

January 9, 2015

Honesty is the best policy... LAW!

In a unanimous seven-judge decision issued on November 13, 2014, the Supreme Court of Canada established a new general principle of law that requires parties to perform their contractual obligations honestly.

Until this decision, the duty of good faith in performance of contractual obligations had been generally established in the common law, but the duty might have been perceived as being of limited application. It was mainly implicated where a contracting party was granted a power of discretion, or in certain relationships where a power imbalance existed between parties (e.g., employer-employee), or where it seemed equitable to ensure that contracting parties did not act in a manner that defeated the objectives of their agreement.

In the landmark ruling, the SCC emphatically stated that, "parties [to a contract] must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of a contract." The SCC's ruling reiterated the principle of good faith in contractual relationships and extended it to include a duty of honest performance.

Facts of the Case

Bhasin v Hrynew involved a dispute among three parties. Two of the parties colluded to deprive the third from the benefit of a contract, and in doing so, lied to achieve their purpose.

The sanctioned activity consisted of a series of deceptions by a wholesaler of educational savings plans, who attempted to mislead one of its retailers for the purpose of accessing the retailer's confidential client records and capturing its lucrative client base for the benefit of a second retailer.

The first retailer's refusal to go along with the wholesaler's demands culminated in the wholesaler exercising its right to not renew the retailer's contract. The first retailer initiated court proceedings claiming damages stemming from the wholesaler's preference for the second retailer, alleging a lack of good faith in the performance of the contract and an unlawful conspiracy, as between the wholesaler and the second retailer, to oust the first retailer. The case found its way to the highest court in the land.

The Supreme Court of Canada

The SCC noted that prior case law pertaining to a good faith duty in contracts was plagued with inconsistencies. It introduced "two incremental steps", intended to bring certainty and coherence to contract law.

(a) Good Faith as a General Organizing Principle

The first step is an acknowledgment of a general organizing principle of good faith that applies to all contracts in Canada.

The principle functions as a minimum standard of behaviour. It requires that contracting parties have "appropriate regard" for each other's legitimate interests by not undermining those interests in bad faith.

(b) The Duty of Honest Contractual Performance

In the second step, the SCC imposed a common law duty of honesty in contractual performance. The duty does **not** seek to impose a positive duty of disclosure or loyalty; neither party is expected to forego any advantages flowing from the contract. However, the duty requires that parties to a contract **must not lie or knowingly mislead** their contractual counterparts.

Implications

The *Civil Code of Quebec* imposes a broad duty of good faith extending to the formation, performance and termination of a contract. It is a unique legal structure in Canada. No common law jurisdiction in Canada demands that pre-contractual negotiations be conducted in good faith, although based on the common law that had previously been pronounced in the realm of good faith, there is at minimum, an expectation that duties are to be performed reasonably and not capriciously or arbitrarily. The United States Uniform Commercial Code also imposes an obligation of good faith in the performance and enforcement of contracts (but not in their formation). With this new SCC ruling, the rest of Canada is effectively catching up to the experience in Quebec and the United States. While this new development does not preclude parties (outside of Quebec) from seeking the best possible deal for themselves in *negotiations*, parties bound to a Canadian contractual relationship must honour duties of good faith and honesty.

What we take from this case is that contracting parties cannot knowingly make false statements to each other to undermine the goals of a contract. For example, if a tenant requested information from its landlord regarding current market

rates in connection with an extension or renewal right under its lease, the landlord would likely be safe in refusing to disclose confidential information, but not in inflating rental information to mislead its tenant.

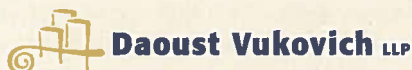
Another example of when the duty of honesty might be triggered in the commercial leasing context would be where a lease requires a landlord to obtain its tenant's consent to alter the site plan of a project (such as by constructing new premises or modifying common areas). If the tenant were to withhold its consent for a collateral purpose unrelated to legitimate concerns about the proposed modifications, it should be prepared to justify its stance.

The Future

The judiciary has never looked favourably on lies and deceit. In that respect, the landmark decision in *Bhasin v. Hrynew* is not to be heralded for establishing a novel principle. However, the case establishes certainty in commercial relations. Traditionally, courts have strained to curb bad behaviour by contracting parties, deploying doctrines of unconscionability and relying on a smattering of case law about good faith. Now there is clarity: contracting parties can be expected to face the consequences of exercising their rights dishonestly or in bad faith.

ANNOUNCEMENT

Daoust Vukovich LLP is pleased to announce that **MELISSA MCBAIN** has been admitted to partnership. Melissa joined the firm as an associate lawyer after working with us as both a summer student and articling student. Melissa has dedicated her career to representing commercial landlords and tenants in a variety of commercial leasing matters. She has expertise in managing commercial lease transactions for all types of properties including office, retail, industrial and mixed-use. Melissa's practice also includes telecommunications and building services arrangements. Melissa was called to the Ontario Bar in 2008. Melissa can be reached at: (416-598-7038) (mmcbain@dv-law.com).



Our secret for closing files lies as much in what is taken out as in what is put in. By eliminating exorbitant expenses and excess time, by shortening the process through practical application of our knowledge, and by efficiently working to implement the best course of action, we keep our clients' needs foremost in our minds. There is beauty in simplicity. We avoid clutter and invest in results.

Often a deal will change complexion in mid-stage. At this critical juncture, you will find us responsive, flexible and able to adjust to the changing situation very quickly and creatively. We turn a problem into an opportunity. That is because we are business minded lawyers who move deals forward. The energy our lawyers invest in the deal is palpable; it makes our clients' experience of the law invigorating.

MARY ANN BADON
416-598-7056
mbadon@dv-law.com

FRANCINE BAKER-SIGAL
416-597-8755
francine@dv-law.com

JEANNE BANKA
416-597-0830
jbanka@dv-law.com

CANDACE COOPER
416-597-8578
ccooper@dv-law.com

DENNIS DAOUST
416-597-9339
ddaoust@dv-law.com

BITALI FU
416-598-7053
bitalif@dv-law.com

GASPER GALATI
416-598-7050
ggalati@dv-law.com

S. RONALD HABER
416-597-6824
rhaber@dv-law.com

WOLFGANG KAUFMANN
416-597-3952
wolfgang@dv-law.com

LYNN LARMAN
416-598-7058
larmann@dv-law.com

MIMI LIN
416-597-8493
mimil@dv-law.com

MELISSA M. MCBAIN
416-598-7038
mmcbain@dv-law.com

JENNA MORLEY
416-597-9225
jmorley@dv-law.com

MONICA PAK
416-598-7049
mpak@dv-law.com

JAMIE PAQUIN
416-598-7059
jpaquin@dv-law.com

BRIAN PARKER
416-591-3036
bparker@dv-law.com

PORTIA PANG
416-597-9384
ppang@dv-law.com

ALICE PERALTA
416-597-1536
aperalta@dv-law.com

KENNETH PIMENTEL
416-597-9306
kpimentel@dv-law.com

NATALIE VUKOVICH
416-597-8911
nvukovich@dv-law.com

DEBORAH A. WATKINS
416-598-7042
dwatkins@dv-law.com