Bhasin V. Hrynew and the Developing Duty of Good Faith

The Supreme Court of Canada’s decision in *Bhasin v. Hrynew* held that good faith contractual performance is a general organizing principle of Canadian common law, and that parties to a contract are under a duty to act honestly in the performance of their contractual obligations. In this article, Cynthia Spry, Julia Webster and Morgan Westgate analyze *Bhasin*’s application to implied terms and to the insurance and franchise law context, and argue that Canadian appellate courts have adopted a narrow application of *Bhasin* as an “incremental change to the common law.”

Carter V Canada: Stare Decisis or a License to Disturb Settled Matters?

In *Carter v Canada*, the Supreme Court of Canada addressed the limits of the doctrine of *stare decisis*, deciding on two general exceptions: (i) when a new legal issue is raised, and (ii) when a change in the circumstances or evidence “fundamentally shifts the parameters of the debate.” In this article, Michel Shneer explores the impact of *Carter* as it relates to the principles of *stare decisis* and discusses the potential impact of the decision on commercial litigation, arguing that the necessary evidentiary threshold to establish the exceptions to *stare decisis* remains unclear.

Recent Developments in the Law of Guarantees

The legal and equitable rules regarding guarantees are complex. A large body of case law has developed out of frequent disputes between creditors seeking to bind sureties to the principals’ obligations and sureties devising new defences. In this article, Samuel L. Robinson reviews recent decisions and considers: (i) what a creditor needs to do to make a claim on a guarantee; (ii) how a surety can protect its rights when paying on a guarantee; and (iii) the current state of the law on the effect of a variation on the underlying obligation.
APPELLATE COURT TREATMENT OF BHASIN V. HRYNEW: THE DEVELOPING DUTY OF GOOD FAITH IN 2016

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In November 2014, the Supreme Court of Canada rendered its unanimous decision in Bhasin v. Hrynew (“Bhasin”) and considered for the first time whether parties owe a duty of good faith in contractual performance.¹ The Court held that good faith contractual performance is a general organizing principle of Canadian common law, and that parties to a contract are under a duty to act honestly in the performance of their contractual obligations.

Bhasin has been cited in over 100 cases in the past year and a half, including decisions from appellate level courts in Ontario, Alberta, British Columbia, Saskatchewan, Nova Scotia, Quebec and New Brunswick.² With the release of Bhasin, counsel across Canada now has Supreme Court jurisprudence to support the obligation of good faith contractual performance, instead of the less definitive appellate level decisions previously relied upon for the same.

This article provides a short overview of the SCC’s decision in Bhasin and outlines its interpretation and application by appellate courts across Canada over the past eighteen months. Specifically, it comments on the appellate courts’ narrow application of Bhasin, the application of Bhasin in the insurance and franchise law context, and Bhasin’s application to implied terms.

BHASIN V. HRYNEW: AN OVERVIEW

The primary issue in Bhasin was whether the respondents had breached a duty to perform honestly in exercising a non-renewal clause in a dealership agreement. The appellant, Mr. Bhasin, was an enrollment director who sold education savings plans to investors on behalf of one of the respondents, Canadian American Financial Corp. (“Can-Am”). The 1998 contract between Mr. Bhasin and Can-Am was a commercial ‘dealership agreement’ and not a franchise agreement. The term of the contract was three years. The contract would automatically renew at the end of the three year term unless one of the parties gave six months’ written notice of termination.

Mr. Hrynew, the other respondent in this appeal, was also a Can-Am enrollment director, and was a direct competitor of the appellant. In the past, Mr. Hrynew had attempted to combine his business with that of Mr. Bhasin, but Mr. Bhasin refused. Mr. Hrynew had also actively encouraged Can-Am to force a merger.

Despite these circumstances, Can-Am appointed Mr. Hrynew as the Provincial Trading Officer responsible for reviewing its enrollment directors for compliance with securities laws. The role required Mr. Hrynew to conduct audits of Mr. Bhasin’s business, including his enrollment directors. Mr. Bhasin objected to having Mr. Hrynew, a competitor, review his confidential business records.

Can-Am gave Mr. Bhasin notice of non-renewal in May of 2001. At the expiry of the non-renewal period, Mr. Bhasin lost the full value of his business, and the majority of his sales agents were successfully solicited by Mr. Hrynew’s agency.

The Supreme Court of Canada allowed the appeal in part. The Court affirmed the trial judge’s ruling that Can-Am had breached its agreement with Mr. Bhasin, and assessed damages at $87,000. The Court found that a dealership agreement was not analogous to other recognized types of agreements that include a duty of good faith; however, there is a general duty requiring parties to be honest in the performance of their contractual obligations. Can-Am had repeatedly misled Mr. Bhasin about Mr. Hrynew’s appointment as the Provincial Trading Officer, and its proposed restructuring and merger of his business with that of Mr. Hrynew. 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.

Writing for a unanimous Court, Cromwell J. stated:

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

¹ 2014 SCC 71.
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…³

A NARROW RECEPTION BY CANADIAN APPELLATE COURTS

Generally speaking, Bhasin has been narrowly applied by Canadian appellate courts. All of the cases outlined below suggest that appellate courts have adopted Bhasin as an incremental change to the common law. ⁴ The decisions are consistent with the Supreme Court’s findings in Bhasin: the organizing principle of good faith does not fundamentally change Canadian contract law, but should only be used as a tool to develop the law where necessary.

In Bank of Montreal v. Javed,⁵ a company’s personal guarantors were sued by the bank after failing to respond to a demand for payment for an amount owing under a promissory note. The defendants filed a statement of defence and crossclaim that alleged, amongst other things, that the demand for payment under the guarantee was unconscionable.⁶ The bank brought a motion for summary judgment. The motion was granted and the defendants were ordered to pay the full amount outstanding under the promissory note.

On appeal to the Ontario Court of Appeal, the guarantor argued that the bank’s actions following the execution of the guarantee rendered the guarantee unconscionable, that there was unequal bargaining power that resulted in an unfair contract, and that pursuant to Bhasin, the Court should extend the doctrine of unconscionability to take into account a party’s performance under an agreement. The Court dismissed the appeal, as there was no evidence that the bank did not conduct itself honestly, and held that there was not “any basis for the appellants’ argument that the Supreme Court extended the common law test for unconscionability. Bhasin recognized a duty of honest performance.”⁷

In Jorgenson v. ASL Paving Ltd.,⁸ the Saskatchewan Court of Appeal also applied Bhasin narrowly, holding that there is no retroactive obligation to act in good faith in a pre-agreement period, and that Bhasin did not change the express terms of an agreement in the circumstances.

In Directcash ATM Management Partnership v. Maurice’s Gas & Convenience Inc.,⁹ the New Brunswick Court of Appeal held that the doctrine of good faith has been “expanded” by Bhasin, and that it now plays a small role in contractual interpretation by informing “the minimum standard of conduct parties are assumed to have intended”.

Although bad faith was not alleged, there was a “subtle overtone that permeates throughout” that allowed the court to consider the effect of the duty of good faith contractual performance on the right of first refusal that was at issue in the case.¹⁰

Accordingly, the trial judge erred in law when he applied a narrow or restrictive interpretation of a right of first refusal in contracts obligating Maurice’s Gas & Convenience to pay monthly maintenance, processing and transaction fees for ATM purchases. Although the Court took a more expansive reading of Bhasin in this case, it accords with the approach mandated by the Supreme Court of Canada in Sattva Capital Corp. v. Creston Moly Corp.:¹¹ contracts do not take place in a vacuum, and the Court must conduct an examination of the surrounding factual matrix when interpreting the terms of a contract. The principle of good faith and honest performance of contracts cannot be divorced from contractual interpretation as a whole.

IMPLIED TERMS AND BHASIN

Traditionally, courts will only imply terms where they are necessary to or provide business efficacy to a contract and do not change the substantive meaning of the parties’ bargain.¹² Bhasin has not altered this test. Appellate courts have consistently applied the Supreme Court’s finding in Bhasin that good faith performance of a contract does not provide a right to imply contractual terms, but instead is a “general doctrine of contract law that imposes as a contractual duty a minimum standard of honest contractual performance.”¹³

In Moulton Contracting Ltd. v. British Columbia,¹⁴ the province of British Columbia appealed an order finding it liable for breach of an implied contractual term and negligent misrepresentation in respect of the sale of timber licenses. The British Columbia Court of Appeal held that Bhasin does not authorize a court to imply contractual terms; rather, the decision clarifies that good faith is not an implied term, but an organizing principle that emphasizes the importance of acting in good faith in contractual dealings.¹⁵

The Court held that Bhasin provides a new approach to the role of good faith in contractual interpretation, but that the Plaintiffs were attempting to apply it too broadly. The Court did not find that there was an issue of honest contractual performance; instead, there was

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³ Bhasin, supra at para. 73.
⁴ We note that a number of the cases surveyed were tried and appealed prior to the release of Bhasin, but the appellate courts still considered it in rendering their decisions.
⁵ 2016 ONCA 49, leave to appeal to SCC refused [“Javed”].
⁶ The doctrine of unconscionability allows a party to void a contract that is unfair. See e.g. Teitelbaum v. Dyson (2000), 7 C.P.C. (5th) 356 (Ont. S.C.J.).
⁷ Javed, supra at para. 12.
⁸ 2015 SKCA 66.
⁹ 2015 NBCA 36.
¹⁰ Supra at para. 30.
¹¹ 2014 SCC 53.
¹² Energy Fundamentals, supra at paras. 30 to 35.
¹³ Bhasin, supra at para. 74.
¹⁴ 2015 BCCA 89.
¹⁵ Supra at paras. 61 to 79.
a question of whether the province had an obligation to disclose certain information and was liable for failing to do so.\textsuperscript{16}

In \textit{Energy Fundamental Group Inc. v. Veresen Inc.},\textsuperscript{17} the Ontario Court of Appeal upheld a lower court decision in which the court implied a term requiring disclosure of pricing information and referenced \textit{Bhasin}. The Court held that the trial judge had erred, because the lower court made a number of factual findings regarding necessity and business efficacy that justified the implied term. The Court of Appeal also affirmed that “good faith is a device for supplementing the terms of the contract to deal with aspects of the relationship that have not been specifically dealt with by the parties.”\textsuperscript{18}

In \textit{High Tower Home Corp. v. Stevens},\textsuperscript{19} the Ontario Court of Appeal considered its pre-\textit{Bhasin} decision in \textit{CivicLife.com Inc. v. Canada (Attorney General)}, in which it held that an entire agreement clause could not preclude an implied duty of good faith.\textsuperscript{20}

In \textit{High Tower}, the motion judge held that the vendor (Stevens) could avoid the sale of real property by relying on the failure by the purchaser (High Tower) to provide personal notice to the vendor of its waiver of conditions. Personal notice was required by the agreement. The notice to waive the conditions was faxed to the vendor’s solicitor, but not the vendor personally.

The purchaser argued that the duty of good faith compelled the Court to imply a term permitting notice by fax, and that such a term was necessary to give business efficacy to the contract. The Court of Appeal disagreed. The Court considered the statement in \textit{Bhasin} that parties cannot exclude the duty of good faith by an entire agreement clause, and held that, “seen in the light of \textit{Bhasin}, CivicLife is about the importance of acting in good faith in contractual dealings, and not about the general ability to imply terms – whatever their nature – notwithstanding an entire agreement clause.” The Court upheld the lower Court decision finding that the entire agreement clause barred the “notice by solicitor” provision and declined to imply such a term, because it would be inconsistent with the personal service required by the agreement.

\textbf{BHASIN IN THE CONTEXT OF FRANCHISE LAW}

Appellate courts have taken a cautious approach to \textit{Bhasin} in franchise law, where traditional protections are afforded to the franchisor/franchisee relationship by statute. Thus far, courts have either not applied \textit{Bhasin}, or have stopped short of considering its consequences.

For example, in \textit{2015 NSCA 104} \textit{the Ontario Inc. v. Pet Valu Canada Inc.},\textsuperscript{21} the Ontario Court of Appeal considered an appeal of a motion for summary judgment finding that Pet Valu breached section 3 of the \textit{Arthur Wishart Act}, and an appeal of the dismissal of a motion to amend a statement of claim. This was a franchisee class action concerning Pet Valu’s refusal to share volume rebates from suppliers with franchisees.\textsuperscript{22} Section 3 of the \textit{Act} concerns fair dealing: “[e]very franchise agreement imposes on each party a duty of fair dealing in its performance and enforcement.”

At first instance, the Court held that a franchisor’s duty under s. 3 of the \textit{Act} is broader than its common law duty, as that duty was articulated in \textit{Bhasin}. The Court of Appeal assumed, without deciding, that post-\textit{Bhasin}, non-disclosure by a franchisor in the course of the performance or enforcement of the franchise agreement can constitute a breach of s. 3 of the \textit{Act}. However, the “non-disclosure” in this case did not amount to such a breach.

Likewise, in \textit{Dunkin’ Brands Canada Ltd. v. Bertico Inc.},\textsuperscript{23} the Quebec Court of Appeal considered the breach of franchise agreements in the context of the Quebec Civil Code and \textit{Bhasin}. The Court excerpted the statement in \textit{Bhasin} that the obligation of good faith “does not displace the legitimate pursuit of economic self-interest,” but its decision did not turn on this consideration. Instead, the Court considered the duty of good faith outlined by the \textit{Quebec Civil Code}.\textsuperscript{24}

\textbf{BHASIN IN THE CONTEXT OF INSURANCE LAW}

In \textit{Industrial Alliance Insurance and Financial Services Inc. v. Brine},\textsuperscript{25} the Nova Scotia Court of Appeal considered the duty of good faith and fair dealing in the administration of insurance policies, specifically whether an insurance policy restricts an insurer’s “unfettered discretion” to provide or terminate rehabilitation services provided under a disability insurance contract.\textsuperscript{26}

The Court upheld the trial judge’s findings, holding that the insurer’s decision to terminate rehabilitation benefits was based on improper considerations. The Court applied \textit{Bhasin} and held that the decision helps to “understand the scope of the insurer’s implied duty” of good faith. The Court held that good faith is not an “executive summary” of a contract’s written terms, but an independent implied contractual obligation, a breach of which is not predicated on the condition that an explicit provision was breached. The court also indicated that a breach of the principles from \textit{Bhasin} may justify a punitive damages award (as in \textit{Whiten v. Pilot Insurance Co.}).\textsuperscript{27}

\textsuperscript{16} Supra at para. 76.
\textsuperscript{17} 2015 ONCA 514.
\textsuperscript{19} 2014 ONCA 911.
\textsuperscript{20} 215 O.A.C. 43.
\textsuperscript{21} 2016 ONCA 24.
\textsuperscript{22} S.O. 2000, C. 3.
\textsuperscript{23} 2015 QCCA 624.
\textsuperscript{24} \textit{Civil Code of Quebec}, art 1375 C.C.Q. and art 1434 C.C.Q.
\textsuperscript{25} 2015 NSCA 104.
\textsuperscript{26} Supra at para. 97.
\textsuperscript{27} 2002 SCC 18.
CONCLUSION

Although the Supreme Court in Bhasin did not find an expansive general duty of good faith, it created an incremental change, by finding a general duty of honest contractual performance. Despite the excitement Bhasin incited, evidenced by the volume of cases citing the decision after its release, appellate courts have narrowly construed the duty of honest contractual performance.

Appellate courts have affirmed that parties still have a right to rely on the express terms of their agreements and to be held to their contractual bargains. Courts will, however, use Bhasin to ensure honest and fair dealing in the performance of their mutually agreed upon obligations. It remains to be seen whether the application of Bhasin will be expanded, as appeal courts are faced with more cases arguing the duty of good faith contractual performance as opposed to, or in addition to, for example, breach of implied terms. In any event, the treatment of Bhasin thus far indicates that companies will not be able to draft their way out an obligation to act in good faith and fairly in the performance of their obligations under contract.
STARE DECISIS OR A LICENSE TO DISTURB SETTLED MATTERS? THE IMPACT OF THE DECISION IN CARTER V CANADA ON COMMERCIAL LITIGATION

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When can judges decide that established rules from previous decisions no longer apply? This was one of the central issues in Carter v Canada, where the Supreme Court of Canada addressed the limits of the doctrine of stare decisis in the context of changing norms of society.

In common law jurisdictions, judges must follow the principle of stare decisis. The principle, whose literal translation means “to stand by decided matters”, requires that judges follow previous rulings (i.e. precedents) of the Supreme Court and of the appellate courts in their jurisdiction, if those precedents address the same issue and contain similar facts.

Yet, in Carter, the Supreme Court found that a trial judge was justified in her deviation from the previous Supreme Court ruling on the same issue. The Supreme Court in Carter did so on the basis that there are two general exceptions to stare decisis: (i) when a new legal issue is raised, and (ii) when a change in the circumstances or evidence “fundamentally shifts the parameters of the debate.”

Litigants have always been entitled to argue that the facts of the case before them are distinguishable in an attempt to justify that a precedent does not apply in the circumstances.

With Carter, the Supreme Court appears to have created a new tool for litigants to argue that lower courts may depart from precedent.

THE DECISION IN CARTER V CANADA

The key issue before the Supreme Court in Carter was whether subsection 241(b) and section 14 of the Criminal Code, which prohibit physician-assisted death, violated sections 7 and/or 15 of the Canadian Charter of Rights and Freedoms in a manner inconsistent with principles of fundamental justice. In 2011, Lee Carter and Gloria Taylor brought a challenge to subsection 241(b) of the Criminal Code.

This issue (i.e., whether subsection 241(b) violated sections 7/15 of the Charter) had already been decided by the Supreme Court in 1993 in Rodriguez v British Columbia, where the Supreme Court upheld the ban on physician-assisted suicide by finding that the legislation did not violate section 7 of the Charter, and that any infringement on section 15 would be justified by section 1.

At first instance in Carter, Smith J. of the British Columbia Supreme Court overruled the precedent established in Rodriguez. She justified her departure from precedent in Rodriguez for three reasons: (1) the majority in Rodriguez failed to specifically address the right to life under section 7 while simply assuming a violation of section 15; (2) significant changes in the law with respect to the Charter had occurred, including a substantive change to the section 1 analysis as well as the introduction of the principles of gross disproportionateness and overbreadth; and, (3) there had been significant changes in legislative and social norms since Rodriguez. She found that the combination of the aforementioned circumstances and the changes in Charter jurisprudence warranted a reconsideration of the constitutionality of physician-assisted death.

The British Court of Appeal overturned the trial decision. The majority opinion by Newbury J.A. found that, although Charter jurisprudence had evolved since Rodriguez, there had been no change sufficient to undermine the binding authority of Rodriguez. According to the majority, Smith J.’s determination that section 1 had been dealt with “only very summarily” in Rodriguez was not the proper inquiry: “the focus for purposes of stare decisis should be on what was decided, not how it was decided or how the result was described.”

On appeal, the Supreme Court restored Smith J.’s ruling by declaring the Criminal Code provisions invalid for adult persons who: (1) clearly consent to the termination of life; and, (2) have a grievous and irremediable medical condition that causes intolerable suffering. The Supreme Court found that the criminal prohibition violated section 7 of the Charter since it forced some individuals to take their own lives prematurely, for fear that they would be incapable of doing so when they reached the point of intolerable suffering. The Supreme Court found that the prohibition was not saved by section 1 because it did not minimally impair one’s right to life, liberty and security of the person since a less restrictive regime could achieve the same objective.

While the Supreme Court’s decision in Carter will undoubtedly have an impact on future Charter cases – the focus here is on the impact of Carter as it relates to the principles of stare decisis.

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1 2015 SCC 5 (“Carter”).
3 Carter, supra note 1 at para 44, citing Bedford v Canada (Attorney General), 2013 SCC 72 at para 42.
5 [1993] 3 SCR 519 [Rodriguez].
6 Carter v Canada (Attorney General), 2012 BCSC 886 at paras 913 and 921 [Carter BCSC].
7 Ibid at paras 974-76 and 994.
8 Carter, supra note 1 at para 28: summarizing the decision of the trial judge.
9 Carter CA, supra note 2 at para 246.
10 Carter CA at para 321.
11 Carter, supra note 1 at para 4.
12 Ibid at para 57. The Court did not consider section 15 of the Charter since it decided that the prohibition on physician-assisted suicide violated section 7.
13 Ibid at para 29.
THE IMPACT OF CARTER ON THE PRINCIPLE OF STARE DECISIS

Based on a strict interpretation of the principle of *stare decisis*, the *Rodriguez* decision should have bound any future decision of a lower court regarding the constitutionality of physician-assisted dying.

Indeed, the Attorney Generals of Canada and Ontario took the position in *Carter* that the trial judge was not at liberty to deviate from *Rodriguez*, and was therefore bound to uphold the *Criminal Code* prohibition. This strict interpretation of *stare decisis* is grounded in the need for predictability, stability and consistency in law.

The Supreme Court in *Carter* approached the question of *stare decisis* differently. The Supreme Court justified its approach by stating the following:

> The doctrine that lower courts must follow the decisions of higher courts is fundamental to our legal system. It provides certainty while permitting the orderly development of the law in incremental steps. However, *stare decisis* is not a straitjacket that condemns the law to stasis.

In order to provide guidance to lower courts in applying this more flexible approach, the Supreme Court listed two situations in which lower courts may reconsider settled rulings:

(i) where a new legal issue is raised; and,
(ii) where there is a change in the circumstances or evidence that fundamentally shifts the parameters of the debate.

The Supreme Court found that both of the above conditions were met in *Carter*; therefore, Smith J. was entitled to consider the different “matrix of legislative and social facts” that was not present in the evidence before the Supreme Court in *Rodriguez*.

A MORE FLEXIBLE APPROACH TO STARE DECISIS IN OTHER RECENT SUPREME COURT CASES

Prior to *Carter SCC*, the Supreme Court articulated the test for overturning its own precedent in *Bedford v Canada (Attorney General)*. The issue in *Bedford* was the constitutionality of sections 197, 210 and 213 of the *Criminal Code*, which prohibited bawdy-houses, living off the avails of sex work, and soliciting for the purpose of sex work. The Supreme Court had previously upheld the constitutionality of the aforementioned provisions in the *Reference re ss. 193 & 195.1(1)(c) of the Criminal Code (Canada)*.

In a departure from its own precedent established in the *Prostitution Reference*, the Supreme Court found that a trial judge can decide arguments that were not raised previously and may revisit matters when:

new legal issues are raised as a consequence of significant developments in the law, or if there is a change in the circumstances or evidence that fundamentally shifts the parameters of the debate.

The Supreme Court in *Carter* relied on this language from *Bedford*, notwithstanding that, in *Bedford*, the issue of *stare decisis* arose in the context of an advisory opinion, not a binding decision.

Aside from *Carter*, recent jurisprudence from the Supreme Court also reveals a more flexible approach to *stare decisis*.

In *Saskatchewan Federation of Labour v Saskatchewan*, which was released one week prior to *Carter SCC*, the Supreme Court again used the “significant developments in the law” criterion set out in *Bedford* to find that the trial judge was entitled to depart from precedent. As a result, the Supreme Court effectively ruled that subsection 2(d) of the *Charter* included a positive right to strike, expanding its scope.

The exceptions to *stare decisis* developed in *Bedford, Saskatchewan* and *Carter SCC* recognize the reality of our common law system as one that is continually evolving as lower courts apply existing law to new facts and evidence.

SUBSEQUENT APPLICATION OF CARTER

Some of the initial reactions to *Carter, Bedford* and to a lesser extent, *Saskatchewan*, include criticism from commentators on the “shockingly standardless approach to precedent,” which may lead to increased judicial activism from the Court.

However, an examination of the case law citing recent Supreme Court cases reveals that, in applying these decisions, the approach taken by the lower courts has been to follow precedent. Many of the recent cases that cite *Carter* or *Bedford* have declined to overturn precedent.

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14 Ibid at para 44.
15 Ibid.
16 Ibid at para 47.
17 2013 SCC 72 [*Bedford*].
18 [1990] 1 SCR 1123 [*Prostitution Reference*].
19 *Bedford SCC*, supra note 17 at para 42.
20 2015 SCC 4 [*Saskatchewan*]
21 Ibid at para 32.
For example, in *Canada v. Caswell*, the Alberta Court of Appeal considered whether to grant leave to appeal to, among other things, have one of its prior decisions reconsidered: *Canada v. Mitchell (Mitchell)*. In *Mitchell*, the Court had found that an individual’s section 10(b) Charter right to counsel was suspended during an investigative detention for impaired driving.

In refusing leave to have *Mitchell* reconsidered, the Court in *Caswell* found there were no significant developments in the law or changes of circumstances or evidence that fundamentally shifted the parameters of the debate. Further, the Court emphasized the public interest aspect of *stare decisis* by stating: “[t]he public interest is not served by upsetting the balance whenever it is asserted ‘it’s different now’.”

However, a recent case in the Federal Court relied on *Carter* to overturn existing case law on judicial review of permanent residency applications based on spousal sponsorship. In *Huang v Canada (Minister of Citizenship and Immigration)*, Boswell J relied on *Carter* to overturn the precedent established in *Dasent v Canada (Minister of Citizenship and Immigration)* on the duty of fairness owed by the immigration officer in spousal sponsorship application interviews. In doing so, Boswell J adopted the *Carter* test by stating: “I am satisfied that significant developments in the law of procedural fairness have implicitly overruled *Dasent*.”

In so finding, the Court emphasized the dissonance in the case law that addressed the duty of procedural fairness generally, and the case law that addressed the duty of fairness owed in spousal sponsorship interviews specifically. In other words, the Court characterized the effect of its departure from precedent as one of stabilization that is normally associated with *stare decisis*.

The Courts have also noted that evidence plays an important role in persuading a court to overturn precedent. In *Canada v. Wagner*, the Ontario Court of Justice denied a Charter challenge to section 223 of the *Criminal Code* on abortions, stating that the evidence presented fell “far, far short of ‘fundamentally shifting the parameters of the debate’.” Similarly, in *Council of Canadians v Canada (Attorney General)*, the Ontario Superior Court of Justice declined to depart from the precedent of refusing interlocutory injunction to suspend a duly enacted legislation (in this case, subsection 46(3) of the *Fair Elections Act*). The Court ruled that the applicants did not meet the evidentiary burden of the *Carter* test: 

“[I]t is difficult to say that the evidence has fundamentally shifted the parameters of any debate when the evidentiary foundation [the Federal Election of 2015] for the applicants’ challenge is not developed.”

**THE POTENTIAL IMPACT OF THE SUPREME COURT DECISIONS IN THE COMMERCIAL CONTEXT**

As of August 2016, the *Carter* decision appears to have only been cited in one commercial case in which the Court ultimately found that the threshold in *Carter* to not follow the decision of a higher court had not been met.

Commercial litigants could take advantage of the Court’s statement that “*stare decisis* is not a straitjacket” to advance arguments that are inconsistent with existing precedent. The evidentiary burden required to show a fundamental change in circumstances should serve to moderate the prospect of a drastic change in the law, absent expert evidence that convinces the court of the fundamental nature of such change. This may in turn introduce further opportunity for expert input in commercial cases (i.e., economics, finance, technology, intellectual property, etc.).

**CONCLUSION**

The *Carter* decision acknowledges the balancing act between the need for predictability in the law and the recognition that precedent will change if enough contextual change has occurred.

Given how recent the *Carter* decision is, the boundaries of the exceptions to *stare decisis* remain to be clarified by the lower courts. Recent case law such as *Huang* have demonstrated the broader applicability of the *Carter* exceptions outside the context of challenging legislation. Future decisions will need to answer some of the pressing questions, such as the necessary evidentiary threshold for establishing a change that is sufficient to truly shift the parameters of a debate.

It remains unclear how lower courts will apply the exceptions to *stare decisis* in a commercial context.

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24 2015 ABCA 97 [Caswell].
26 *Caswell*, supra note 24 at para 34; citing *Bedford*, supra note 17 SCC at para 42.
27 *Caswell*, supra note 24 at para 38.
28 2015 FC 2015 [Huang].
30 *Huang*, supra note 34 at para 11.
32 2015 ONCI 66 [Wagner].
33 Ibid at para 76.
34 2015 ONSC 4940.
36 Ballantrae Holdings Inc v “Phoenix Sun” (The), 2016 FC570.
Guarantees are curious things. They are contracts in which the surety’s consideration is normally that the creditor agrees to contract with a third party. It is assumed that, given their relationship, the surety wants the creditor to contract with this third party on the terms proposed. Often, this is true, but the law mandates no actual inquiry before the surety is bound. Because of this, the law has traditionally been rather protective of sureties. Numerous legal and equitable rules have been developed to protect them from the potentially onerous liability that a guarantee may entail. These rules, however, cannot change the fact that guarantees are contracts. Sureties and creditors may agree to dispense with most of the protections that the courts have devised. The result has been an arms race in which creditors (through their counsel) devise increasing broad contractual language in an attempt to bind sureties to the principal’s obligations, while sureties’ defence lawyers work equally hard to find new defences.

This article considers three aspects of law of guarantees, with reference to three recent appellate decisions. It considers: (i) what a creditor needs to do to make a claim on a guarantee, (ii) how a surety can protect its rights when paying on a guarantee, and (iii) the current state of the law on the effect of a variation to the underlying obligation. Before considering these topics, however, we pause to review what guarantees are.

FORMALITIES – WHAT GUARANTEES ARE

A guarantee is a promise by one person (the “surety”) that a second person (the “principal”) will fulfil his or her obligations to a third person (the “creditor”). Usually, and especially in the banking context, the underlying obligation is a loan. If the principal defaults on the loan, then the surety must pay it – subject to the terms of the guarantee.

Guarantees are a species of contract, subject to the general law of contract. This includes the law of contractual interpretation, the parol evidence rule and, of course, the requirement for consideration.

The type of consideration given for a guarantee is particularly important. As noted in the introduction, many sureties provide the guarantee in order to obtain a benefit for the principal. Often, these sureties are husbands or wives guaranteeing their spouse’s business, or parents guaranteeing their child’s venture. For such sureties, who are referred to as “accommodation sureties,” the actual benefit is really rather ephemeral, and frequently in hindsight often quite disproportionate to the surety’s liability. For this reason, the law can be quite protective of accommodation sureties.

There are also sureties who are in the business of providing guarantees for profit. Such sureties have been referred to as “professional sureties.” They have found themselves held to a higher standard at law.

Regardless of the type of surety, it is a requirement of the Statute of Frauds that the guarantee “or some memorandum or note thereof” be in writing and be signed by the surety. The absence of a written guarantee will normally be fatal to any attempt by the creditor to enforce the guarantee. However, equity has prevailed over the statute of frauds in at least one case. In Hatch Associates Ltd. v. Dual Removal Systems Ltd., the court held that a surety may be estopped, in extraordinary circumstances, from relying on the Statute of Frauds to invalidate a guarantee where the surety has deliberately failed to sign a guarantee despite undertaking to do so.

Apart from the requirements of the Statute of Frauds, most provinces have not imposed any other statutory formalities on the making of guarantees. Counsel should be aware, however, that additional formalities do exist in Alberta (pursuant to the Guarantees Acknowledgement Act) and Saskatchewan (pursuant to the Saskatchewan Farm Security Act). The former is uniquely burdensome, and dangerous to the unwary. The Guarantees Acknowledgement Act requires that a prospective surety acknowledge his or her obligation under guarantee before a lawyer, who must then confirm the acknowledgement by endorsement on the guarantee agreement. The failure to obtain the acknowledgement will render a guarantee unenforceable.

MAKING A CLAIM ON A GUARANTEE

Since a guarantee is a form of contract, the normal rules of contractual interpretation apply: the intentions of the parties as to the obligations of the surety are to be found in the language of the guarantee itself. In many cases, a guarantee will set out a procedure to be followed when a claim is made - such as a requirement that the creditor make a demand for payment to the principal, or give a notice of default to the surety prior to enforcing a claim. If contained in the guarantee, such a requirement may be found to be a condition precedent to a claim by the creditor under the guarantee.

The recent decision of the BC Court of Appeal in 0867740 BC Limited v. Quails View Farm is instructive. In that case, the

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1 R.S.O. 1990, c. S-19, s. 4 and 5
2 See, for example, Entry Point Investments v. Invis Inc., 2015 ONCA 701 at paragraph 10
3 1998 CanLII 4840 (ONCA)
4 R.S.A. 2000, c. G-11
5 S.Sask. 1988-89, c. S-17.1
6 Whitby Landmark Development Inc. v. Mollenhauer Construction Ltd., 2003 CanLII 50085 (ONCA) at paragraph 16
7 2014 BCCA 252
The plaintiff had contracted to build a trailer park for the corporate defendant, whose obligation to pay the plaintiff was guaranteed by the individual defendants.

After default by the corporate defendant, the plaintiff sued the sureties without making a separate prior demand for payment. The guarantee was payable on demand. The sureties defended on the basis that no demand had been given. The plaintiff argued that their pleading itself was the demand.

The BC Court of Appeal held that in the absence of a formal demand to the sureties, the claim against them was premature. In coming to this conclusion, the Court noted that the defendants were accommodation sureties who are entitled to the strict benefit of the protections available to them. As the court noted, at paragraph 61:

The personal appellants concede that their position is very technical. That does not make it less valid. … it cannot be assumed that if a demand had been made prior to action being commenced no defences would have been open to the personal appellants.

The decision of the BC Court is consistent with the law in Ontario. In Bank of Nova Scotia v. Williamson, the Ontario Court of Appeal held (at para 13):

Where the obligation of a third-party guarantor is to pay on demand, then demand is a condition precedent to that obligation. The rationale is that where the guarantee obligation is made on demand, the third-party guarantor is given an opportunity to marshal the funds before the obligation is due.

The failure to make a demand to an accommodation surety will normally be fatal to the enforceability of a guarantee that is payable on demand. The situation is different, however, for professional sureties.

In Citadel Insurance v. Johns-Manville Canada, the Supreme Court of Canada has held that professional sureties are not entitled to the strict protections that are afforded to accommodation sureties. A failure to give demand, or to observe other conditions of the guarantee, will only defeat a claim against a professional surety if the latter has suffered actual prejudice as a consequence. Justice McIntyre wrote, for the court (at p. 524):

It is my view, however, that the rules which have been applied to accommodation sureties are in many ways unrealistic and inappropriate to cases where professional sureties, in the course of their ordinary business, undertake surety contracts for profit and thereby approach very closely the role of the insurer. The basis of the surety’s

liability must, of course, be found in the bond into which it has entered, but in the case of the compensated surety it cannot be every variation in the guaranteed contract, however minor, or every failure of a claimant to meet the conditions imposed by the bond, however trivial, which will enable the surety to escape liability. Where, as here, the object of the notice provisions in the bond has been fully achieved within the time limits imposed and where there has been no prejudice whatever to the appellant, the whole purpose for the obtaining of the bond would be defeated if the appellant were to be discharged.

If the creditor does seek to realize against the principal’s assets, it must do so in a commercially reasonable manner. This obligation too may be waived by agreement between the creditor and the surety. Even where this obligation exists, however, it does not apply to the lender’s decision whether or not to enforce its contractual rights in the first place. Thus a surety has no right to challenge a creditor’s decision to force a receivership rather than to permit an insolvent principal to be sold as a going concern.

In the absence of a contractual requirement, however, there is no obligation on the part of the creditor to bring an action or to seek to collect from the principal before making a claim against the surety. Nor is the surety entitled, as a matter of law, to be notified of the principal’s default before a claim is made against the surety. An action to enforce the guarantee may also be brought separately from any action to enforce the principal debt (if indeed such an action is even brought). Actions on guarantees are frequently resolved on motion for summary judgment, and the new rules in Ontario have only increased this trend.

SURETY’S RIGHTS WHEN PAYING A CLAIM

The Mercantile Law Amendment Act provides that, on payment of a claim, a surety becomes subrogated to the rights of the creditor as against the debtor and any co-sureties. As a general rule, this means that a surety who honours a guarantee may seek contribution against any defaulting co-sureties. There are, however, important limits to this right.

Can-Win Leasing (Toronto) Limited v. Moncayo was a case in which the Ontario Court of Appeal refused to permit a surety to recover against his co-surety, because the court said payment of the debt had been premature.

In that case, the two co-sureties had guaranteed the debts of their jointly-owned truck company. In addition to the guarantees, these debts were also secured against certain real estate. One of the co-sureties became concerned about the possibility that the bank may try to realize on the security against the real estate, which he did not want to risk happening. So he decided to pay out the loan

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8 2009 ONCA 754
9 [1983] 1 S.C.R. 513
12 Global Food Traders Inc. v. Massalin, 2015 ONCA 362
13 McGuinness, Kevin; The Law of Guarantee, 3d ed. (LexisNexis, Markham: 2013)
14 Mercantile Law Amendment Act, R.S.O. 1990, c. M-10, s. 2(2)
15 2014 ONCA 689
himself. He then turned to his co-surety and demanded to be reimbursed for the latter’s share.

The court observed that a guarantee is a secondary and contingent liability. It is secondary to the primary obligation of the principal. It is contingent on a default by the principal. At its earliest, therefore, liability under a guarantee may only arise once there has been a default by the principal (and if it is a demand guarantee, after a demand has been made).

In this case, the principal was not in default. The result was that the co-surety who paid the loan was held to be an officious volunteer. Although he had paid the loan, he had no right to seek contribution from the co-surety.

On a practical level, this result makes intuitive sense: if a co-surety were able to subrogate itself at will to the rights of the creditor, and by doing so to force the other co-sureties and the principal to pay the debt, the co-surety would in effect have the right to accelerate the loan. This would mean that a co-surety could create liabilities for the others than would be more onerous (in the sense of being more immediate) than the liabilities under the primary obligation. The principal would be exposed to a liability it might otherwise be able to avoid.

A co-surety must therefore be very careful not to act prematurely. He or she must wait until the liability under the guarantee has crystallized.

The court did admit of one limited exception to this rule: where the failure of the principal is inevitable, a surety may pay out on a guarantee to “stop the bleeding” if doing so will not disadvantage the co-sureties. The onus of proving this, however, lies on the co-surety who pays out the loan.

Where the right to contribution does arise, it is limited to contribution by the co-surety of that proportion of the total debt for which it “is justly liable.” The proportion of just contribution may be set by agreement between the co-sureties. In the default, each will bear an equal contribution.

SURETY’S DEFENCE: VARIATION OF THE UNDERLYING OBLIGATION

The most frequently raised defence to a claim to enforce a guarantee is that the underlying obligation has been impermissibly varied without the consent of the surety. This defence arises from the rule first articulated by Lord Coton in the old case of Holme v. Brunskill that the surety must consent to any variation to the obligation that he or she has guaranteed:17

The true rule in my opinion is, that if there is any agreement between the principals with reference to the contract guaranteed, the surety ought to be consulted, and that if he has not consented to the alteration, although in cases where it is without inquiry evident that the alteration is unsubstantial, or that it cannot be otherwise than beneficial to the surety, the surety may not be discharged; yet, if it if not self-evident that the alteration is unsubstantial, or one which cannot be prejudicial to the surety, the Court...will hold that in such a case the surety himself must be the sole judge whether or not he will consent to remain liable notwithstanding the alteration, and if he has not so consented he will be discharged.

The rule in Holme v. Brunskill was adopted by the Supreme Court of Canada in Manulife Bank of Canada v. Conlin.18 In that case, the Court held that a change in the terms of a loan or obligation, or the renewal of a loan, will release the surety unless clear language permits the alteration of the loan without the surety’s consent.

Most recently, in Turfpro Investments Inc. v. Heinrichs,19 the Ontario Court of Appeal summarized and restated the law regarding the effect on a guarantee of a variation to the underlying obligation. The rule, which is predicated on fairness to the surety, is that the latter will be discharged upon a variation of the underlying obligation unless one of the following four exceptions applies:20 (i) that the alteration is “plainly unsubstantial”; (ii) that the alteration is “necessarily beneficial” to the surety; (iii) that the surety has contracted out of the protection of the rule; or (iv) that the surety has consented to the alteration.

The application of this defence can be seen in two recent decisions of the Ontario Court of Appeal. In GMAC Leaseco Corporation v. Jaroszynski,21 the Court released a surety from liability on a vehicle lease because the lease had been extended without his knowledge or consent. In Royal Bank of Canada v. Samson Management & Solutions Ltd.,22 the Court enforced a “continuing guarantee” despite the fact that the underlying debt had been increased, because the surety was found to have contracted out of the protection of their rule.23

POSTSCRIPT

As with any contract, the parties are best served by clear drafting that sets out each side’s obligations. In the area of guarantees, however, the constant skirmishing between creditors and sureties leads to a substantial volume of case law. Counsel and parties are well advised, therefore, to keep up to date.

16 Mercantile Law Amendment Act, R.S.O. 1990, c. M-10, s. 2(3)
17 (1878), 3 Q.B. 495 (C.A.) at pages 505-506
18 [1996] 3 S.C.R. 415
19 2014 ONCA 502
20 ibid, at paragraphs 15 to 19
21 2013 ONCA 765
22 2013 ONCA 313
23 In this case, the surety had signed a “continuing all accounts guarantee.”