision, Justice Hourigan provides a very good summary of the law. His Honour notes at the outset that "In order to advance a claim of breach of a duty of good faith in the performance of a contract a plaintiff must point to a specific term of the contract, whether express or implied, which the defendant has not performed in good faith." The framing of the question is essential because it focuses on the duty of good faith *in the performance of the contract*, which accurately reflects the relatively narrow scope of the duty as it has developed in Ontario.

After referring to *Transamerica* and other case law, Justice Hourigan summarizes the law neatly as follows:

As I interpret the case law, I must look to the actual agreement entered into by the parties to determine whether there is a specific provision, whether express or implied, which is not being performed in good faith. In addition, it is open to me to determine whether the objectives of the parties, as gleaned from the contract, have been eviscerated or defeated by the conduct of the defendants. But it is impermissible for me to impose an extra contractual duty of good faith performance which is not grounded in the contract. [7]

Against this backdrop, Justice Hourigan honed in on the specific contractual provision that grounded the good faith claim, a provision relating to the defendant's responsibility to provide volume projections and information required by the plaintiff for planning. The plaintiff claimed that under this provision the defendant had an obligation to provide information about "in-sourcing intentions and activities." The Court did not accept this argument because it was based on "a flawed interpretation of the clause." The Court found that, "when read in context, the clause is "purely operational" and merely required the defendants to provide accurate volume and related information "so that the plaintiff is in a position to ensure that it can effectively provide logistics services." The clause did not impose a broader obligation on the defendant "to provide information regarding its long-term intentions."

The Court went on to find that the express terms of the agreement demonstrated that there was no mutual expectation of a long term relationship between the parties: the contract was for an initial 23 month term, only the defendant had an option to renew and either party could terminate the agreement "at any time for convenience on 180 days prior written notice." The Court specifically distinguished these facts from the statement of law in *Transamerica*: "This is not the type of case referred to by Justice O'Connor in *Transamerica* where the conduct of a party in the performance of the contract amounts to an evisceration of the objectives of the contract." [8]

Based on these findings of fact and conclusions of law, the Court granted the defendants' motion and dismissed the

plaintiff's claim of a breach of duty of good faith.

CONCLUSION

As the decision in *National Logistics* demonstrates, the law on the duty of good faith will hold the parties close to the terms of the contract and the objectives that are grounded in those terms. The phrase "good faith" may appear to invite a broad-ranging claim about a party's conduct in the context of a contractual relationship, but the law does not support that kind of claim and the courts in Ontario will enforce the strict bounds of these legal principles.

PART 3 – DID YOU KNOW?

Did you know that…a party who makes an inquiry into an offer to settle but signs the offer before he or she gets a response will typically still be held to that agreement? It is true, and you should be careful! (See *Elgar v. Koetsier,* 2012 ONSC 2957 (CanLII))

If you have any questions about the issues discussed in Raising the Bar, or would like more information, please contact a member of the Hicks Morley Litigation Practice Group, and we would be pleased to assist you.

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[1] 2003 CanLII 9923 (ON CA).

[2] *Transamerica*, at para. 54.

[3] 2010 ONCA 654 at para. 49.

[4] *Dumbrell v. The Regional Group of Companies Inc.,* 2007 ONCA 59 at para. 55.

[5] *Transamerica*, at para. 64.

[6] 2012 ONSC 384 (CanLII).

[7] *ibid.* at para. 52.

[8] *ibid,* at para. 58.

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