

FTR Now

The Duty of Good Faith and Honesty: An Important Foundational Decision by The Supreme Court Of Canada

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The Supreme Court of Canada has issued a significant decision on the duty of good faith in the law of commercial contracts. In [Bhasin v. Hrynew](#), the Court recognized good faith contractual performance as a general organizing principle of contract law and recognized a new “duty of honest performance” in the fulfillment of contractual obligations. This marks an expansion of the duty of good faith and is an attempt to unify an extensive body of case law that has been fragmentary and at times at tension with itself. In this *FTR Now*, we discuss the decision and its implications.

FACTS

The legal dispute in this case arose from the non-renewal of a three-year dealership agreement (“Agreement”) between Canadian American Financial Corp. (“Can-Am”) and Harish Bhasin (“Bhasin”) in Calgary, Alberta. Bhasin sold Can-Am’s investment products exclusively and he owed Can-Am a fiduciary duty. Can-Am owned Bhasin’s client lists, and was responsible for branding of his business and the implementation of policies that governed his operations. Bhasin required Can-Am’s consent to sell, transfer, or merge his operations with another business.

The term of the contract was for three years, and provided for automatic renewal unless notice of non-renewal was provided by either party at least six months prior to the date of renewal.

Larry Hrynew (“Hrynew”), one of Bhasin’s competitors, was one of the largest retail dealers of Can-Am’s products in Calgary. Can-Am had agreed to provide particular consideration for the merger of his business with that of Can-Am’s other retail dealers, thereby granting a significant advantage to Hrynew in expanding the scope of his business.

Around this time, Can-Am was being scrutinized by the Alberta Securities Commission (“Commission”) which had concerns about compliance among Can-Am’s retail dealers. As a result, Can-Am appointed Hrynew as its provincial trading officer (“PTO”) to review and enforce compliance among retail dealers with the province’s securities laws.

In this role, Hrynew was required to conduct audits of Can-Am’s retail dealers, which included Bhasin. In light of Hrynew’s previous and repeated expressed desire to acquire Bhasin’s business, Bhasin refused to grant Hrynew access to his confidential business records. In response

to Bhasin's objections, Can-Am dishonestly advised him that Hrynew was under an obligation to treat any information he obtained as a PTO confidentially and that the Commission had rejected a proposal to retain a third-party PTO. Can-Am also disclosed to the Commission that it planned to restructure its retail dealership such that Bhasin would work for Hrynew. Can-Am did not advise Bhasin of this intention. When Bhasin heard of the planned merger, Can-Am equivocated its intentions and did not advise that the merger was a "done deal."

Can-Am threatened to terminate its Agreement with Bhasin for refusing to grant Hrynew access to his business' confidential information. It then gave notice of non-renewal to Bhasin in accordance with the Agreement. Bhasin consequently lost the majority of his sales team to Hrynew. As his sales team was the principal asset that accounted for the value of his business, Bhasin joined a competitor for reduced compensation.

Bhasin commenced a lawsuit against Can-Am arguing that the non-renewal of the dealership Agreement constituted, among other things, a breach of Can-Am's duty of good faith. He alleged that Can-Am had misled him repeatedly over the course of their business relationship in favour of Hrynew, who had on several occasions unsuccessfully sought to accomplish a hostile takeover of Bhasin's business.

DUTY OF GOOD FAITH

Although there were other issues in the case (e.g. the torts of inducing breach of contract or civil conspiracy, and the appropriate measure of damages), the main issue was whether Can-Am owed Bhasin a duty of good faith and whether it had breach the duty of good faith.

AT TRIAL AND THE COURT OF APPEAL

The trial judge found that the Agreement was of the sort that as a matter of law required good faith performance, even though it did not fall within the recognized categories of contract where that duty was imposed (i.e. employment, insurance, franchise). The Court of Appeal reversed that decision, finding that the trial judge improperly analogized the Agreement to the established categories in which a duty of good faith was recognized. The error was compounded by the fact that in contractual categories where a duty had been recognized, its ambit was limited to *the manner in which a party terminated the contract or exercised a discretionary power*. These cases could not be relied upon to require the renewal of a contract, because that would bind the parties to a perpetual contract which went against the explicit termination provisions of the Agreement.

AT THE SUPREME COURT OF CANADA

The Court noted at the outset that the law had traditionally resisted the notion of an independent duty of good faith performance in the law of contract, and that this had resulted in an unsettled body of law that had developed in a piecemeal fashion and was difficult to analyze.

To remedy this situation, the Court did two things:

1. It recognized good faith contractual performance as a general organizing principle of the common law, which underpins and informs the further development of the law of contract.
2. As an extension of this general principle, it recognized a common law duty to act honestly in the performance of contractual obligations.

The Court emphasized that the developments it was proposing to the law of contract did not amount to a reversal of settled law, “but a development directed to bringing greater certainty and coherence to a complex and troublesome area of the common law.”

The Court started by recognizing “an organizing principle of good faith”, which requires that parties to a contract must generally perform their contractual duties “honestly and reasonably and not capriciously or arbitrarily.” In carrying out the obligation under a contract, a party “should have appropriate regard to the legitimate contractual interests of the contracting partner.”

While the precise content of this requirement will vary with the circumstances of each case, it does not include duty to place the interest of the other contracting partner ahead of one’s own. In other words, it is not equivalent to a fiduciary duty. It simply requires that a party “not seek to undermine [the other party’s interests] in bad faith.” The Court also noted that this new principle is not at odds with the traditionally accepted notion of efficient breach: i.e. where a party can breach a contract in the legitimate pursuit of economic self-interest. As a result, this new requirement “should not be used as a pretext for scrutinizing the motives of contracting parties.”

After stating the requirements of the general principle, the Court turned to explaining the “general duty of honesty in contractual performance.” The Court described this as a new common law duty which is “under the broad umbrella” of the organizing principle of the good faith performance of contracts. This duty of honesty, according to the Court, requires that parties “must not lie or knowingly mislead each other about matters directly linked to the performance of the contract.”

The Court dismissed arguments that were based on skepticism of this duty of honesty by reasoning that no party to a contract would agree that “they may be dishonest with each other in performing their contractual obligations.” It characterized this duty as an incremental step that did not imply a duty of loyalty, disclosure, or a requirement to forego legitimate advantages.

Notably, the Court ruled that this duty of honesty in contractual performance “is a general doctrine of contract law that applies to all contracts”, and that therefore parties are not free to exclude this duty of honesty as a matter of law. Parties to a contract are, however, free to negotiate “the scope of honest performance in a particular context.” However, any modification of this duty would need to be in express terms.

In applying these principles to the facts, the Court found that there was ample evidence of

dishonesty on the part of Can-Am and held that Can-Am had breached its duty of honesty in the performance of its obligations under the Agreement.

CONCLUSION

This decision represents an important step in the law of contracts and more specifically in the law of good faith. The Supreme Court of Canada's ruling provides, for the first time, a unified, cohesive and more comprehensive statement of general principles than the law of good faith, in relation to contracts, has seen before.

What does this mean for contracting parties and for litigants? It means at least three things:

1. parties should keep the duty of good faith and the duty of honesty in contractual performance front and centre in considering how to draft contracts;
2. a party carrying out its performance of a contract must be mindful of the Court's admonitions about honesty, reasonableness and good faith in performance; and
3. parties who are involved in litigation in relation to a breach of contract should carefully consider whether a claim for a breach of the duty of good faith or the duty of honesty in performance is available on the facts.

Should you have any questions about this decision, please contact [Frank Cesario](#) at 416.864.7355, Joshua F. Concessao at 416.864.7027 or your [regular Hicks Morley lawyer](#).

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