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Honesty in contracts and other oxymorons

By Neill May

When the subjects of law and good faith intersect, a common result is lawyer jokes. Over the winter months, for example, there's the old saw that you know it's cold outside when lawyers have their hands in their own pockets. To me, though, the law is all about trustworthiness. In fact, all of my siblings (and I) are trained as lawyers, except one, who is a trained artist. And the lawyer siblings have never trusted the artist because art seems a bit shifty, right?

A recent Supreme Court of Canada case delved into the issue of the good faith performance of contracts, which had been described by the Law Commission of Ontario as an “unsettled and incoherent body of law.” There are some understandable reasons for the lack of coherence in this area. Among them is my own possibly heretical view that contracts are interpreted and enforced by judges, who are understandably influenced by instincts to reward good faith. Another is that different areas of commercial activity beget different roles for a principle of good faith. For example, expectations of honest performance may have greater traction and significance where there is an inequality of bargaining power, and where the contract governs a long-term relationship rather than a one-time commercial exchange.

One further, important reason is a duty of good faith performance intrudes on the principle of the sanctity of contract (which sounds almost religious, harkening back to more jokes where contractual certainty is a higher virtue than honest performance).

In *Bhasin v. Hrynew*, the SCC sought to sew this all together by creating an overarching “organizing principle” of good faith, and specifically a new duty of honest performance, in contract law. The organizing principle of good faith, in the words of the SCC, “is simply that parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily.” To be

clear, this does not imply an independent, general duty of good faith. Rather, this is simply an organizing principle that is the foundation for more specific duties. (This is the type of distinction for which lawyers, and maybe some artists too, are notorious.) In any event, relying on this newly recognized organizing principle and the proposition that all commercial activity rests on a basic level of honesty and trust, the SCC developed a new common law duty of honesty in contractual performance.

Predictably, the duty of honest performance is not that straightforward: the new duty is limited and contextual. It is not meant to encroach unreasonably on parties' freedom to bind themselves and, once bound, to pursue their self-interest. Importantly, a duty of honest performance does not include a duty of loyalty or of disclosure; a contracting party does not have to show its cards at the negotiating table or during the contract's term (unless the contract requires it to do so). Rather, there is simply a duty not to lie or mislead the counterparty in connection with performance of the contract. It is notable, too, that contracting parties are free to agree in writing what the doctrine will consist of in the specific context of their agreement (though they cannot exclude the duty to act honestly entirely).

The facts of *Bhasin* involve a three-year contract between the appellant, Harish Bhasin, and Canadian American Financial Corp. (Canada) Ltd., under which Bhasin was entitled to sell

CAF's RESPs through sales agents. Larry Hrynew, a competitor of Bhasin's interested in capturing Bhasin's lucrative market share, proposed a merger, but Bhasin refused.

It was clear from CAF's discussions with regulators that it planned to restructure its relationships, and specifically that it intended for Bhasin to end up working for Hrynew. CAF proceeded to repeatedly mislead Bhasin (for example, by encouraging Bhasin to make his confidential information available to Hrynew in the latter's capacity as provincial trading officer on the basis that Hrynew would have an obligation to maintain the confidentiality of that information, which was not the case) and by not responding truthfully when asked by Bhasin about CAF's plans. Ultimately, CAF gave notice of termination, the contract terminated, and Bhasin's sales agents began working for Hrynew.

The court found CAF acted dishonestly leading up to the contract non-renewal and, importantly, had it acted honestly, Bhasin could have retained his agency's value.

The decision is expected to have implications beyond the cutthroat world of education savings plans. The possibility of more litigation is one, as well as more record-keeping and lawyer involvement in contractual performance. Perhaps the most entertaining consequence is the prospect of commercial parties negotiating with each other about how honest they are required to be in the performance of their contractual commitments. It will be a complicated quagmire of signalling, contract drafting, and negotiating. Engaging in this exercise (“When does my client have to be honest, and just what do we mean here by honest?”) will serve as good rebuttal when my parents introduce my artist sister as “the only creative one.” Not that I'm bitter; honestly. **CL**

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