

# THE SUPREME COURT OF CANADA WILL REVISIT THE DUTY OF GOOD FAITH SIX YEARS AFTER *BHASIN*

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In December 2019 the Supreme Court of Canada (“SCC”) heard two appeals that revisit the nature and scope of the contractual duty of good faith it articulated in *Bhasin v Hyrnew*<sup>[1]</sup> (“*Bhasin*”). The judgments are expected to confirm the minimum standards of acceptable commercial behavior and provide new guidance on how parties should carry out their commercial agreements.

*C.M. Callow Inc. v. Tammy Zollinger, et al.*<sup>[2]</sup> (“*Callow*”) concerns whether a party has a duty to disclose material information relating to the performance of a contract when it knows that silence could mislead the other party. *Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage District*<sup>[3]</sup> (“*Wastech*”) considers whether discretionary powers in contracts must be exercised reasonably in the absence of dishonesty or an improper motive.

## The Duty of Good Faith in *Bhasin*

In *Bhasin*, the SCC recognized good faith as a general organizing principle in matters of contractual performance. The organizing principle is simply that parties must perform their contractual obligations “honestly and reasonably and not capriciously or arbitrarily”. When exercising their contractual rights, good faith requires parties to have appropriate regard for the legitimate interests of their counterparties. They must not seek to undermine the other party’s interest in bad faith.

*Bhasin* also recognized a new duty of honest performance as a manifestation of the organizing principle. This duty imposes a minimum standard of honesty on contracting parties. It requires parties not to “lie or knowingly mislead” each other about matters directly relating to contractual performance. However, the SCC warned that the organizing principle of good faith must not be used as a pretext for scrutinizing the motives of contracting parties, who are generally free to pursue their individual self-interest even where it causes a loss to the other party.

While the SCC aimed to bring “a measure of coherence and predictability” to the duty of good faith, *Bhasin* left some unanswered questions. For instance, the SCC held that “a clear distinction can be drawn between a failure to disclose a material fact, even a firm intention to end the contractual arrangement, and active

*dishonesty*". While lying is a straightforward concept, it is unclear if and when silence, equivocation or failure to disclose a material fact amount to "active dishonesty". It is also debated whether bad faith requires a subjective element of dishonesty or if it can occur where a counterparty's interests are harmed in the absence of dishonesty.

### **Callow: Is Deliberate Silence Bad Faith?**

C.M. Callow Inc., a property maintenance company owned and operated by Christopher Callow, had winter and summer maintenance contracts with a group of condominium corporations. The winter contract allowed the condos to terminate for any reason on 10 days' notice. In early 2013, the condos decided that they would terminate the winter contract, which was set to begin later that year, but withheld that decision from Mr. Callow. During that summer, Mr. Callow performed various "freebie work" in the expectation that the condos would renew the winter contract. Upon completion of the summer maintenance work, the condos gave notice that they were terminating the winter agreement. Callow sued, alleging that the condos breached their duty of good faith.

At trial, the judge found that while the condos had an express right to terminate the contract on notice, they "deliberately" misled and deceived Callow. The trial judge held that the condos acted in bad faith (1) by failing to disclose material information to ensure Callow completed the summer maintenance work, and (2) by leading Callow to believe that the winter contract was not in danger of non-renewal.

The Ontario Court of Appeal reversed the trial judge's decision, observing that *Bhasin* did not impose on the condos a unilateral duty to disclose their intention to terminate apart from the express notice period. The Court of Appeal held that the trial judge improperly expanded the duty of honest performance in a way that altered and conflicted with the express terms of the winter agreement. While recognizing that the condos failed to act 'honorably', the Court of Appeal held that their conduct did not rise to the "high level" of bad faith.

On appeal to the SCC, Callow argued that the condos' silence coupled with "active statements" breached (i) the duty of honest performance; and (ii) the duty not to abuse discretionary contractual rights. In the alternative, Callow asked the Court to recognize a new duty under the organizing principle that prohibits "active non-disclosure".

### **Wastech: Can Good Faith Limit a Bargained-For Right?**

Wastech Services Ltd. ("Wastech") and Greater Vancouver Sewerage and Drainage District ("Metro") are parties to a 20-year solid waste disposal agreement. Under the contract, Metro has sole discretion to allocate waste between certain disposal facilities. Wastech's compensation for services is determined by a "target operating ratio" of costs to revenues. In 2011, Metro reallocated waste among disposal sites. This had a negative impact on

Wastech's operations and costs and resulted in Wastech not achieving its target operating ratio.

The matter was referred to arbitration. The arbitrator found that Metro's allocation of waste was "honest and reasonable" but concluded that Metro breached the duty of good faith by ignoring Wastech's financial interests when it implemented a material change in the volume of waste allocated between disposal facilities. That finding was overturned on appeal to the British Columbia Supreme Court. The Court held that the arbitrator improperly expanded *Bhasin*, altering Metro's contractual rights in the absence of dishonest contractual performance. The British Columbia Court of Appeal affirmed the decision and emphasized that a breach of good faith requires a subjective element of improper motive or dishonesty, which Metro lacked.

On its appeal to the SCC, Wastech argued that, notwithstanding an absence of dishonesty, the duty of good faith is breached where a party fails to exercise its contractual discretion in good faith. In Wastech's view, good faith required Metro to have appropriate regard to Wastech's costs and loss of profits when exercising its discretion under the parties' agreement.

### **Implications**

The appellants in both *Callow* and *Wastech* seek to expand the duty of good faith and honest performance, notwithstanding warnings from various appellate courts of the dangers of improperly expanding the principle of good faith. Canadian courts have generally applied the organizing principle narrowly and have noted that *Bhasin* was not intended to alter basic principles of contractual interpretation. Writing for a unanimous Court in *Bhasin*, Justice Cromwell expressly warned against judicial interference under the rubric of good faith. He emphasized that the principle must always be weighed against competing principles of freedom of contract and contractual certainty.

The SCC's decisions in these appeals could have a significant impact on the way that commercial parties negotiate, structure and perform their agreements. The SCC could recognize new duties, including a duty to disclose relevant information in certain circumstances, and impose a higher standard of behavior on contracting parties. The Court could also decide that the duty of good faith can be breached in the absence of dishonesty or improper motive. Whether the SCC expands the duty of good faith performance remains to be seen.

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[1] 2014 SCC 71.[ps2id id='1' target='']

[2] 2018 ONCA 896.[ps2id id='2' target='']

[3] 2019 BCCA 66.[ps2id id='3' target='']

### **A Cautionary Note**

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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