

FALL 2014

by **Marco P. Falco**

Director of Legal Research / Research and  
Opinions Lawyer at Torkin Manes LLP



## PRACTICE AREA LINKS

[Business Law](#)

[Employment & Labour](#)

[Insolvency & Restructuring](#)

[Insurance Defence](#)

[Litigation](#)

### **Marco P. Falco**

As Director of Legal Research at Torkin Manes, Marco provides legal opinions and analyses on a range of topics in the civil litigation and corporate/commercial context. He has drafted legal memoranda, facta and materials for all levels of court, with a particular emphasis on appellate cases.

## “Be Honest”: Supreme Court Of Canada Recognizes The Duty Of Honest Contractual Performance

THE SUPREME COURT OF CANADA HAS HELD THAT THE COMMON LAW IMPOSES A DUTY ON PARTIES TO A CONTRACT TO PERFORM THEIR OBLIGATIONS HONESTLY.

In *Bhasin v. Hrynew*, 2014 SCC 71, per Cromwell J., the appellant, Mr. Bhasin, started an action after his relationship with Canadian American Financial Corp. (“Can-Am”) soured. Ultimately, Can-Am refused to renew the dealership agreement it had with Mr. Bhasin.

Mr. Bhasin had acted as an enrollment director for Can-Am, which was in the business of marketing education savings plans to investors (“ESPs”). Like all other enrollment directors associated with Can-Am, Mr. Bhasin acted like a small business owner.

The relationship between Mr. Bhasin and Can-Am was governed by a 1998 commercial dealership agreement (the “Agreement”), which was not a franchise agreement, but included aspects of a franchise agreement, such as the fact that Mr.

Bhasin was required to sell only Can-Am investment products and owed Can-Am a fiduciary duty. Critically, the Agreement provided that the contract would automatically renew at the end of the three-year term unless one of the parties gave six months’ written notice to the contrary.

Another enrollment director, the respondent Mr. Hrynew, was a competitor of Mr. Bhasin. According to the evidence at trial, Mr. Hrynew attempted to convince Can-Am not to renew its Agreement with Mr. Bhasin. In particular, Mr. Hrynew wanted to capture the market created by Mr. Bhasin’s efforts. Mr. Hrynew proposed a merger with Mr. Bhasin, which Mr. Bhasin repeatedly rejected.

In or about 1999, the Alberta Securities Commission raised

compliance concerns with respect to Can-Am's enrollment directors. The Commission required Can-Am to appoint a single provincial trading office ("PTO") to review its enrollment directors for compliance with securities laws. Can-Am appointed Mr. Hrynew to that position, which required Mr. Hrynew to review Mr. Bhasin's confidential business records. Mr. Bhasin objected to Mr. Hrynew, as his competitor, having access to that information. Despite Mr. Bhasin's concerns, Can-Am repeatedly misled Mr. Bhasin by advising him that, as a PTO, Mr. Hrynew had to treat all information he received confidentially. Can-Am further lied to Mr. Bhasin and told him that the Commission had rejected a proposal to appoint a third-party PTO. Further, Can-Am did not give Mr. Bhasin a straight-forward response when Mr. Bhasin asked in August, 2000 if a merger between his and Mr. Hrynew's business was a "done deal". When Mr. Bhasin refused to allow Mr. Hrynew to conduct an audit of his business, Can-Am threatened to terminate the Agreement between them. In May 2001, Can-Am eventually gave notice of non-renewal under the Agreement. At the end of the contract, Mr. Bhasin lost the value of his business in his workforce and Mr. Hrynew had solicited most of Mr. Bhasin's sales agents. Mr. Bhasin brought an action against Mr. Hrynew and Can-Am.

The trial judge of the Alberta Court of Queen's Bench held that Can-Am had breached an implied term of good faith in its dealings with Mr. Bhasin. It held that Can-Am had acted dishonestly with Mr. Bhasin in the period leading to the non-renewal of its Agreement. The trial judge therefore found that Can-Am was in breach of the implied term of good faith, Mr. Hrynew had induced the breach of contract, and both respondents were liable for civil conspiracy. The Alberta Court of Appeal allowed the respondents' appeal and dismissed Mr. Bhasin's action. It held that the trial judge had erred by implying a term of good faith conduct where there was an unambiguous contract that included an entire agreement clause.

On appeal to the Supreme Court of Canada, Justice Cromwell held that there was no liability for inducing breach of contract and for unlawful means conspiracy; the action against Mr. Hrynew was therefore dismissed. However, the Court held that Can-Am breached the Agreement it had with Mr. Bhasin when it failed to act honestly with Mr. Bhasin in exercising the non-renewal clause. In so doing, the Court recognized and established a duty on the part of contracting parties to engage in honest contractual performance.

The Supreme Court of Canada's analysis is guided by three broad principles, which are summarized at paragraph 93 of the decision. They

are as follows:

1. **"Good faith" is a "general organizing principle" that underlies many facets of contract law.**

According to the Court, good faith has deep roots in contract law and "permeates many of its rules". However, at common law, Courts have generally resisted acknowledging an independent doctrine of good faith performance of contracts. In particular, Canadian common law with respect to the good faith performance of contracts was described by the Court as "piecemeal, unsettled and unclear". Therefore, the Court held that it was time to recognize that good faith contractual performance is a "general organizing principle" at common law, "which underpins and informs the various rules in which the common law, in various situations and types of relationships, recognizes obligations of good faith contractual performance". An organizing principle, such as the duty of good faith, states in general terms a requirement of justice from which more specific legal doctrines may be derived.

2. **In general, the particular implications of the broad principle for particular cases are determined by resorting to the body of doctrine that has developed which gives effect to aspects of that principle in particular types of situations**

**and relationships.**

Good faith can be used in a range of contexts. The Court noted that this calls for 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. The Court identified existing situations or relationships in which duties of good faith have been found to exist, i.e. the employment or franchise relationship. In this case, Can-Am's conduct did not fit within any of these existing relationships. Accordingly, the Court could not classify Can-Am's non-renewal decision as an exercise of contractual discretion under any of the situations or relationships already identified by the case law.

**3. It is appropriate to recognize a new common law duty that applies to all contracts as a manifestation of the general organizing principle of good faith: a duty of honest performance, which requires the parties to be honest with each other in relation to the performance of their contractual obligations.**

Based on the analysis above, the Court held that it was time to recognize, as a manifestation of the organizing principle of good faith, a duty at common law which applies to all contracts to act honestly in the performance of contractual obligations. The Court

found that recognizing this duty was not contrary to the reasonable expectations of most commercial parties entering into contracts:

Commercial parties reasonably expect a basic level of honesty and good faith in contractual dealings. While they remain at arm's length and are not subject to the duties of a fiduciary, a basic level of honest conduct is necessary to the proper functioning of commerce. The growth of longer term, relational contracts that depend on an element of trust and cooperation clearly call for a basic element of honesty in performance, but, even in transactional exchanges, misleading or deceitful conduct will fly in the face of the expectations of the parties: see *Swan and Adamski*, at 1.24.

The scope of the duty of honest contractual performance was identified by the Court as follows: parties to a contract must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract. The Court was careful to note that this does not impose a duty of loyalty or of disclosure or even require a party to forgo advantages flowing from the contract. Rather, in the words of the Court, "it is a simple requirement not to lie or mislead the other party about one's contractual performance".

In recognizing this duty, the Court states that it has simply carved out a modest, incremental step in the

law of contract. The duty of honest performance has little effect on freedom of contract, "since parties will rarely expect that their contracts permit dishonest performance of their obligations". Moreover, the Court held that the recognition of a duty of honest performance poses no risk to commercial certainty in the law of contract. Reasonable commercial parties expect, at a minimum, that the persons with whom they contract do not act dishonestly.

Notably, the Court held that the duty of honest contractual performance should not be considered an implied term of the contract. Rather, it was a general doctrine of contract law that imposes a contractual duty, regardless of the parties' intentions. The Court compared it to other doctrines which impose limits on freedom of contract, such as the doctrine of unconscionability.

The Court further held that it would not exclude any role for the agreement of the parties in influencing the scope of honest performance in a particular context. That is, parties "should be free in some contexts to relax the requirements of the doctrine so long as they respect its minimum core requirements". However, any alteration to honest performance has to be in express terms; generically-drafted "entire agreement" clauses do not satisfy this requirement.

On the facts, the Supreme Court held that Can-Am breached its duty to perform the Agreement honestly in the exercise of the non-renewal clause. Can-Am appointed Mr. Hrynew as PTO, with the effect that he would audit his competitors' business. Can-Am also wanted to force a merger of Mr. Bhasin's business under Mr. Hrynew's, effectively giving Mr. Bhasin's agency to Mr. Hrynew. It was clear that Can-Am acted dishonestly with Mr. Bhasin throughout the period

leading to its exercise of the non-renewal clause. Can-Am's breach of contract consisted of its failure to be honest with Mr. Bhasin with respect to its settled intentions regarding renewal. The Court found Can-Am liable for \$87,000 in damages, being the value of Mr. Bhasin's business around the time of non-renewal.

Naturally, the Supreme Court of Canada's decision in *Bhasin v. Hrynew* will have significant implications for the law of contract in years to

come. The extent to which lawyers and parties in Canada will test the bounds of a duty of honest contractual performance remains to be seen. The Court sought to strike a balance between ensuring that the duty of honest contractual performance does not amount to an unnecessary burden on freedom of contract, while at the same time recognizing a basic and fundamental ethic of honesty that must underlie all contractual performance.