

Commercial Litigation

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New Standard of Honesty in Contractual Performance

Contract law doesn't change very often and it's for this reason the Supreme Court of Canada's recent decision in *Bhasin v. Hrynew* is so newsworthy. In a first of its kind, landmark decision, Canada's highest court has recognized what it's called a new **general duty of honesty in contractual performance**.

While ground-breaking and previously unknown to Canadian law, the decision brings contract law in this country in-line with other jurisdictions, including the United States, by explicitly recognizing that all contracts are subject to a minimum standard of honest performance.

Despite being a significant development in Canadian contract law, our Supreme Court has played down the potential impact of its ruling on the business community and on contractual performance more generally, but those who are unaware of this important change risk needlessly exposing themselves to liability where previously no such risk existed.

No Longer Just an Issue of Reputation

Commercial parties recognize that the manner in which contracts are performed can impact relationships with their customers, suppliers and other business partners. There are undoubtedly reputational risks to poor performance or execution of a contractual obligation. Those who live up to their contracts and exceed client or customer expectations are better positioned to succeed over those who do not. The rewards are obvious and include repeat business, referrals and other reputation enhancing plaudits. Often there is a direct correlation between honest and diligent performance of a contract and commercial success.

Until the *Bhasin* decision, however, the risks associated with dishonest performance of a contract were limited to reputational damage. Simply put, before *Bhasin* there was no ability to sue for bad faith performance of a contract.

After *Bhasin*, however, how and why contractual obligations and duties are performed can result in a lawsuit for damages. Those who perform contracts dishonestly or deceive their contracting partners in carrying out their contractual obligations risk more than their reputations, indeed they now risk being held liable for this conduct.

The Decision

The *Bashin* case, the first of its kind, demonstrates how and in what circumstances liability for bad faith breach of contract can arise. The Plaintiff in that case, Bhasin, was in a

contractual relationship with Can-Am, a company who marketed education saving plans to investors through a chain of dealers called "enrolment directors". Bhasin was an enrolment director who slowly built up a thriving business selling Can-Am's products to the investing public.

As an enrolment director, Bhasin was in competition with other "enrolment directors" who were also under contract to sell Can-Am's savings plans. One such competitor, Hrynew, had tried for some time to acquire Bhasin's business through various means, including directly approaching him to merge his business with his own.

When his direct advances failed, Hrynew pressured Can-Am not to renew its agreement with Bashin in the hope of acquiring the business for himself. Can-Am gave in to this pressure and declined to renew Bashin's contract forcing a *de facto* hostile "merger" of Bhasin's agency with Hrynew's. When his contract with Can-Am lapsed, Bashin lost the value of the business which he had built for the better part of a decade.

Not renewing its contract with Bashin was something contemplated by the four corners of Can-Am's contract and allowing this to happen was not something which, as a technical matter, could give rise to damages. There was no breach of contract as the concept had been previously understood. Where Can-Am went wrong, however, and what it was ultimately found liable for, was its failure to be truthful with Bashin about the circumstances surrounding its decision to terminate his contract. In the Supreme Court's words, Can-Am's failure to be honest with Bashin about its contractual performance, and in particular with respect to its settled intentions not to renew the agreement, was a breach of contract. But for Can-Am's dishonesty surrounding the reasons for ending the agreement, the Court reasoned, Bashin could have taken steps to retain the value of his agency.

What are the Implications of this Decision?

The new duty of honest performance doesn't prohibit making commercially self-interested decisions surrounding contractual performance. To the contrary, the Supreme Court was clear that intentionally causing loss to another contracting

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party is not contrary to good faith on its own. Rather, the Court has said this kind of behaviour has been encouraged at times because it may be economically efficient and on this basis socially desirable. What is prohibited, however, and a civil wrong, is the undermining of the legitimate contractual interests of the contracting partner in *bad faith*.

The principles in the *Bashin* decision don't require a party to a contract to subordinate their interests to those of the other contracting party and they don't impose a duty of loyalty or duty of disclosure. They simply require the parties to a contract not to lie or mislead one another about their contractual performance. It's now a civil wrong to actively mislead or deceive another contracting party about matters directly and intimately connected to their performance of that

contract. Where this type of conduct deprives a party of a fair opportunity to protect their interests and avoid a loss, offending parties could be on the hook for those losses even where they otherwise complied with the terms of the contract.

Many people in the business community will hail this development as long overdue and a rational expansion of the law to check undesirable behaviour. Others may view this as an unnecessary intrusion on freedom of contract which could result, in the words of the Supreme Court, in *ad hoc* judicial moralism or "palm tree" justice. Regardless, this new duty of honest contractual performance is now the law in Canada and must be reckoned with when decisions are made about how contracts are going to be performed.

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