The decision of the Supreme Court of Canada in *Bhasin v. Hrynew*, 2014 SCC 71, which was released on November 13, 2014, deals with the common law duty to perform contracts honestly. It also provides a thorough and reasoned examination of the development of the good faith principle in Anglo-Canadian contract law and will likely be seen as a seminal decision in this area.

Cromwell J. framed the central questions in the case as follows (¶ 1): “[d]oes Canadian common law impose a duty on parties to perform their contractual obligations honestly? And, if so, did either of the respondents breach that duty?” In answering both questions in the affirmative, Justice Cromwell stated:

[33] 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.

[34] In my view, taking these two steps is perfectly consistent with the Court’s responsibility to make incremental changes in the common law when appropriate. Doing so will put in place a duty that is just, that accords with the reasonable expectations of commercial parties and that is sufficiently precise that it will enhance rather than detract from commercial certainty.

The Facts

The plaintiff in this action, Bhasin, operated a business in which he retailed education savings plans as an enrollment director on behalf of Can-Am through a commercial dealership agreement. The court noted that this was not a franchise agreement but that it nonetheless bore similarities to that kind of agreement (¶¶ 4-5). However, the court expressly found that s. 7 of the Alberta *Franchises Act* did not apply.

The particular agreement that governed the relationship took effect in 1998. It contained a renewal clause that provided for an automatic renewal at the end of the three-year term unless one of the parties gave six months’ written notice to the contrary. The relationship began to sour in 1999. The other defendant, Hrynew, another enrollment director, had previously moved his business to Can-Am. Can-Am promised him that he would be given
consideration regarding mergers that might take place and he in fact merged with other agencies in Calgary after moving over to Can-Am. Hrynew was in a strong position of influence with Can-Am. He had the largest agency in Alberta and a good working relationship with the Alberta Securities Commission. Hrynew wanted to capture Bhasin’s niche market and had proposed merging with Bhasin’s business on numerous occasions, but to no avail.

As a result of certain compliance, the Securities Commission required Can-Am to appoint a provincial trading officer (PTO) to review and audit the activities of its enrollment officers. Can-Am appointed Hrynew to the position over Bhasin’s objection. Bhasin subsequently refused to allow Hrynew to audit his books as they were in direct competition. Can-Am ultimately relied on Bhasin’s refusal to allow the audits to give notice of non-renewal under the agreement.

Bhasin sued both Can-Am and Hrynew. The trial judge held that Can-Am had breached an implied duty of good faith with respect to renewal (that is, the court implied a term that decisions about renewal would be made in good faith). The trial judge also found that Hrynew had intentionally induced a breach of contract and that both defendants were liable for civil conspiracy. The Alberta Court of Appeal reversed, finding that the court below erred by implying a term of good faith in the context of an unambiguous contract containing an entire agreement clause. Bhasin appealed.

The Decision

After reviewing the decisions below (¶¶ 22-28) and the positions of the parties (¶¶ 29-31), Cromwell J. discussed the relatively inconsistent development and application of the contractual good faith principle in the common law world. In this analysis, he stated:

[47] There have been many attempts to bring a measure of coherence to this piecemeal accretion of appeals to good faith: ... By way of example, Professor McCamus has identified three broad types of situations in which a duty of good faith performance of some kind has been found to exist: (1) where the parties must cooperate in order to achieve the objects of the contract; (2) where one party exercises a discretionary power under the contract; and (3) where one party seeks to evade contractual duties (pp. 840-56; CivicLife.com Inc. v. Canada (Attorney General) (2006), 215 O.A.C. 43, at paras. 49-50).

[48] While these types of cases overlap to some extent, they provide a useful analytical tool to appreciate the current state of the law on the duty of good faith. They also reveal some of the lack of coherence in the current approach. It is often unclear whether a good faith obligation is being imposed as a matter of law, as a matter of implication or as a matter of interpretation. Professor McCamus notes:

Although the line between the two types of implication is difficult to draw, it may be realistic to assume that implied duties of good faith are likely, on occasion at least, to slide into the category of legal incidents rather than mere presumed intentions. Certainly, it would be difficult to defend the implication of terms on each of the cases considered here on the basis of the traditional business efficiency or officious bystander test. In the control of contractual discretion cases, for example, it may be more realistic to suggest that the implied limitation on the exercise of the discretion is intended to give effect to the “reasonable expectations of the parties.” [pp. 865-66]
After recognizing that “Canadian common law in relation to good faith performance of contracts is piecemeal, unsettled and unclear” (¶ 59), the learned justice premised his discussion of good faith as a general organizing principle with the following comments:

[60] 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.

[61] … It is, to say the least, counterintuitive to think that reasonable commercial parties would accept a contract which contained a provision to the effect that they were not obliged to act honestly in performing their contractual obligations.

Turning to the organizing principle itself. Cromwell J. stated:

[63] The first step is to recognize that there is an organizing principle of good faith that underlies and manifests itself in various more specific doctrines governing contractual performance. That organizing principle is simply that parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily.

[64] As the Court has recognized, an organizing principle states in general terms a requirement of justice from which more specific legal doctrines may be derived. An organizing principle therefore is not a free-standing rule, but rather a standard that underpins and is manifested in more specific legal doctrines and may be given different weight in different situations: see, e.g., R. v. Jones, [1994] 2 S.C.R. 229, at p. 249; R. v. Hart, 2014 SCC 52, [2014] 2 S.C.R. 544, at para. 124; R. M. Dworkin, “Is Law a System of Rules?”, in R. M. Dworkin, ed., The Philosophy of Law (1977), 38, at p. 47. It is a standard that helps to understand and develop the law in a coherent and principled way.

[65] 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 seek to undermine those interests in bad faith. This 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.

[66] This organizing principle of good faith manifests itself through the existing doctrines about the types of situations and relationships in which the law requires, in certain respects, honest, candid, forthright or reasonable contractual performance. Generally, claims of good faith will not succeed if they do not fall within these existing doctrines. But we should also recognize that this list is not closed. The application of the organizing principle of good faith to particular situations should be
developed where the existing law is found to be wanting and where the development may occur incrementally in a way that is consistent with the structure of the common law of contract and gives due weight to the importance of private ordering and certainty in commercial affairs.

And further:

[69] The approach of recognizing an overarching organizing principle but accepting the existing law as the primary guide to future development is appropriate in the development of the doctrine of good faith. Good faith may be invoked in widely varying contexts and this calls for a highly context-specific understanding of what honesty and reasonableness in performance require so as to give appropriate consideration to the legitimate interests of both contracting parties. For example, the general organizing principle of good faith would likely have different implications in the context of a long-term contract of mutual cooperation than it would in a more transactional exchange: Swan and Adamski, at §1.24; B. Dixon, “Common law obligations of good faith in Australian commercial contracts — a relational recipe” (2005), 33 A.B.L.R. 87.

[70] The principle of good faith must be applied in a manner that is consistent with the fundamental commitments of the common law of contract which generally places great weight on the freedom of contracting parties to pursue their individual self-interest. In commerce, a party may sometimes cause loss to another — even intentionally — in the legitimate pursuit of economic self-interest: A.I. Enterprises Ltd. v. Bram Enterprises Ltd., 2014 SCC 12, [2014] 1 S.C.R. 177, at para. 31. Doing so is not necessarily contrary to good faith and in some cases has actually been encouraged by the courts on the basis of economic efficiency: Bank of America Canada v. Mutual Trust Co., 2002 SCC 43, [2002] 2 S.C.R. 601, at para. 31. The development of the principle of good faith must be clear not to veer into a form of ad hoc judicial moralism or “palm tree” justice. In particular, the organizing principle of good faith should not be used as a pretext for scrutinizing the motives of contracting parties.

The court then considered whether a new duty of good faith should be recognized, stating:

[72] In my view, the objection to Can-Am’s conduct in this case does not fit within any of the existing situations or relationships in which duties of good faith have been found to exist. The relationship between Can-Am and Mr. Bhasin was not an employment or franchise relationship. Classifying the decision not to renew the contract as a contractual discretion would constitute a significant expansion of the decided cases under that type of situation. After all, a party almost always has some amount of discretion in how to perform a contract. It would also be difficult to say that a duty of good faith should be implied in this case on the basis of the intentions of the parties given the clear terms of an entire agreement clause in the Agreement. The key question before the Court, therefore, is whether we ought to create a new common law duty under the broad umbrella of the organizing principle of good faith performance of contracts. [Emphasis added]

[73] In my view, we should. 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 a simple 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: ...  

[74] ... I am at this point concerned only with a new duty of honest performance and, as I see it, this should not be thought of as an implied term, but a general doctrine of contract law that imposes as a contractual duty a minimum standard of honest contractual performance. It operates irrespective of the intentions of the parties, and is to this extent analogous to equitable doctrines which impose limits on the freedom of contract, such as the doctrine of unconscionability.

While the passage emphasized in ¶ 72 above would appear to preclude a duty of good faith with respect to renewals generally, it is to be noted that the court simply suggested that characterizing a decision not to renew as a contractual discretion would be a significant expansion of the existing case law. It is submitted that this statement does not unequivocally preclude the characterization of the manner or terms of a renewal as a contractual discretion, and in particular, in those provinces with franchise legislation.

Cromwell J. then made the following important statement:

[75] Viewed in this way, the entire agreement clause in cl. 11.2 of the Agreement is not an impediment to the duty arising in this case. Because the duty of honesty in contractual performance is a general doctrine of contract law that applies to all contracts, like unconscionability, the parties are not free to exclude it: see CivicLife.com, at para. 52

Thus, the good faith principle under this formulation cannot be excluded by an entire agreement clause or otherwise. Even so, the court allowed that the parties “should be free in some contexts to relax the requirements of the doctrine so long as they respect its minimum core requirements” (¶ 77).

The court qualified the organizing principle as follows:

[86] The duty of honest performance that I propose should not be confused with a duty of disclosure or of fiduciary loyalty. A party to a contract has no general duty to subordinate his or her interest to that of the other party. However, contracting parties must be able to rely on a minimum standard of honesty from their contracting partner in relation to performing the contract as a reassurance that if the contract does not work out, they will have a fair opportunity to protect their interests. That said, a dealership agreement is not a contract of utmost good faith (uberrimae fidei) such as an insurance contract, which among other things obliges the parties to disclose material facts: Whiten. But a clear distinction can be drawn between a failure to disclose a material fact, even a firm intention to end the contractual arrangement, and active dishonesty.

The learned justice added that it is “clear that there is no unilateral duty to disclose information relevant to termination. But the situation is quite different, as I see it, when it comes to actively misleading or deceiving the other contracting party in relation to performance of the contract” (¶ 87).
Cromwell J. summarized the foregoing into three broad principles:

(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.

Applying these principles to the facts of the case, the court stated:

[96] The factual matrix in which the judge made her finding of dishonest performance is complicated and I will only outline it in very broad terms in order to put that finding in context. There were two main interrelated story lines.

[97] The first concerns Mr. Hrynew’s persistent attempts to take over Mr. Bhasin’s market through a merger — in effect a takeover by him of Mr. Bhasin’s agency. The second concerns the difficulties, beginning in early April 1999, that Can-Am was having with the Alberta Securities Commission, which regulated its business and its enrollment directors in Alberta. The Commission insisted that Can-Am appoint a full-time employee to be a PTO responsible for compliance with Alberta securities law. Can-Am ultimately appointed Mr. Hrynew, with the result that he would audit his competitor agencies, including Mr. Bhasin’s, and therefore have access to their confidential business information. Mr. Bhasin’s refusal to allow Mr. Hrynew access to this information led to the final confrontation with Can-Am and its giving notice of non-renewal in May 2001. Can-Am, for its part, wanted to force a merger of the Bhasin agency under the Hrynew agency, effectively giving Mr. Bhasin’s business to Mr. Hrynew. It was in the context of this situation that the trial judge made her findings of dishonesty on the part of Can-Am.

[98] The trial judge concluded that Can-Am acted dishonestly with Mr. Bhasin throughout the period leading up to its exercise of the non-renewal clause, both with respect to its own intentions and with respect to Mr. Hrynew’s role as PTO. Her detailed findings amply support this overall conclusion.

[99] By early 2000, Can-Am was considering a significant reorganization of its activities in Alberta; by June of that year, it sent an organizational chart to the Commission showing that Mr. Bhasin’s agency was to be merged under Mr. Hrynew’s. But it had said nothing of this to Mr. Bhasin: trial reasons, at paras. 167-68. The trial judge found that these representations made by Can-Am to the Commission were clearly false if, as she concluded, they intended to refer to Mr. Bhasin: para. 246. She also found that Can-Am, by June 2000, was fearful that the Commission was going to pull its licence in Alberta and that it was prepared to do whatever it could to forestall that possibility. “However, it was not dealing honestly with [Mr.] Bhasin about the realities of the situation as [it] saw them”: para. 246.
In August 2000, Mr. Bhasin first heard of Can-Am’s merger plans for him during a meeting with Can-Am’s regional vice-president. But when questioned about Can-Am’s intentions with respect to the merger, the official “equivocated” and did not tell him the truth that from Can-Am’s perspective this was a “done deal”. The trial judge concluded that the official was “not honest with [Mr.] Bhasin” at that meeting: para. 247.

When Mr. Bhasin complained about Mr. Hrynew’s conflict of interest in being both auditor and competitor, Can-Am in effect blamed the Commission, claiming that the Commission had rejected its proposal to appoint a third party PTO. This was not truthful. Can-Am failed to mention that it had proposed to appoint a non-resident of Alberta who was clearly not qualified according to the Commission’s criteria or that it had decided to appoint Mr. Hrynew even though he did not meet the Commission’s criteria either: trial reasons, at paras. 195 and 221. It also misrepresented — repeatedly — to Mr. Bhasin that Mr. Hrynew was bound by duties of confidentiality and segregation of activities in the course of an audit, when in fact there was no such requirement. Can-Am did not even finalize its PTO contract with Mr. Hrynew until March 2001 and, notwithstanding its assurances to Mr. Bhasin, it failed to include such a provision in the contract: paras. 190-221. As the trial judge found, Can-Am “could not possibly have missed this honestly in the PTO agreement, given that [Mr. Bhasin’s] very protests about [Mr.] Hrynew’s appointment as PTO were about confidentiality and segregation of activities”: para. 221. The judge also found that Can-Am repeated these “lies” about Mr. Hrynew’s supposed obligations of confidentiality even after the PTO agreement, without these protections, had been signed: para. 204.

Can-Am pushed on with the requirement that Mr. Hrynew audit Mr. Bhasin’s agency as if it were required to do so by the Commission even though it had arranged to have one of its employees conduct the audit of Mr. Hrynew’s agency: trial reasons, at para. 198.

As the trial judge found, this dishonesty on the part of Can-Am was directly and intimately connected to Can-Am’s performance of the Agreement with Mr. Bhasin and its exercise of the non-renewal provision. I conclude that Can-Am breached the 1998 Agreement when it failed to act honestly with Mr. Bhasin in exercising the non-renewal clause.

The court refused the claims made regarding inducing breach of contract and civil conspiracy. As to damages, the court concluded that the proper measure was to calculate them on the basis of what Bhasin’s economic position would have been had Can-Am fulfilled its duty. Thus, damages were awarded based on the value of Bhasin’s business at the time of non-renewal, which, on the basis of the evidence adduced at trial, was $87,000 (see ¶¶ 108-111).

It is submitted that this decision firmly establishes that the duty of good faith applies to all commercial contracts. While the court was careful to frame the duty as an organizing principle rather than a free standing rule or an implied term, it is clear from ¶ 103 that the failure of Can-Am to meet its duty was a breach of contract. Despite this apparent contradiction, the application of the principle to the facts of this case was relatively straightforward: Can-Am actively lied throughout the process and with respect to its intentions going forward.
Bhasin is an interesting decision on several levels. While trying to confine the common law good faith obligation to the role of an organizing principle and not a free standing rule or an implied term (see ¶ 74), Cromwell J. clearly held that there was a breach of contract. However, the renewal provision in question (¶ 95) does not contain any qualifiers on the parties’ right to give notice of non-renewal. It is difficult to see how Can-Am’s conduct amounted to a breach of contract unless, as the trial judge found, there was in fact an implied contractual term to act in good faith (or at least honestly in the sense of not actively lying to the other side).

What can be said is that the decision will have far-reaching implications for the Canadian common law of contracts. How the organizing principle will be applied in other, less obvious contexts remains to be seen. The court has essentially thrown the issue back to lower courts to work out the scope of this duty. It will be interesting to watch its development.