Liar, Liar – Supreme Court of Canada Creates Duty to be Honest in Contract Performance

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The Duty of Honest Performance

On November 13, 2014, the Supreme Court of Canada (the "Court"), in the groundbreaking decision Bhasin v. Hrynew¹ ("Bhasin"), created a new common law duty of "honest performance". This new duty, simply stated, provides that:

Parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract.

This new duty of honest performance of contractual obligations applies to all contracts, regardless of the intentions of the parties. The Court also recognized an "organizing principle of good faith" in contract law, which grounds the duty of honest performance.

The Facts

Canadian-American Financial Corp. ("Can-Am") was in the business of marketing education savings plans through retail dealers. Mr. Bhasin and Mr. Hrynew were major competitors for the retail sale of Can-AM's marketing education savings plans in Alberta and there was considerable animosity between them. Mr. Hrynew wanted to capture Mr. Bhasin's business by merging their organizations, but Mr. Bhasin refused to participate in any such merger.

Can-Am was at the time under scrutiny from the Alberta Securities Commission. The Commission asked Can-Am to appoint an auditor to review the retail dealers. Can-Am appointed Mr. Hrynew to audit Mr. Bhasin's records. When Mr. Bhasin objected to sharing his confidential information with Mr. Hrynew, Can-Am assured him that Mr. Hrynew was under a duty of confidentiality (he wasn't) and that the Commission would not have accepted an external auditor (it would have).

¹ 2014 SCC 71.
Can-Am was worried about the Commission's scrutiny and planned to solve any potential problems by restructuring. Can-Am decided that Mr. Bhasin's agency should be merged with Mr. Hrynew's in order to establish Mr. Hrynew's agency as Can-Am's principal retailer in Alberta. When Mr. Bhasin asked if the merger was a "done deal", Can-Am equivocated—even though the decision had been made.

The contract governing the relationship between Can-Am and Mr. Bhasin provided that either party could choose not to renew at the end of the three-year term. Can-Am decided not to renew Mr. Bhasin's contract at the end of the term. Mr. Hrynew then solicited the majority of Mr. Bhasin's agents.

Outcome

While Can-Am was within its contractual rights to refuse to renew Mr. Basin's contract, the Court found that Can-Am had breached its duty to perform the agreement honestly. Can-Am lied to Mr. Bhasin about the circumstances surrounding its decision not to renew. In particular, Can-Am told Mr. Bhasin that the merger wasn't a "done deal" when it was, and deceived Mr. Bhasin about Mr. Hrynew's role as an auditor. If Can-Am had been honest about its plans to restructure, Mr. Bhasin would have known he was being forced out and could have retained some of the value of his agency. Mr. Bhasin was awarded damages equaling the value of his agency at the time of non-renewal—$87,000.

What It Means

*No lying in performance*

The duty of honest performance means that the parties to a contract cannot lie or knowingly mislead each other about matters linked directly to their performance of the contract. This gives effect to what is already the expectation of most commercial parties—that the other party to a contract will be honest in performing its side of the bargain. This duty will have different meanings in different contractual contexts, but it necessitates a minimum standard of honesty between contracting parties.

*Duty distinct from actual contract*

Breach of the duty of honest performance is a doctrine of common law, not an implied term of the contract. As a result, it can be breached even if no other express or implied term of the contract is breached. This has the potential to expand the scope of remedies that might now become available for this breach of contract, such as actions for inducing breach of contract and civil conspiracy.

What It Doesn't Mean

*Not a fiduciary duty*

The duty of honest performance is not a fiduciary duty. A fiduciary relationship is one characterized by utmost trust and confidence, such as the solicitor-client relationship. A fiduciary is required to put the interests of the vulnerable party first. The duty of honest performance is far
less demanding. It does not require a party to a contract to subordinate his or her interest to the other party. Contracting parties are free, in the absence of breach, to pursue their own legitimate economic self-interest, even if that may cause loss to the other party.

Not a duty of utmost good faith or disclosure

The duty of honest performance is also not a general duty of "utmost" good faith. Certain kinds of contracts require an elevated level of candour, such as insurance contracts. But the duty of honest performance does not require disclosure. In particular, it does not require disclosure of an intention to terminate a contract.

Not a general duty of "good faith"

Mr. Bhasin originally framed his complaint in terms of Can-Am's failure to perform the contract in "good faith". Mr. Bhasin argued that Can-Am should not have been able to use its discretionary power to refuse renewal in order to force a merger.

However, the Court declined to consider the issue of whether a general duty of good faith exists in contract law. Instead, the Court recognized a general "principle" of good faith in contract law that motivates more specific contractual doctrines—such as the duty of honest performance. In recognizing such a principle, the Court hoped to bring some coherence to Canadian contract law's complex and inconsistent use of the concept of "good faith".

Therefore, there is still no general "duty" of good faith in contract law, only the "principle" of good faith that motivates other, more specific rules. But preexisting contract rules that involve good faith continue to be applicable in particular contexts, such as employment and insurance contracts, and contracts involving significant discretion.

Unanswered Questions

Considering that it creates such an unprecedented change in contract law, Bhasin is a relatively short decision. This suggests that the Court viewed the duty of honest performance as a truly incremental development in Canadian contract law. But is it really? Much remains undefined. The Court noted that the "precise content" of the duty would vary from contract to contract, and would probably be different for long-term contracts of mutual cooperation than for more transactional agreements. This raises a number of questions that may be answered differently in different contexts.

Honest about what, exactly?

In Bhasin, the Court stated that, as a general principle, a party to a contract should have appropriate regard for the legitimate contractual interests of the contracting partner. The Court also wrote that the purpose of the duty of honest performance is, at least in part, to reassure parties that if the contract does not work out they will still have a fair opportunity to protect their interests. What constitutes "appropriate regard" and "fair opportunity" will likely be context-specific, but these concepts appear to flow from the reasonable expectations of the contracting parties.
The Court also made clear that the duty of honest performance is restricted to just that—honesty about matters directly linked to the performance of the contract. This means that not just any dishonesty between the parties to a contract will be a breach of contractual duty. The party seeking to prove a breach of duty of honest performance will likely have to show that the dishonest conduct at issue was "directly linked" to the performance of the contract.

**Is non-disclosure dishonest?**

The duty of honest performance prohibits intentional deception in contract performance. However, the Court stated several times in *Bhasin* that the duty of honest performance does *not* impose disclosure obligations. The lack of disclosure obligations sets an important limit on the duty of honest performance. It suggests that the parties to a contract are only responsible for what they actually communicate to one other, and places a greater onus on parties to seek out information they feel is material to contract performance.

However, where one party knows that the other party is relying on a mistaken understanding, it is not clear whether silence on an issue will withstand scrutiny. The duty to be honest encompasses all communication relating to contractual performance, even information that one party does not expect the other to rely on. If information that was initially true later turns out not to be the case, the party with superior knowledge may be required to correct its earlier statements. In such cases, non-disclosure will probably not meet the standard of honest performance.

In any event, this does suggest that once parties embark upon the performance of a contractual relationship, they might now more carefully consider their explicit communications concerning that performance. It may invoke the old adage "the less said the better".

**Can you contract out of the duty?**

The duty of honest performance is an independent common law doctrine, not an implied contractual term. This means that parties are not free to contract out of their respective duties to be honest with one another. However, the Supreme Court left open the possibility that parties could narrow the scope of the duty through express contractual terms, as long as these refinements respected the "core requirements" of the duty. What the "core requirements" will look like in any given commercial context is, however, unclear.

**What are the consequences for breach?**

In *Bhasin*, Mr. Bhasin was put in the economic position he would have occupied if Can-Am had behaved honestly, which meant receiving the value of his business that he could have retained if he had known that the contract was coming to an end. However, the findings of the Court on this point unfortunately do not provide much guidance for future litigants. It is not clear on the facts what Mr. Bhasin could have done differently to "preserve the value" of his business if Can-Am had been forthright in exercising its right of non-renewal. It is therefore entirely possible that a breach of the duty of honest performance could have little or no effect on the non-breaching party's economic position, resulting only in nominal damages.

That said, a breach of duty of honest performance is, by definition, an intentional breach of contract with negative overtones of "dishonesty" and "lack of candour". As such, remedies for
damages could potentially include disgorgement (where a party is forced to give up the profits arising from breach) or punitive damages.

**Simple in Concept, Complex in Application**

The Court's recognition of the organizing principle of good faith has opened the door to many new kinds of arguments in contract law. The "official" desirability of good faith will help to bolster claims based on existing contract doctrines. And since the list of specific rules flowing from the general principle is not closed, litigants will likely argue that other new kinds of duties informed by the organizing principle of good faith should formally regulate contractual relationships.

Yes, the new doctrine is "simple in concept", but it has the potential to be complex and far reaching in application. As a result, the duty of honest performance is certain to receive significant attention from lower courts going forward. The precise scope of this duty and the existence of other, similar duties that are discovered under the broad umbrella of the "organizing principle of good faith" remains to be determined. However, the Court made clear that any further development of these concepts must be in synch with the reasonable commercial expectations of contracting parties.

Parties operating in the oil and gas industry will already be aware of various duties and obligations, both explicit and implicit, that are imposed upon or accepted by them through various operating procedures, accounting procedures, and industry standards. Many industry participants would find common ground in the general principle of good faith. However, the parameters to be drawn by future courts interpreting this principle, as well as the new contractual duty of honest performance, may yet alter the course of future contractual relationships.