

# BUSINESS LAW TODAY

## Keeping Current:

### “Promise Not to Lie”: The Duty of Honest Contractual Performance in Canada

By [Marco P. Falco](#)

The Supreme Court of Canada has recognized the existence of a duty of honest contractual performance at Canadian common law, based on the “organizing principle” of good faith.

In *Bhasin v. Hrynew*, 2014 SCC 71, per Cromwell J., the appellant, Mr. Bhasin started an action against Canadian American Financial Corp. (Can-Am) after Can-Am refused to renew the dealership agreement it had with Bhasin. Bhasin acted as an enrollment director for Can-Am, which was in the business of marketing education savings plans to investors.

The relationship between Bhasin and Can-Am was governed by a 1998 commercial dealership agreement (the “Agreement”). 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.

Bhasin was in competition with another enrollment director, the respondent Mr. Hrynew. Hrynew attempted to convince Can-Am not to renew the Agreement with Bhasin.

In or about 1999, the Alberta Securities Commission raised compliance issues with respect to Can-Am’s enrollment directors. The Commission requested that Can-Am appoint a single provincial trading officer (PTO) to review its enrollment directors for compliance with securities laws. Can-Am appointed Hrynew to that position. Hrynew’s role as PTO required him to re-

view Mr. Bhasin’s confidential business records. Not surprisingly, Bhasin objected to Hrynew, as his business competitor, having access to that information.

In view of Bhasin’s concerns, Can-Am repeatedly misled Bhasin by advising him that in his role as PTO, 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. Moreover, Can-Am did not give Mr. Bhasin a straightforward response when Mr. Bhasin asked in August, 2000 if a merger between his and Hrynew’s business was a “done deal.”

Ultimately, the relationship between Can-Am and Bhasin soured. Bhasin refused to allow Hrynew to conduct his audit of Bhasin’s business. As a result, Can-Am threatened to terminate the Agreement between them. Eventually, in May, 2001, Can-Am gave notice of its non-renewal under the Agreement.

At the end of the contract, Bhasin lost the value of his business in his workforce and Hrynew had solicited most of Bhasin’s former sales agents. As a result, Bhasin started an action against Hrynew and Can-Am.

The trial judge of the Alberta Court of Queen’s Bench held that Can-Am was in breach of the implied contractual 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 Bhasin’s action.

On appeal to the Supreme Court of Canada, the Court held that there was no liability for inducing breach of contract and for unlawful means conspiracy; thus, the action against Hrynew was dismissed.

Nevertheless, the Court held that Can-Am was in breach of the Agreement it had with Bhasin when it failed to act honestly with him in exercising the non-renewal clause. The Court established a duty on the part of contracting parties to engage in honest contractual performance, which it held was an element of the “organizing principle” of good faith.

The Supreme Court of Canada’s reasoning was guided by three core principles, which are listed at paragraph 93 of the decision. They are:

#### 1. Good faith is a “general organizing principle” that underlies many facets of contract law.

The principle of good faith has deep roots in contract law and “permeates many of its rules.” At common law, courts have generally resisted acknowledging an independent doctrine of good faith performance of contracts. As a result, the Court held 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.”

**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.**

In short, the organizing principle of good faith can be applied in a variety of contexts. Accordingly, the Court noted that this principle calls for a highly context-specific understanding of what honesty and reasonableness in performance require. The Court identified existing situations or relationships in which duties of good faith have already been found to govern, i.e., the employment or franchise relationship. In this case, Can-Am's conduct in exercising the non-renewal clause of the Agreement did not fit within any of these existing relationships.

**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.**

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. The duty requires parties to a contract to act honestly in the performance of their contractual obligations.

In the Court's view, recognizing such a 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 Court identified the scope of the duty of honest contractual performance 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, "it is a simple requirement not to lie or mislead the other party about one's contractual performance."

According to the Court, 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.

The Court further held that the duty of honest contractual performance should not be considered as an implied term of a contract. Rather, it was a general doctrine of contract law that imposes a contractual duty, regardless of the parties' intentions. In classifying the duty of honesty as a doctrine, the Court likened it to other doctrines governing contractual performance, such as the doctrine of unconscionability.

The Court also held that 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 the duty of honest performance has to be made in express terms in the contract; for example, 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 when it exercised the non-renewal clause. In particular: (1) Can-Am appointed Hrynew as PTO, with the effect that he would audit his competitors' business; (2) Can-Am wanted to force a merger of Bhasin's business under Hrynew's, effectively "giving" Bhasin's agency to Hrynew; and (3) Can-Am's breach of contract consisted of its failure to be honest with Bhasin with respect to its intentions regarding the non-renewal of the Agreement. The Court found Can-Am liable for \$87,000 in damages, being the value of Bhasin's business around the time of non-renewal.

The decision in *Bhasin* raises a myriad of interesting legal issues. For example: (1) will a party to a contract have breached the duty of honest contractual performance where the party is willfully blind, rather than actively dishonest, to the other party?; (2) to what extent should a Court limit freedom of contract on the basis of a dishonest act?; and (3) if a dishonest act is ultimately disclosed by the dishonest party to the other contracting party, are damages for breach of contract mitigated? These issues will undoubtedly be raised in subsequent case law, where Courts will attempt to strike the proper balance between freedom of contract and a principle of honesty that should govern all contractual relations.

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