A Trip to Quebec: Exploring The New Duty of Good Faith in Contractual Performance

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The doctrine of good faith in Canadian contract law is evolving, after a long period of patchy and piecemeal judicial solutions to unfairness in contractual performance. With the Supreme Court's decision in *Bhasin v. Hrynew*,[1] a new duty of honest performance of contracts has been recognized for common law jurisdictions in Canada.

This paper briefly reviews the recognition of good faith performance obligations and the recent *Bhasin v. Hrynew* decision. It then discusses some Quebec jurisprudence that suggests how common law litigators might approach this new duty.

Context: Good Faith in Quebec and the United States

Other jurisdictions have long incorporated the principle of good faith in contractual performance into their contract law regimes. Parties to contracts in Quebec "shall conduct themselves in good faith both at the time the obligation arises and at the time it is performed or extinguished".[2] A duty of honest performance of contracts is also incorporated in the United States *Uniform Commercial Code*.[3]

Some commentators are concerned that good faith duties hamper commercial activity by restricting the freedom of contract. The doctrine has been argued to be "an invitation to judges to abandon the duty of legally reasoned decisions and to produce an unanalytical incantation of personal values."[4] Nevertheless, the commercial life of the United States does not seem to have been harmed by the incorporation of honest performance doctrine into its contract law. Honest

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[1] *Bhasin v. Hrynew*, 2014 SCC 71 (*Bhasin*).

[2] Civil Code of Québec, CQLR c C-1991, c. 64, a. 1375

[3] *Uniform Commercial Code* (2012), §1-302(b): "The obligations of good faith, diligence, reasonableness and care… may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable."

[4] M. Bridge, "Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?" (1984) 9 CBLJ 385 at p 412-3, cited in John D. McCamus, "Abuse of Discretion, Failure to Cooperate and Evasion of Duty: Unpacking the Common Law Duty of Good Faith Contractual Performance" (2004) 29 The Advocates' Quarterly (2004) 29.1 & 2, 72-101.

performance is only a subspecies of a general good faith duty in contract: a jurisdiction may recognize good faith obligations in certain circumstances (e.g. certain classes of contracts or the interpretation of particular contractual terms) without injecting a general duty into all aspects of contract law.

There may be further room for the development of good faith duties in international applications such as in arbitration and chartering, to preserve the viability and efficiency of international arbitration.[5]

Good Faith in Common-Law Canada

While it is possible to go back as far as Roman law in reviewing the evolution and occurrences of good faith performance duties,[6] this paper does not propose such a broad historical review. Canada's common law jurisprudence has recognized good faith duties in contract, but not as a general principle applicable across all categories of contracts and across all provinces.

As early as 1953, the Supreme Court held that a person bringing about the end of an agreement must "exercise that right reasonably and in good faith and not in a capricious or arbitrary manner".[7] However, the Ontario Court of Appeal held in *TSP-Intl Ltd. v. Mills* that an independent contractor had no duty of honest performance that would bar him from negotiating, in secret, a contract with the company that was his main client's main source of revenue.[8] As recently as 2006, Professor Fridman felt it "too soon to conclude that Canadian courts have recognized as a general principle that contracts must be performed in good faith."[9]

[5] William Tetley, "Good Faith in Contract Particularly in the Contracts of Arbitration and Chartering" (2004) 35 JMLC 561-616.
[6] For a review of good faith rules in Roman law, natural law, civil law systems, and in the history of the common law, see: William Tetley, "Good Faith in Contract Particularly in the Contracts of Arbitration and Chartering" (2004) 35 JMLC 561-616.
[7] *Mason v. Freedman*, [1958] SCR 483, at p. 487.
[8] *TSP-Intl Ltd. v Mills*, 2006 CanLII 22468 (ON CA).
[9] G.H.L. Fridman, *The Law of Contract in Canada*, 5th ed, (Toronto: Carswell, 2006) at 541.

Bhasin v. Hrynew at the Supreme Court

Facts

The facts in *Bhasin* involve a dealership agreement for education savings plans. Mr. Bhasin's contract was for a three-year term as a dealer with a company called Can-Am, renewable unless the non-renewing party gave six months' notice. The agreement was not a franchise agreement, although some of its terms were similar to a franchise agreement. Mr. Hrynew, a competing dealer, wanted to take over Mr. Bhasin's dealership. Can-Am had promised to consider Hrynew for mergers of dealerships, because he had a good relationship with the securities regulator and was a successful retail dealer for Can-Am. When Alberta's securities commission required Can-Am to appoint a provincial trading officer (PTO) to check compliance with provincial securities laws, Can-Am appointed Hrynew. As PTO, he would have had access to the confidential business records of Bhasin and Mr. Hon, another enrollment director. Bhasin and Hon objected.

The trial record showed that, in 2000, Can-Am was clearly considering a merger for Hrynew. However, Can-Am misled Mr. Bhasin: it told him that Hrynew as PTO would have to treat Bhasin's business information confidentially, and that the securities commission had rejected a proposal to have an outside PTO review the records. Can-Am equivocated when Bhasin asked point-blank whether the merger was a "done deal", though it was already proposing the merger to the securities regulator. In May 2001, Can-Am gave Bhasin notice that the agreement would not be renewed. The damages were assessed based on the value in the business that Bhasin was deprived of, as his business was essentially expropriated by Can-Am and given to Hrynew.

Bhasin's View of Good Faith Duties in Contract Law

Bhasin enumerates the existing incidences of a duty of good faith in the common law. Recognized good faith obligations arise where:

1. The contract logically requires the parties to cooperate to achieve the objectives of the contract, for example, where a party must make reasonable efforts to carry out a task because it is the only party able to carry out the required task;[10]
2. The contract's terms require the exercise of contractual discretion, such as clauses involving the establishment of "reasonable market value" by a party;
3. Contractual power is used to evade a contractual duty. For example, it is not permitted to repudiate a contract in a capricious or arbitrary manner even where it is in the power of a party to repudiate the contract, as in *Mason v. Freedman*;[11] and
4. The contract belongs to a class of contracts for which good faith performance duties are recognized. Good faith is required in the manner of dismissal from employment.[12] In insurance contracts, the behavior of insurer and the disclosure of information by the insured are subject to good faith requirements.[13] Tendering contracts also have a duty of good faith.[14] In Ontario, the *Arthur Wishart Act* imposes a duty of good faith in performance and enforcement on franchisors and franchisees.[15]

Justice Cromwell holds that good faith is a general organizing principle of contract law. Good faith is not an implied term of contracts, but a general doctrine similar to existing equitable doctrines, and which parties are similarly not free to exclude from contracts.[16]

Bhasin delicately avoids giving overly broad application to this organizing principle. The classes and incidences of good faith obligations enumerated above continue to exist in their contexts; no general duty of good faith in contract is created. Further, Justice Cromwell writes that "the organizing principle of good faith should not be used as a pretext for scrutinizing the motives of contracting parties."[17] This is restrictive, as motives and intent are necessarily part of assessing good faith. The Supreme Court clearly intends a modest and incremental change.

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[10] *Dynamic Transport Ltd. v. O.K. Detailing Ltd* (1978), 2 SCR 1072.
[11] *Mason v. Freedman*, [1958] SCR 483.
[12] *Wallace v. United Grain Growers*, [1997] 3 SCR 701, 1997 CanLII 332 (SCC); *Honda v. Keays* [2008] 2 SCR 362, 2008 SCC 39.
[13] *Fidler v. Sun Life Assurance Co. of Canada*, [2006] 2 SCR 3, 2006 SCC 30.
[14] *Bhasin* at paras 49 to 52.
[15] See, e.g. *Salah v. Timothy's Coffees of the World Inc*., 2010 ONCA 673 (CanLII).
[16] *Bhasin.* at para 74.
[17] *Bhasin*, at para. 70.

The Duty of Honest Performance

The plaintiff would not have benefited from the existing incidences of good faith obligations in contract, but *Bhasin* goes on to recognize a new manifestation of this general organizing principle of good faith, to the plaintiff's benefit: namely, the duty of honest performance. Honest performance is a new incidence of good faith obligations, and as a result of *Bhasin* it applies in all contracts.

The honest performance duty that is described in *Bhasin* refers to a minimum standard of honesty in the contract's performance. It requires parties to be honest with each other in relation to the performance of contractual obligations.[18] It is not a duty of loyalty to the interests of other parties, but does require a minimum standard of forthrightness and reasonable effort. It is explicitly about planning for downside risk: "a reassurance that if the contract does not work out, [parties] will have a fair opportunity to protect their interests" even if the contract is not a contract of utmost good faith such as an insurance contract.[19]

From Duty to Damages

Determining the scope and applications of this newly recognized duty of honest contractual performance in Canada's common law jurisdictions will require further jurisprudential work. The next step for an enterprising litigator is to consider where this new duty might be applied in practice.

Litigating Good Faith Performance

Existing rules and remedies for unfairness in contractual performance continue to apply – these include rules on duress, unconscionability, implied terms, waiver, and estoppel, as well as misrepresentation. Paragraph 88 of *Bhasin* is instructive on the niche in litigation for claims relating to honest performance:

> "The duty of honest performance has similarities with the existing law in relation to civil fraud and estoppel, but it is not subsumed by them. Unlike promissory estoppel and

[18] *Bhasin* at para 93.
[19] *Bhasin* at para 86.

> estoppel by representation, the contractual duty of honest performance does not require that the defendant intend that his or her representation be relied on and is not subject to the uncertainty around whether estoppel can be used to found an independent cause of action…. As for the tort of civil fraud, breach of the duty of honest contractual performance does not require the defendant to intend that the false statement be relied on and breach of it supports a claim for damages according to the contractual rather than the tortious measure."[20]

Good Faith Performance and Non-Disclosure

Breaches of good faith performance duties can result from non-disclosure of relevant information during the performance of a contract. A Supreme Court decision on a Quebec case granted relief to the heirs of a surety where a bank failed to disclose to the heirs that the terms of the suretyship provided for the heirs to revoke the suretyship. The heirs could end their obligation to repay the debts for which the deceased surety was responsible. The bank's obligation to disclose the letters "results from the principle that agreements must be performed in good faith".[21] "The *Bank* especially could not simply disclose what it was to its advantage to disclose and withold [*sic*] what was in its interest to conceal."[22]

Suits by Non-Parties for Non-Disclosure

Good faith disclosure obligations in contractual performance can establish rights for third parties who have been harmed by non-disclosure in contracts to which they were not party. For instance, in *Bank of Montreal v. Bail Ltee*,[23] a subcontractor was compensated for damages it suffered when Hydro-Quebec misrepresented the technical difficulties entailed in a substation construction project. Hydro-Quebec knew its design for the substation was erroneous or impossible due to quicksand and drainage issues at the work site. It refused to admit its error, inducing the contractor and the subcontractor to complete the work without completely renegotiating the contract.

[20] *Bhasin* at para 88.
[21] *National Bank of Canada v. Soucisse*, [1981] 2 SCR 339 at p 356 (*Soucisse*).
[22] *Soucisse* at p 357.
[23] *Bank of Montreal v. Bail Ltee*, [1992] 2 SCR 554 (*Bail Ltee*).

The subcontractor was not party to the contract; it nevertheless suffered damages from Hydro-Quebec's actions and went bankrupt because of the project. Hydro-Quebec was found liable to the assignee of the subcontractor's accounts receivable due to the breach of its obligation to inform. Justice Gonthier wrote:

> "… it is entirely possible that the performance of a contract may be the basis for an action in delictual liability against a contracting party, even in the absence of contractual fault and without regard to the obligations set out in the contract in question, if that party failed in its general duty to act reasonably."[24]

Such liability can arise when contractual obligations entail express or implied benefits for third parties, for example the users of the road in relation to a contract for road maintenance. Other contractual obligations are for the benefit of the contracting party, and the basis for liability to third parties would be weaker. Finally there are "obligation to inform" cases, where breach of the obligation caused damage to a third party, as in *Bail Ltee*.[25]

Situations like the one in *Bail Ltee* could easily recur in contracts involving construction and environmental remediation. In fields where subcontracting is common due to technical expertise, non-parties to the original contract will often suffer damage if the contract was not honestly performed.

Abuse of Contractual Rights

The duty of good faith in contractual performance could potentially protect parties against snap actions by other parties, even parties exercising contractual rights. In *Houle*, another Quebec case, an "abuse of contractual rights" occurred when a bank, in the space of three hours, called in a demand on a credit facility it held in a family business, took possession, and liquidated the assets of the business.[26]

[24] *Bail Ltee* at 583.
[25] *Bail Ltee* at 584-5.
[26] *Houle v. Canadian National Bank* [1990] 3 S.C.R. 122. The liquidation was incited by the bank learning that the business owners were about to sell some shares in the business.

Consider, for instance, snap changes to rates payable under a contract, or particularly onerous changes to terms of use. Many standard form contracts grant the offering party authority to make such unilateral changes, and therefore a plaintiff might have difficulty making out a case for misrepresentation (indeed, they would be receiving the unilateral changes outlined in the contract) or reliance on any representation. The duty of honest performance might provide recourse for particularly egregious unilateral exercises of contractual powers. There may therefore be applications for the duty of good faith performance in consumer protection litigation.

Closing Thoughts

There is, in our view, no real risk that the newly recognized duty of honest performance of contracts will let loose a flood of litigation on behalf of parties who have failed to take any reasonable steps to protect their own interests in a contract. Professor McCamus has this reassurance to offer: "I suspect that if and when a recognition of the general duty occurs, it will be discovered that not very much has changed in the Canadian common law of contract."[27]

It remains to be seen how the duty of honest performance interacts with remedies doctrines. Where a claim is founded on a breach of honest performance duties, will pecuniary damages remain sufficient, as they normally are for breaches of contract?

Where parties have acted reasonably and according to accepted commercial and community standards, there is not likely to be any breach of the duty of honest performance. The duty of honest performance may allow new access to recourse for injured parties and even some non-parties to contracts. Common law jurisdictions where the duty has just been recognized by *Bhasin v. Hrynew* can draw from the jurisprudence of provinces for suggestions on situations where the duty is relevant.

[27] John D. McCamus, "Abuse of Discretion, Failure to Cooperate and Evasion of Duty: Unpacking the Common Law Duty of Good Faith Contractual Performance" (2004) 29 The Advocates' Quarterly (2004) 29.1 & 2, 101.