

Construction Law

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The Duty of Good Faith in Construction Contracts

by Howard Wise

Bhasin v. Hrynew, 2014 SCC 71

Construction projects have become larger and more complex over the past several years. Large and ever-changing project delivery methods and the number of parties involved in construction projects have increased.

In addition to more parties in the construction pyramid, the relationships between the parties have also become more complex, as has the contractual documentation that governs their legal relationship.

Recently, in dealing with contractual relationships, the Supreme Court of Canada established that a new duty exists, namely, the duty of good faith. While this duty has been expressed in different ways in different contractual contexts, until now, there was no overarching legal duty of good faith between contracting parties. While some statutes imposed a duty of good faith, and some cases have outlined where the duty may arise, the recent decision will have far reaching implications with respect to construction contracts. Until recently, a party wanting to raise the issue of good faith obligations often pled that there was an “implied” duty to act in good faith. However, the recent decision now formally establishes that duty as a matter of law, and expresses it as a duty of honest performance.

The facts of *Bhasin v. Hrynew* were as follows:

1. The Appellant, Mr. Bhasin, had a contract with Canadian American Financial Corp. (“**Can Am**”) with respect to the marketing of Registered

Educational Savings Plans (RESPs). Mr. Bhasin built his sales force and was a top enrollment director for Can Am. There was a contract between Mr. Bhasin and Can Am that was a commercial dealership agreement.

2. The contract was for a three year term and provided for termination on short notice for misconduct or other cause. The contract further provided that it would automatically renew at the end of the three year term unless one of the parties provided six months written notice that it wished to terminate it.
3. One of Mr. Bhasin’s competitors, Mr. Hrynew, also had a relationship with Can Am.
4. In late 1999, the Alberta Securities Commission (ASC) raised certain compliance concerns among Can Am’s enrollment directors. Can Am was required to appoint a single provincial trading officer (PTO) to review its enrollment directors for compliance. Can Am appointed Mr. Hrynew to that position. This role required him to conduct audits of Can Am’s enrollment directors. Mr. Bhasin, and one other enrollment director, objected to Mr. Hrynew, a competitor, reviewing their confidential business records.
5. Can Am was concerned that its licence might be revoked by the ASC and had many discussions with the ASC about compliance. It was found by the Trial Judge that, during these discussions, Can Am was considering restructuring its agencies. One of the scenarios included Mr. Bhasin working for Mr. Hrynew. This plan had been formulated prior to June, 2000, but none of this was made known to Mr. Bhasin. It was found that Can Am misled Mr. Bhasin by telling him that Mr. Hrynew, as a PTO, was under an obligation to treat information confidentially. Mr. Bhasin continued to refuse to allow Mr. Hrynew to audit his records and Can Am threatened to terminate the agreement. In May, 2001, Can Am gave notice of non-renewal under the agreement.

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It was found that, during the period that Mr. Bhasin had his contract with Can Am, Mr. Hrynew had pressured Can Am not to renew its agreement with Mr. Bhasin and that Can Am dealt dishonestly with Mr. Bhasin and gave into that pressure. Mr. Hrynew wanted to capture Mr. Bhasin's business and approached Mr. Bhasin to propose a merger of their agencies. Mr. Hrynew also encouraged Can Am to force the merger.

6. As a result, at the expiry of the contract term, Mr. Bhasin lost the value in his business. The majority of his sales agents were solicited by Mr. Hrynew's agency and Mr. Bhasin ended up taking less profitable work with one of Can Am's competitors.
7. Mr. Bhasin sued Can Am and Mr. Hrynew. The trial judge found that it was an implied term of the contract that decisions about whether to renew the contract would be made in good faith. The Court held that Can Am was in breach of this implied term of good faith, and Mr. Hrynew had intentionally induced breach of contract. The respondents were liable for civil conspiracy. The trial judge further found that Can Am acted dishonestly and misled Mr. Bhasin about its intentions.
8. On appeal to the Alberta Court of Appeal, the case was overturned and Mr. Bhasin's claim was dismissed. The Court of Appeal found the pleadings to be insufficient and that the trial judge erred by implying a term of good faith in the context of an unambiguous contract including an entire agreement clause.
9. Mr. Bhasin appealed to the Supreme Court of Canada and was successful.

In overturning the decision of the Court of Appeal, the Supreme Court held that Can Am owed Mr. Bhasin a duty of good faith but went further in establishing a formal legal duty of good faith owed between contracting parties.

In analyzing the common law, the Supreme Court said:

Anglo-Canadian common law has resisted acknowledging any generalized and independent doctrine of good faith performance of contracts. ... This approach is out of step with the civil law of Quebec and most jurisdictions in the United States and produces results that are not consistent with the reasonable expectations of commercial parties. [para. 32.]

In formally establishing the duty of good faith as a tenet of Canadian common law, the Supreme Court stated:

In my view, it is time to take two incremental steps in order to make the common law less unsettled and piecemeal, more coherent and more just. The first step is to acknowledge that good faith contractual performance is a general organizing principle of the common law of contract 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. The second is to recognize, as a further manifestation of this organizing principle of good faith, that there is a common law duty which applies to all contracts to act honestly in the performance of contractual obligations. [para. 33]

The Supreme Court went to considerable lengths to consider the case law established prior to this decision and the competing arguments against establishing a duty. The Court did consider different contexts where the duty of good faith had been applied and noted that this duty had filtered to certain industries in certain contractual contexts. The Supreme Court noted that, in insurance cases, where an insurer failed to deal with the insured's claim fairly, a duty of good faith existed. The Supreme Court further recognized that a duty of good faith would generally be implied in the tendering context.

In outlining the general particulars of the duty, the Court stated:

The organizing principle of good faith exemplifies the notion that, in carrying out his or her own performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner. While "appropriate regard" for the other party's interests will vary depending on the context of the contractual relationship, it does not require acting to serve those interests in all cases. It merely requires that a party not

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seek to undermine those interests in bad faith. The general principle has strong conceptual differences from the much higher obligations of a fiduciary. Unlike fiduciary duties, good faith performance does not engage duties of loyalty to the other contracting party or a duty to put the interests of the other contracting party first. [para. 65]

In effect, the Court has outlined a flexible approach to the application of the duty of good faith.

In concluding that a duty of good faith in contract does exist, Justice Cromwell stated:

I would hold that there is a general duty of honesty in contractual performance. This means simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract. This does not impose a duty of loyalty or of disclosure or require a party to forego advantages flowing from the contract; it is simply a requirement not to lie or mislead the other party about one's contractual performance. Recognizing a duty of honest performance flowing directly from the common law organizing principle of good faith is a modest, incremental step. The requirement to act honestly is one of the most widely recognized aspects of the organizing principle of good faith. [para. 73]

While the Supreme Court went to great lengths to clarify that the intention of establishing the duty of good faith was not to impede freedom of contract, it stated that, regardless of the terms of a contract, the duty of honest performance - not to lie or mislead - was a minimum requirement. All contracting parties must be able to rely on at least this minimum standard in relation to the performance of the contract so that they have a fair opportunity to protect their interests.

The Supreme Court summarized the principles as follows:

(1) There is a general organizing principle of good faith that underlies many facets of contract law.

(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.

(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. [para. 93]

While there appears to be some flexibility in the application of the duty, the fact that the Supreme Court has now endorsed it as a formal legal duty will certainly have implications on the contractual dealings between owners and contractors and contractors and their subcontractors. One can envisage many situations where this principle would be invoked in the context of a construction project subject to numerous changes, scope issues and complexities. One can certainly anticipate this duty being raised where there are any issues of wrongful actions between the parties, including issues surrounding contract administration and the performance of one's obligations under the contract.

For further information relating to this decision and how it may affect you, please contact any member of our Construction Law Group.