DOCTRINE OF HONEST PERFORMANCE

By: Noah D. Schein, J.D.

On November 13, 2014, the Supreme Court of Canada released its long awaited decision on the issue of good faith in contractual performance.

The facts of Bhasin v. Hrynew (2014 SCC 71) are set out in brief as follows. Mr. Bhasin operated a business in Alberta selling RESPs on behalf of Canadian American Financial Corp (“Can-Am”). After almost 10 years of successfully building his sales force, Mr. Bhasin and Can-Am entered into a new agreement governing their relationship featuring a three-year term which renewed automatically unless one party gave six months’ notice to the contrary.

Mr. Hrynew, a direct competitor of Mr. Bhasin, began working for Can-Am with a view to “merging” his business with that of Mr. Bhasin, and was placed in the position of “auditing” Mr. Bhasin’s records. Can-Am repeatedly misled and acted dishonestly toward Mr. Bhasin in connection with Mr. Hrynew’s duties and obligations as “auditor”, as well as the plan to “merge” Mr. Bhasin and Mr. Hrynew’s respective businesses. Ultimately, Can-Am gave notice of non-renewal of Mr. Bhasin’s agreement resulting in the loss of the value in Mr. Bhasin’s business and assembled workforce, which was assumed by Mr. Hrynew.

Mr. Bhasin sued Can-Am and Mr. Hrynew alleging, among other things, that the decision not to renew the contract was subject to an implied term of good faith, which had been breached. Mr. Bhasin was successful at trial, but his claim was dismissed by the Alberta Court of Appeal.

In a unanimous decision delivered by Justice Cromwell, the Supreme Court of Canada held that the common law in Canada should take an incremental step forward to recognize a general doctrine in contract law that imposes a minimum standard of honest contractual performance.

The Law in Canada pre-Bhasin v. Hrynew

In his judgement, Justice Cromwell canvasses the current jurisprudence on a duty of good faith in contract law in Canada, and reviews the law in Quebec, the United States, the United Kingdom and Australia. He concludes that Anglo-Canadian common law has resisted acknowledging any generalized and independent doctrine of good faith performance of contracts, which is out of step with the civil law of Quebec and most jurisdictions in the United States. Canadian common law, in relation to good faith performance of contracts, is piecemeal, unsettled, unclear and inconsistent with the reasonable expectations of commercial parties.

Consistent with the Supreme Court’s approach in the past, Justice Cromwell identifies the court’s role to develop the common law to keep up with the dynamic and evolving fabric of Canadian society where it can do so in an incremental fashion. What is contemplated in this case, according to Justice Cromwell, is not a wholesale change or reversal of a settled

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rule, but a development directed at bringing greater certainty and coherence to a complex area of the common law.

The Doctrine of Honest Performance

The “new” doctrine of honest performance is the result of two “incremental steps” proposed by Justice Cromwell:

- 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.

The intended result of these steps is the establishment of a duty that is just, accords with the reasonable expectations of commercial parties and is sufficiently precise that it will enhance rather than detract from commercial certainty. While the Court acknowledges that parties will continue to remain at arm’s length and will not be subject to the duties of a fiduciary, a basic level of honest conduct is necessary to the proper functioning of commerce.

The Court is very careful to distinguish that the new duty of honest performance is not to be thought of as an implied term, but rather a general doctrine. This means that the duty is operative irrespective of the intentions of the parties and is analogous to any other equitable doctrine, such as unconscionability (more on this below).

In Practice

How does this new Doctrine manifest itself in the day-to-day practice of commercial parties? Justice Cromwell provides some guidance: A general duty of honesty in contractual performance “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.”

Because the duty of honesty in contractual performance is a general doctrine of contract law that applies to all contracts (rather than an implied term), parties are not free to exclude or “contract-out” of it. While this would seem to limit the parties freedom of contract to a certain extent, the interference with such freedom would be minimal, according to Justice Cromwell, as parties rarely expect that their contracts would permit dishonest performance.

Back to Bhasin v. Hrynew

Having established the doctrine of honest performance, the Court had little trouble concluding that by repeatedly misleading and acting dishonestly toward Mr. Bhasin, Can-Am breached its duty to perform its agreement with Mr. Bhasin honestly. The “entire agreement” clause in the agreement between the parties did not preclude the application of the doctrine. Mr. Bhasin was awarded damages equal to the value of his business at the time of non-renewal of the agreement.

It would seem that with this case, the Supreme Court, deciding unanimously, was able to seize the opportunity to make an incremental change in the law that has been long in the making. They had the necessary facts -- Can-Am's high-handed theft of Mr. Bhasin's business coupled with no indication that Mr. Bhasin had any other source of revenue -- as well as piecemeal, unsettled and unclear law. Further, the Supreme Court's approach to making the necessary “incremental change” was to create a general doctrine, rather than imply a term in some or all circumstances. This approach forecloses the opportunity for parties to contract out of honest performance obligations and specifically embeds those obligations in every commercial contract.*~*~*

A complete copy of the Supreme Court’s decision can be found at http://scc-csc.lexum.com/scc-csc/scc-csc/en/item/14438/index.do