

Corporate and Commercial Law

November 17, 2014

Supreme Court of Canada Creates a New Duty to Act Honestly in Performing Contracts

The Supreme Court of Canada has created a new duty of honest performance in contract law, requiring parties to all commercial contracts to be honest with each other in relation to the performance of their contractual obligations.

The decision in *Bhasin v. Hrynew*¹ attempts to consolidate what the Court calls an “unsettled and incoherent body of law” under an overarching “organizing principle” of good faith. The organizing principle of good faith, in the words of the Court, “is simply that parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily.” There is no independent duty of good faith. Rather, the organizing principle is the foundation for more specific duties.

Relying on this newly recognized organizing principle of good faith, and citing the proposition that all commercial activity rests on a basic level of honesty and trust, the Court developed the doctrine of honesty in contractual performance as a specific new common law duty. The new common law duty is intended to be “consistent with reasonable commercial expectations.”

The duty of honest performance requires that the parties to a contract “must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract.” Commercial contracts, therefore, even if they are

silent on matters of good faith and honesty, inherently impose a duty of honest performance on the parties.

The duty of honest performance is limited, however, and highly contextual. The Court is mindful of not encroaching unreasonably on the fundamental common law principle of the parties’ freedom to bind themselves and, once bound, to pursue their own self-interest. Specifically, a duty of honest performance does not include a duty of loyalty or a duty of disclosure. It simply includes a duty not to lie or mislead the counterparty in connection with performance of the contract. The Court notes that the organizing principle of good faith would apply differently to a long-term contract that requires mutual cooperation than to a more “transactional exchange.” With respect to the doctrine of honesty specifically, parties to a contract are free to “relax the requirements of the doctrine so long as they respect its minimum core requirements.” While contracting parties can agree in writing what the doctrine will consist of in the specific context of their agreement, they cannot exclude the doctrine entirely.

The facts of *Bhasin* involve a three-year contract between the appellant, Bhasin, and Canadian American Financial Corp. (CAF), under which Bhasin was entitled to sell CAF’s RESPs through sales agents. The contract included an automatic renewal clause, but could be terminated by either party with notice at least six months before the end of the term. Hrynew, one of the respondents and a competitor of Bhasin’s during the contract term, suggested a merger with Bhasin. When rejected, Hrynew worked with CAF to force the merger. The merger did not occur. Ultimately, CAF gave notice of termination, the contract terminated and Bhasin’s sales agents began working for Hrynew. It was determined that

¹ 2014 SCC 71 (“*Bhasin*”), available online at <http://scc-csc.lexum.com/scc-csc/scc-csc/en/item/14438/index.do>.

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CAF acted dishonestly leading up to the non-renewal of the contract and that had CAF acted honestly, Bhasin could have retained his agency's value.

In recognizing the organizing principle of good faith and developing the doctrine of honest performance, the Court was able to determine that the contract was breached through CAF's dishonest conduct.

Parties to commercial contracts should note that, in light of *Bhasin*, the text of an agreement does not encompass all duties owed to a counterparty.

Contracting parties may consider including explicit provisions in contracts establishing the boundaries of the duty of honest performance. It is expected that courts will have ample opportunity to consider and apply the newly recognized organizing principle and the newly established duty.

Please contact any member of our Corporate and Commercial Law Group to discuss this decision.