Case Law Update

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Supreme Court of Canada Recognizes a New Common Law Duty of Good Faith

By Angela Swan

The decision of the Supreme Court of Canada in *Bhasin v. Hrynew* illustrates a paradox. In saying that there is now a general organizing principle by which or under which parties to a contract must perform in good faith, the way in which the bulk of contracts are performed will not change. Almost every contracting party performs its contractual obligations honestly and decently. On the other hand, the few who lie or seek to deceive the other party to a contract may now be held to account.

Even with the small number of people who do not perform their contracts honestly, not much may actually have changed. What the Supreme Court has done is less to change the law than it is to gather together several different constraints on bad behaviour and bring them with one general organizing principle.

From the point of view of the development of the Canadian law of contracts, the importance of *Bhasin v. Hrynew* lies in the way in which Cromwell J., giving the reasons of the unanimous court, both justifies and explains what he has done: the reasons are well-crafted and careful to deal with the obvious arguments against and consequences of the creation or imposition of a duty of good faith performance.

One consistent objection over the years has been that the imposition of an obligation of good faith performance would do two bad things. One is that it would make the law uncertain. Cromwell J. refers to this argument at para. 39 and deals with it by observing that the current law, *i.e.*, the law absent a duty of good faith performance, is actually uncertain because (para. 41) it lacks coherence and fails to build on the experience of both Quebec and the United States. In Quebec, under the *Civil Code*, Arts. 6, 7, & 1375, and in the United States under the *Uniform Commercial Code* (UCC), §§1-304, 1-305 and §1-201(b)(202), and the Restatement, §205, obligations of good faith performance have been imposed for years without anyone complaining that contracts were somehow made uncertain.

The second objection is that the imposition of such an obligation would be something external to the contract and to the obligations the parties freely assumed; it would be something imposed by a court. Cromwell J. dismisses this objection and holds, para. 45, that such an obligation "inheres in the parties' relation."

This last point does more than identify where the obligation comes from; it deals with the very dangerous argument that a standard "integration" or "entire agreement" clause can exclude the duty of good faith or, perhaps, evidence of one party's bad faith. If the obligation of good faith performance inheres in or simply arises more or less automatically out of the simple fact that the parties have made or are in a contractual relation, then it is not something external that can be excluded by the terms of the usual clauses mentioned. The Alberta Court of Appeal when it dealt with the case seemed to suggest, 2013 ABCA 98, paras. 30 and 32, that both the evidence and the obligation were excluded by the rules it postulated for governing the parties' relation.

Cromwell J. deals with the obvious question: can parties, by the terms of their agreement, exclude any obligation to perform in good faith? He said: (para. 75)

> … Because the duty of honesty in contractual performance is a general doctrine of contract law that applies to all contracts, like unconscionability, the parties are not free to exclude it.…

He does, however, and relying on the UCC, suggest that the parties may modify the "scope of honest performance." He said: (para. 77)

> … I would not rule out any role for the agreement of the parties in influencing the scope of honest performance in a particular context. The precise content of honest performance will vary with context and the parties should be free in some contexts to relax the requirements of the doctrine so long as they respect its minimum core requirements. The approach I outline here is similar in principle to that in §1-302(b) of the UCC (2012):
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> > The obligations of good faith, diligence, reasonableness and care … may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable.

The importance of *Bhasin v. Hrynew* lies in the fact that it is characterized as an "organizing principle." The development of the Anglo-Canadian common law of contracts has had too few of these principles. The compensation principle as a basis for awarding damages for breach of contract has been accepted for many years, but for a long time there was hardly any other organizing or general principle. The "bargain principle" as a basis for identifying those contracts that would be enforced was a largely useless principle because it was subject to so many exceptions — promissory estoppel being a large and obvious one — and to the frequent enforcement of promises by courts determined to do so, *i.e.*, by looking hard for and "finding" consideration. There is no principle behind the rules of offer and acceptance, mistake or frustration. At best the courts struggled (and usually succeeded) in doing what they saw as proper and necessary to do.

There was, however, one very important organizing principle that Canadian courts had adopted, one that comprehends the one developed by Cromwell J. This principle sees the goal of the law of contracts — and particularly that of the process of interpretation — as being to protect the reasonable expectations of the parties. In many cases in the Supreme Court (see, *e.g.*, *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69, at para. 62), this goal, this principle, had been accepted as governing the courts' approach to interpretation.

To that organizing principle can now be added another instance of it: the organizing principle from *Bhasin v. Hrynew*. Cromwell J. summarized the principle: (para. 93)

1. There is a general organizing principle of good faith that underlies many facets of contract law.
2. In general, the particular implications of the broad principle for particular cases are determined by resorting to the body of doctrine that has developed which gives effect to aspects of that principle in particular types of situations and relationships.
3. It is appropriate to recognize a new common law duty that applies to all contracts as a manifestation of the general organizing principle of good faith: a duty of honest performance, which requires the parties to be honest with each other in relation to the performance of their contractual obligations.

The identification of this principle and the careful way in which Cromwell J. justifies and describes its origin, scope and relation to the general law of contracts has set the law in an exciting direction. It will now no longer be necessary to search for some particular instance where an obligation very like an obligation to perform in good faith existed to make the protection of the parties' reasonable expectations a reality in Canadian law.

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