

The obligation of good faith in the performance of Canadian contracts

Presented to the 2025 Commonwealth Lawyers Association Conference by Justice Lynne C. Leitch, President Commonwealth Magistrates' and Judges' Association

In Canada, recent developments concerning the duty of fairness have related to the development of the obligation of good faith in the performance of contracts.

In 2014, the Supreme Court of Canada released a decision relating to the non-renewal of a retail dealers' agreement with an education savings plan company.

This decision, *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 S.C.R. 494 ("*Bhasin*"), has been described as one of the most significant cases - perhaps the most significant case - ever decided in Canadian contracts jurisprudence.¹

It has been noted that, in the decade after its release, more words have been written about *Bhasin v. Hrynew* than any other case in the Canadian law of contracts.²

Mr. Bhasin sold the education savings plans of Can-Am. The two parties entered into a contract which would automatically renew at the end of the term unless one of the parties gave six months written notice to the contrary.

Mr. Hrynew also sold Can-Am's education savings plan and was a direct competitor of Mr. Bhasin.

Mr. Hrynew had previously made efforts to merge businesses with Mr. Bhasin, as encouraged by Can-Am, but Mr. Bhasin refused.

Separately, Can-Am appointed Mr. Hrynew to review the business records of all of its retail dealers, including Mr. Bhasin, to ensure compliance with securities law.

Not surprisingly, Mr. Bhasin objected to having his competitor review his confidential business records.

Can-Am misled Mr. Bhasin about how and why Mr. Hrynew was selected for the role and repeatedly told Mr. Bhasin that Mr. Hrynew was bound by duties of confidentiality in that role when, in fact, he was not.

¹ Brandon Kain, *Good Faith in Canadian Contract Law* (Toronto: LexisNexis, 2024), at p. 100.

² Kain, at p. 101.

Furthermore, unbeknownst to Mr. Bhasin, Can-Am had plans which involved Mr. Bhasin working for Mr. Hrynew's agency.

Mr. Bhasin refused to allow Mr. Hrynew to audit his records.

Can-Am then threatened to terminate his contract and ultimately gave him notice of non-renewal in accordance with the terms of the contract.

As a result, Mr. Bhasin lost the value in his business and most of his sales agents were successfully solicited by his competitor.

Mr. Justice Cromwell writing for a unanimous Supreme Court made some interesting comments about the state of the law in Canada, observing that "Anglo Canadian common law has resisted acknowledging any generalized and independent doctrine of good faith performance of contracts".³

The result is an "unsettled and incoherent body of law" that has developed "piecemeal", and which is "difficult to analyze".⁴

He concluded that it was time to take what he described as two incremental steps in relation to good faith responsibilities to make the common law less unsettled and piecemeal, more coherent and more just.⁵

Justice Cromwell had several reasons for taking these incremental steps.

First, he observed that the doctrine of good faith is supported by jurisprudence dating back to Roman law and English contract law from as early as 1758.⁶

Secondly, he surveyed the current state of the common law and observed that "developments in the United Kingdom and Australia point to enhanced attention to the notion of good faith, mitigated by reluctance to embrace it as a stand-alone doctrine".⁷

Thirdly, he stated that commercial parties reasonably expect a basic level of honesty and good faith in contractual dealings, and a basic level of honest conduct is necessary to the proper functioning of commerce.⁸

³ *Bhasin v. Hrynew*, 2014 SCC 71, [2014] 3 S.C.R. 494, at para. 32 ("*Bhasin*").

⁴ *Bhasin*, at para. 32.

⁵ *Bhasin*, at para. 33.

⁶ *Bhasin*, at para. 35.

⁷ *Bhasin*, at para. 57.

⁸ *Bhasin*, at para. 60.

The first step he took was 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.

This organizing principle of good faith requires parties to perform their contractual duties honestly and reasonably and not capriciously or arbitrarily.⁹ Additionally, in performing the contract, parties must “have appropriate regard to the legitimate contractual interests of the contracting partner”.¹⁰

Helpfully, Justice Cromwell defined what he meant by “appropriate regard”, explaining that it “merely requires that a party not seek to undermine the other party's interests in bad faith”.¹¹ 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.

Justice Cromwell also confirmed the existence of three specific duties of good faith performance falling within the “general organizing principle”:

1. A duty to cooperate in the achievement of the purposes of the agreement
2. A duty to exercise contractual discretionary powers in good faith and not for an ulterior motive
3. A duty not to evade contractual obligations.

The second step was to create a new fourth common law duty under the broad umbrella of the organizing principle; specifically, a general duty of honesty in contractual performance.

Cromwell J. instructed that this duty means that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract.¹²

He concluded that recognizing such a duty would pose no risk to commercial certainty in the law of contract, opining that “a reasonable commercial person would expect at least

⁹ *Bhasin*, at para. 63.

¹⁰ *Bhasin*, at para. 65.

¹¹ *Bhasin*, at para. 65.

¹² *Bhasin*, at para. 73.

that the other party to a contract would not be dishonest about his or her performance”.¹³He also observed that such a duty is clear and easy to apply.

Cromwell J. bolstered his conclusions by noting that in the United States and Quebec, broad conceptions of the duty of good faith had not impeded contractual activity or contractual stability.¹⁴

Parenthetically, let me explain that a duty of good faith is required pursuant to the *Civil Code of Quebec*, which has been considered a leader in the area of good faith jurisprudence. The *Civil Code of Quebec* in force since 1994 includes 3 provisions relating to good faith.¹⁵

These provisions provide the following: parties must conduct themselves in good faith both at the time the obligation is created and at the time it is performed or extinguished; every person is bound to exercise his civil rights in good faith; and no right may be exercised with the intent of injuring another or in an excessive and unreasonable manner and therefore contrary to the requirements of good faith.¹⁶

Given the facts in *Bhasin*, it will come as no surprise that Cromwell J. for the Supreme Court upheld the findings of the trial judge that Can-Am failed to act honestly with Bhasin in exercising the non-renewal clause.

The Court found that Can-Am was liable for damages calculated on the basis of what Mr. Bhasin’s economic position would have been had Can-Am fulfilled its duty in performing the contract honestly – in this case, Mr. Bhasin would have been able to retain the value of his business rather than see it essentially expropriated and turned over to his competitor.

The decision was described as “a “blockbuster”, ground-breaking, effecting a dramatic change in the law, and having massive and significant implications.”¹⁷

Some commentators considered the approach in *Bhasin* as “radical”¹⁸, but others found it “unlikely to revolutionize contract law in common law Canada at all”.¹⁹

¹³ *Bhasin*, at para. 80.

¹⁴ *Bhasin*, at para. 85.

¹⁵ *Civil Code of Québec*, CQLR c. CCQ-1991.

¹⁶ *Civil Code of Québec*, at art. 6, 7, 1375.

¹⁷ Shannon O’Byrne & Ronnie Cohen, “The Contractual Principle of Good Faith and the Duty of Honesty in *Bhasin v. Hrynew*” (2015) 53 Alta L Rev 1 at 2.

¹⁸ O’Byrne & Cohen, at 2.

¹⁹ O’Byrne & Cohen, at 3.

The latter perspectives noted a further caution from Cromwell J. that “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”.²⁰

Further clarity with respect to the newly established common law duty was provided in the case, a year later, of *Potter v. New Brunswick Legal Aid Services Commission* (2015), a constructive dismissal case, where the Supreme Court of Canada elaborated that “At a minimum, acting in good faith in relation to contractual dealings means being honest, reasonable, candid and forthright”.²¹

In 2020 the SCC reiterated their conclusions in *Bhasin* in the decision of *C.M. Callow v. Zollinger*, 2020 SCC 4, [2020] 3 S.C.R. 908 (“*Callow*”).

The issues in that case required the consideration of the new duty of honest performance.

The plaintiff and the defendant had entered into a winter maintenance contract which could be terminated without cause on 10 days’ notice. They also had a separate summer contract.

The defendant had decided to terminate the winter contract, but the defendant encouraged the plaintiff to believe the defendant was satisfied with the plaintiff’s performance under the winter contract.

The plaintiff provided additional work under the summer contract for free hoping to curry favour with the defendant.

The defendant was aware of the plaintiff’s motivation for doing this extra work.

When the defendant gave the plaintiff the required 10 days written notice to terminate the winter agreement, the plaintiff sued for damages on the basis that the defendant had breached the *Bhasin* duty of honest performance.

The interesting point in *Callow* is that the defendant argued that they had not made any outright lie to the plaintiff, and they had no duty to disclose that they had made a decision to terminate the winter contract specifically noting that *Bhasin* had not imposed any duty of disclosure.

²⁰ *Bhasin*, at para. 66.

²¹ *Potter v. New Brunswick Legal Aid Services Commission*, 2015 SCC 10, [2015] 1 S.C.R. 500, at para. 99.

The court confirmed that the defendant had no duty to disclose its decision to terminate the winter contract, but it was subject to a duty not to engage in active communications by words or conduct that deceived the plaintiff.

The court found that by positively commenting about the plaintiff's performance it was reasonable for the plaintiff to infer that the winter contract was not in jeopardy, which constituted a breach of the duty of honest performance.

The court found a second breach by virtue of the fact that the defendant accepted free work during the summer from the plaintiff being aware of the plaintiff's motivation for offering those services.

While the defendant was legally entitled to terminate the contract, it could only do so honestly, and the court found the defendant was dishonest in actions directly linked to the exercise of its right to terminate.

The court emphasized that no contractual right, including a termination right, can be exercised dishonestly, and, as such, contrary to the requirements of good faith.

Putting it another way, the terms of a contract cannot relieve a party from its duty of honest performance, a duty which is a contract law doctrine, not a tort.

In relation to damages, in *Callow*, the plaintiff was awarded damages to put him in the position he would have been in if the contract had been performed.

The court was satisfied that if the defendant's dishonesty had not deprived the plaintiff of the opportunity to bid on other contracts, then the plaintiff would have made an amount that was at least equal to the profit it lost under the winter contract and awarded those damages.²²

It is interesting also to note that both in *Bhasin* and in *Callow* breaches of the duty of honest performance were found when the defendant had created impressions that were false.

In *Bhasin* the defendant had been equivocal about the inevitability of a merger and in *Callow* the defendant did not correct a false impression that the contract would not be terminated.

As one legal scholar has commented, while there is nothing new about the proposition that representations can be communicated by conduct as well as words, the *Callow* decision indicates that when this proposition is applied in the context of a decision to terminate an agreement, it is not easy to draw the line between permissible non-

²² *C.M. Callow v. Zollinger*, 2020 SCC 4, [2020] 3 S.C.R. 908, at para. 117 ("*Callow*").

disclosure and misleading conduct leading the other party to draw false inferences with respect to the other party's intentions.²³

A further development of a duty of good faith was revealed in the 2021 decision of the Supreme Court of Canada in *Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage District*, 2021 SCC 7, [2021] 1 S.C.R. 32, where the sole issue was whether the discretion under a contract was exercised in good faith.

The plaintiff and defendant had a 20-year contract. The contract allowed the defendant to allocate waste management to different locations in its absolute discretion.

The defendant did so, and the re-allocation significantly impacted the plaintiff's profitability.

The plaintiff alleged that the defendant breached the contract by allocating waste among the facilities in a manner that deprived the plaintiff of the possibility of achieving its target profit.

The court noted that the duty to exercise contractual discretion in good faith was well established in the common law and was expressly recognized in *Bhasin*.

The court observed that it was unnecessary in *Bhasin* to spell out the contours of that duty but to answer the plaintiff's claim in *Wastech*, the court now had to determine what constraints the duty to exercise contractual discretion in good faith imposed on the holder of that discretion.

It was acknowledged by both parties in *Wastech* that for a contractual discretionary power to be exercised in good faith, it cannot, at a minimum, be exercised dishonestly.²⁴

The Court held that the duty to exercise contractual discretion in good faith is breached where the discretion is exercised unreasonably, which means in a manner inconsistent with the purposes for which it was granted in the contract.²⁵

The exercise of discretion does not have to be morally opportune or wise from a business perspective, but it must be exercised in ways connected to the purposes for which the contract grants that power.²⁶

²³ John D. McCamus, "The Canadian Doctrine of Good Faith Contractual Performance: Further Clarification" (2022) 38 J of Cont Law 1 at p. 20.

²⁴ *Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage District*, 2021 SCC 7, [2021] 1 S.C.R. 32, at para. 54 ("*Wastech*").

²⁵ *Wastech*, at para. 63.

²⁶ *Wastech*, at para. 74.

The Court specifically stated that the fact that the exercise of discretion substantially nullifies or eviscerates the fundamental contractual benefit may be relevant, but it is not a necessary prerequisite to establishing a breach.²⁷

Importantly the court stated that, like the duty of honest performance, the duty to exercise contractual discretion in good faith applies regardless of the intentions of the parties – it should be understood as obligatory in all contracts.²⁸

The Court ultimately found that under the contract the defendant had been given absolute discretion to determine waste allocation to allow it the flexibility necessary to maximize efficiency and minimize operational costs and based on these purposes – legitimate business objectives - it had not acted unreasonably.

The purpose of the defendant's discretionary power was specifically set out in the recitals to the contract.

Wastech has been considered to have significantly enhanced the common law good faith obligations.

As one scholar has noted, while the Supreme Court emphasized in *Bhasin* that the organizing principle of good faith does not impose a fiduciary standard, suggesting a limitation on the scope of the obligations of good faith, the Court at the same time has taken an expansionist approach to such obligations by broadening the definition of misleading conduct in *Callow* and elevating the duty to exercise contractual discretion in good faith to a mandatory legal requirement in *Wastech*.²⁹

As a former commercial lawyer who worked very hard to litigation-proof commercial agreements, I was curious about the reaction of the commercial bar to these cases.

It seems to have been fairly positive.

As one commentator has written, *Wastech* confirmed that the courts will only intervene in respect of the exercise of discretionary powers where it has been proven that the discretion was exercised in a manner unconnected to the purposes of the discretion.³⁰

The commentator considered this not a wide scope of review for the courts and the decision should be considered as a business-friendly judgment that gives accord to the primacy of the contract.

²⁷ *Wastech*, at para. 88.

²⁸ *Wastech*, at para. 94.

²⁹ Kain, at p. 141.

³⁰ Derek J. Bell, Jordan Deering & Malinda Yuen, "Wastech v Greater Vancouver: The Supreme Court narrows the scope of review over the exercise of contractual discretionary power" (9 February 2021), online: <https://canliiconnects.org/en/commentaries/73406>.

They observe further that the court is inviting commercial parties in Canada to fix their problems themselves: simply draft clauses about the scope of the discretion to be afforded and the court should give effect to the party's intent.³¹

My reaction to these cases has been very similar. *Bhasin* was beautifully written – and as a trial judge, unanimous judgments are appreciated – *Callow* and *Wastech* had concurring opinions.

For what it is worth, my view is that the Supreme Court of Canada has not gone too far in identifying and setting the scope of the duty of good faith in contracts.

It is important that the Court has been very clear that these duties should not be confused with a duty of disclosure or of fiduciary loyalty³² and they do not require a party to confer a benefit on the other that was not a part of the original agreement, nor do they require a party to subordinate its interest to those of the other party.³³

The bottom line is that in performing a contract and exercising rights under a contract, you must act honestly and exercise your contractual discretion for the intended purpose.

I agree with Justice Cromwell in *Bhasin*, that these duties are clear, easy to apply and promote the value of contracts and their stability and most importantly they reflect the expectations of a reasonable commercial party.

Justice Lynne C. Leitch

³¹ Bell, Deering & Yuen.

³² *Wastech*, at para. 86.

³³ *Wastech*, at para. 113.