

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.

² *Maxam Opportunities Fund Limited Partnership v. 729171 Alberta Inc.*, 2016 BCCA 53; *Bank of Montreal v. Javed*, 2016 ONCA 49; *1250264 Ontario Inc. v. Pet Valu Canada Inc.*, 2016 ONCA 24; *Stewart Estate v. 1088294 Alberta Ltd.*, 2014 ABCA 375; *Industrial Alliance Insurance and Financial Services Inc. v. Brine*, 2015 NSCA 104; *Dunkin’ Brands Canada Ltd. v. Bertico Inc.*, 2015 QCCA 624; *Moulton Contracting Ltd. v. British Columbia*, 2015 BCCA 89; *Scott & Associates Engineering Ltd. v. Finavera Renewables Inc.*, 2015 ABCA 51; *Alim Holdings Ltd. v. Tom Howe Holdings Ltd.*, 2016 BCCA 84; *Hole v. Hole*, 2015 ABCA 34; *Canacrod Genuity Corp v. Pilot*, 2015 ONCA

716; *Water’s Edge Resort Ltd. v. Canada (AG)*, 2015 BCCA 319; *AMEC Americas Ltd. v. HB Construction Co.*, 2015 CarswellNB 316 (C.A.) (WL Can); *Directcash ATM Management Partnership v. Maurice’s Gas & Convenience Inc.*, 2015 NBCA 36; *Jorgenson v. ASL Paving Ltd.*, 2015 SKCA 66; *Siskinds LLP v. Canadian Imperial Bank of Commerce*, 2015 ONCA 265; *Brule v. Rutledge*, 2015 BCCA 25; *High Tower Homes Corp. v. Stevens*, 2014 ONCA 911; *Gnys v. Narbutt*, 2016 ONSC 2594; *Energy Fundamentals Group Inc. v. Versen Inc.*, 2015 ONCA 514; and *Utility Advocates Inc. v. 1333375 Ontario Ltd.*, 2015 ONSC 666.



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

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.¹⁶

In *Energy Fundamental Group Inc. v. Veresen Inc.*,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 *Bhasin*. The Court held that the trial judge had not 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.”¹⁸

In *High Tower Home Corp. v. Stevens*,¹⁹ the Ontario Court of Appeal considered its pre-*Bhasin* decision in *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.²⁰

In *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 *Bhasin* that parties cannot exclude the duty of good faith by an entire agreement clause, and held that, “seen in the light of *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.

BHASIN IN THE CONTEXT OF FRANCHISE LAW

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

¹⁶ *Supra* at para. 76.

¹⁷ 2015 ONCA 514.

¹⁸ *Supra* at para. 49, citing Swan & Adamski, *Canadian Contract Law*, 3rd ed. (Markham: LexisNexis, 2012) at para.8, p.113.

¹⁹ 2014 ONCA 911.

²⁰ 215 O.A.C. 43.

²¹ 2016 ONCA 24.

For example, in *1250264 Ontario Inc. v. Pet Valu Canada Inc.*,²¹ the Ontario Court of Appeal considered an appeal of a motion for summary judgment finding that Pet Valu breached section 3 of the *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.²² Section 3 of the *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 *Act* is broader than its common law duty, as that duty was articulated in *Bhasin*. The Court of Appeal assumed, without deciding, that post-*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 *Act*. However, the “non-disclosure” in this case did not amount to such a breach.

Likewise, in *Dunkin’ Brands Canada Ltd. v. Bertico Inc.*,²³ the Quebec Court of Appeal considered the breach of franchise agreements in the context of the Quebec Civil Code and *Bhasin*. The Court excerpted the statement in *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 *Quebec Civil Code*.²⁴

BHASIN IN THE CONTEXT OF INSURANCE LAW

In *Industrial Alliance Insurance and Financial Services Inc. v. Brine*,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.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 *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 *Bhasin* may justify a punitive damages award (as in *Whiten v. Pilot Insurance Co.*).²⁷

²² S.O. 2000, C. 3.

²³ 2015 QCCA 624.

²⁴ *Civil Code of Quebec*, art 1375 C.C.Q. and art 1434 C.C.Q.

²⁵ 2015 NSCA 104.

²⁶ *Supra* at para. 97.

²⁷ 2002 SCC 18.

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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.