

YOU SHOULD HAVE SAID SOMETHING: SUPREME COURT OF CANADA HOLDS THAT FAILURE TO CORRECT A MISTAKEN BELIEF VIOLATED THE DUTY OF HONEST CONTRACTUAL PERFORMANCE

Posted on December 23, 2020

Categories: [Insights](#), [Publications](#)

The Supreme Court of Canada (“**SCC**”) recently released its much-anticipated decision in *C.M. Callow Inc. v. Tammy Zollinger et. al* (“**C.M. Callow**”).^[1] The decision revisits the common law duty of honest contractual performance six years after the SCC’s seminal decision in *Bhasin v. Hrynew* (“**Bhasin**”).^[2] The C.M. Callow decision clarifies what constitutes a breach of the duty of honesty in circumstances where one party does not correct the other’s mistaken belief pertaining to the agreement.

Background: Unanswered Questions following Bhasin

The SCC’s unanimous decision in *Bhasin* described good faith as a “general organizing principle” in the Canadian common law of contracts that requires parties to perform their obligations “honestly and reasonably and not capriciously or arbitrarily”.^[3] *Bhasin* recognized that contracting parties must have appropriate regard for the legitimate interests of their counterparties and must not seek to undermine those interests in bad faith.^[4] *Bhasin* also recognized a new specific common law duty of honest performance as a manifestation of this general organizing principle. It requires parties not to “lie or otherwise knowingly mislead” each other about matters directly relating to contractual performance.^[5] However, the SCC warned that 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.^[6] Importantly, it held that good faith does not impose a duty of disclosure, including disclosure of information relevant to a termination of the parties’ agreement.^[7]

As [we wrote earlier this year](#), the decision in *Bhasin* left some questions about the scope of the duty of honesty unanswered. In *Bhasin*, the SCC observed 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*”.^[8] The SCC’s decision in C.M. Callow sheds some light on the distinction between innocent non-disclosure (which does

not give rise to liability) and active dishonesty or misleading conduct (which, by contrast, may give rise to liability for breach of the duty of honesty).

The Facts in C.M. Callow

The plaintiff, C.M. Callow Inc. ("**Callow**"), a company operated by Mr. Callow, supplied property maintenance services to the defendants (collectively, "**Baycrest**") under two separate contracts the parties entered into in 2012: one for winter maintenance services (snow removal) and the other for summer services (lawn and garden services). The winter contract was for a two-winter term expiring on April 30, 2014 and contained provisions permitting Baycrest to terminate the agreement: (i) for cause; and (ii) if for any reason Callow's services were no longer required, on ten days written notice.

Baycrest decided in early 2013 to terminate the winter contract under the without cause ten day notice provision, ostensibly due to performance issues, but decided not to tell Callow of its decision at the time. Baycrest instead permitted Callow to finish the summer contract, and even accepted some 'freebie' work Callow provided that was outside of the scope of the summer contract (which Callow provided hoping to incentivize Baycrest to renew the winter agreement when it expired in 2014). On September 12, 2013, Baycrest notified Callow that it was terminating the winter contract under the ten-day notice provision.

Callow sued for breach of contract, alleging that Baycrest acted in bad faith by accepting the free services while knowing Callow was providing them in the hopes of maintaining a future relationship. Callow also alleged that it did not source other winter maintenance contracts because Baycrest led it to believe the winter contract would not be terminated. Callow sought damages essentially amounting to the value of the year remaining on the winter contract.

The Lower Court Decisions

The trial judge found that Baycrest breached its duty of honest performance by failing to disclose material information and by leading Callow to believe that the winter contract was secure. She held that Baycrest "actively deceived" Callow from the time the termination decision was made in March or April 2013 to September 12, 2013 when it sent its notice of termination. More specifically, the trial judge concluded that Baycrest did so by: 1) withholding the information to ensure Callow performed the summer contract; and 2) continuing to represent that the winter contract was not in danger despite Baycrest's knowledge that Callow provided "freebie" summer services to bolster the chances of having the winter contract renewed.^[9] She awarded Callow damages to put it in the same position it would have been had the breach not occurred (being \$64,306.96, representing Callow's losses on the winter contract, an additional \$14,835.14, representing the cost of leasing equipment Callow would not have incurred had it known the winter contract would be terminated and \$1,600 for the final amount owing under the summer contract that Baycrest had failed to pay).

The Ontario Court of Appeal reversed the trial judge's decision, holding that, because there is “no unilateral duty to disclose information relevant to termination”, Baycrest was free to terminate the winter contract in accordance with its terms (by giving ten days' written notice of termination).^[10] According to the Court of Appeal, although Baycrest may not have acted honourably, any deception was not directly linked to performance of the winter contract, but rather, related to the renewal of that agreement that Callow hoped to negotiate.^[11]

The SCC Decision

A five-judge majority, along with a three-judge minority who concurred in the result (Justice Côté dissented), reversed the Court of Appeal's decision and upheld the trial judge's findings. Both the majority and minority held that Baycrest breached its duty of honest performance by “knowingly misleading” Callow into believing that the winter contract would not be terminated.^[12] The SCC observed that the requirements of honesty can and do go further than prohibiting outright lies,^[13] and both the majority and minority reasons agree that “knowingly misleading” a counterparty can include “half-truths, omissions, and even silence, depending on the circumstances”.^[14] In this case, Baycrest's failure to correct Callow's false impression amounted to a breach of its duty of honest performance.^[15]

Importantly, the majority as well as the concurring and dissenting reasons in *C.M. Callow* all agreed that this case *did not require an expansion* of the duty of honest performance identified in *Bhasin*.^[16] The majority reaffirmed the statement in *Bhasin* that there is no free-standing positive duty of disclosure on contracting parties.^[17] It also observed that the duty of honest performance does not permit a court to require one party to exercise a contractual right or power “to serve” the other party's interest at the expense of their own.^[18]

The majority did not conduct a thorough review of Baycrest's statements and conduct that allegedly caused Callow's misapprehension. Instead, it noted that whether a party “knowingly misleads” is a highly fact-specific determination and ultimately deferred to the trial judge's findings in this respect.^[19] In this regard, the majority noted that the trial judge found on the evidence that Baycrest had deceived Callow through two forms of “active communications”. First, Baycrest made statements to Mr. Callow suggesting that a renewal of the winter maintenance contract was likely and that it was satisfied with his services. Second, a Baycrest representative understood that Callow had provided some “freebie” services under the summer contract to incentivize Baycrest to renew the winter contract, and told Mr. Callow that he would inform the other board members about this “freebie” work. These representations suggested, deceptively, that there was hope for a renewal of the winter contract and, perforce, the current winter contract would not be terminated.^[20] The majority therefore concluded that Baycrest had intentionally withheld information about exercising its termination right “knowing that such silence, when combined with its active communications, had deceived Callow”, and that Baycrest had thereby breached its contractual duty of honest performance.^[21]

The minority reasons approached the issue much more simply. They noted that the trial judge found that Baycrest represented to Callow that the winter contract would not be terminated, and that Callow, by relying on Baycrest's representations, lost the opportunity to secure other work. Accordingly, they observed that Callow's complaint does not relate to Baycrest's silence, but rather to its positive representations.^[22] The trial judge's findings that Baycrest's conduct and express communications deceived Callow into thinking the winter contract would not be terminated and that Baycrest knew its representations were misleading and made to keep Callow in the dark, were sufficient to support the conclusion that it had breached the duty of honest performance.^[23]

The minority reasons went on to explain that the law of misrepresentation applies to the duty of honest performance. In the context of misrepresentation, sometimes silence or half-truths can amount to a statement, as can the defendant's acts or conduct.^[24] The entire context, including the nature of the parties' relationship, is to be considered when determining whether a misrepresentation has been made.^[25] The minority noted that if a defendant's active conduct contributed to a misapprehension that can only be corrected by disclosing more information, then the defendant must make that disclosure. Conversely, a contracting party is not required to correct a misapprehension to which it has not contributed.^[26]

Both the majority and minority reasons upheld the damages award made by the trial judge, however, they disagreed as to how damages should be measured. The majority held that the correct measure of damages for breach of the duty of honest contractual performance is 'expectation damages' (being the ordinary measure of damages for breach of contract - to put the plaintiff in the position it would have been had the duty been performed).^[27] The concurring justices disagreed and found that the duty of honest performance serves to vindicate the plaintiff's reliance on a dishonest representation, and so the correct measure of damages should be 'reliance damages' (being the measure typically used in tort).^[28] The minority found that Bhasin contemplates using this approach to damages for breach of the duty of honest performance.^[29]

Justice Côté wrote alone in dissent. In her view, Baycrest was under no obligation to correct Callow's mistaken belief about the future renewal of the winter contract.^[30] She noted that the reasons in Bhasin indicate that the duty of honest performance would interfere "very little" with parties' contractual freedom and that, absent a positive duty of disclosure, it is difficult to know when one's silence will "knowingly mislead" the other party.^[31] In her view, a party is only required to correct the counterparty's mistaken belief where they have "*materially contributed*" to that mistaken belief.^[32] In her view, the trial judge did not consider whether Baycrest did anything that could have misled Callow into its mistaken belief that the winter contract would not be terminated for reasons other than unsatisfactory performance, and the evidence did not support such a finding.^[33]

Key Takeaways

- The decision does not purport to expand the common law duty of good faith and instead reaffirms the principles in *Bhasin*. The holdings in *Bhasin* that contracting parties are not under a positive duty of disclosure (including that they have no obligation to disclose their intention to terminate a contract in advance) and that they may pursue their individual self-interest (including at the expense of their counterparty) remain intact.
- The duty of honest contractual performance goes beyond simply not lying. One can violate this duty by knowingly misleading your counterparty through actions or inaction, half-truths and, in some cases, silence.
- Even though there is no positive duty to disclose material facts, the duty of honesty may require a party, in certain circumstances, to correct their contractual counterparty's mistaken beliefs or misapprehensions. It appears this is limited to situations where one party caused the other party's misapprehension by some conduct or statement separate from silence itself. Both the concurring and dissenting judges expressly state that this is a precondition for any obligation to correct a mistaken belief.^[34] The majority also seems to acknowledge this precondition implicitly in its reasons: "*One can mislead ... by failing to correct a misapprehension caused by one's own misleading conduct*".^[35] A contracting party who is not responsible for the other party's mistaken belief should therefore be under no obligation to correct it.
- That said, the decision does not provide a bright line test that enables commercial parties to know when the obligation to correct a counterparty's mistaken belief arises and when it does not. When determining whether a party has lied or knowingly misled their counterparty about a matter related to the contract, the entire context, including the nature of the relationship between them, is to be considered.
- The decision reinforces the conclusion reached in *Bhasin* that, to be actionable, dishonesty must be directly linked to the performance of the contract. The relevant question to ask is whether a right under a contract was exercised, or an obligation under the contract was performed, dishonestly.
- The duty of honesty as a contractual doctrine has a limiting effect on the exercise of an unfettered contractual right. While it does not preclude a party from exercising a without cause termination provision, the duty of honest contractual performance will attract damages where the manner in which the termination right is exercised is dishonest.
- The SCC considered it unnecessary to address Callow's alternative argument (that, apart from violating the duty of honest contractual performance, Baycrest also breached a duty to exercise a discretionary contractual power in good faith). That issue will likely be explored in the SCC's Wastech decision that remains under reserve.

by [Brad Hanna](#), [Stephen Brown-Okruhlik](#) and [Paola Ramirez](#)

[1][ps2id id='1' target=''] 2020 SCC 45 [*C.M. Callow*], which decision the SCC released on December 18, 2020. The SCC heard the *C.M. Callow* case together with a companion case, *Wastech Services Ltd v Greater Vancouver Sewerage and Drainage District*, 2019 BCCA 66 [*Wastech*], in December 2019. The SCC has not yet released its decision in *Wastech*, which will consider the duty of good faith as it relates to the exercise of discretionary contractual powers in the absence of dishonesty.

[2][ps2id id='2' target=''] 2014 SCC 71. [*Bhasin*]

[3][ps2id id='3' target=''] *Bhasin* at 63.

[4][ps2id id='4' target=''] *Bhasin* at 65.

[5][ps2id id='5' target=''] *Bhasin* at 73.

[6][ps2id id='6' target=''] *Bhasin* at 70.

[7][ps2id id='7' target=''] *Bhasin* at 86.

[8][ps2id id='8' target=''] *Bhasin* at 86.

[9][ps2id id='9' target=''] *C.M. Callow Inc v Tammy Zollinger et al*, 2017 ONSC 7095, at 65.

[10][ps2id id='10' target=''] *CM Callow Inc v Zollinger*, 2018 ONCA 896, at 17. [*C.M. Callow ONCA*]

[11][ps2id id='11' target=''] *C.M. Callow ONCA*, at 18.

[12][ps2id id='12' target=''] *C.M. Callow* at 5, 40 and 134. There was a sharp divergence in view between the majority, on the one hand, and the concurring and dissenting judges, on the other hand, about whether it is necessary and appropriate to consider civil law concepts to inform the common law duty of good faith in the context of this case. That aspect of the decision is not discussed in this bulletin.

[13][ps2id id='13' target=''] *C.M. Callow* at 90.

[14][ps2id id='14' target=''] *C.M. Callow* at 90 and 132.

[15][ps2id id='15' target=''] *C.M. Callow* at 32.

[16][ps2id id='16' target=''] *C.M. Callow* at 44, 152 and 191.

[17][ps2id id='17' target=''] *C.M. Callow* at 80, citing *Bhasin* at 73.

[18][ps2id id='18' target=''] *C.M. Callow* at 82.

[19][ps2id id='19' target=''] *C.M. Callow* at 91, 94-95, 98 and 134-135.

[20][ps2id id='20' target=''] *C.M. Callow* at 94-100.

[21][ps2id id='21' target=''] *C.M. Callow* at 101.

[22][ps2id id='22' target=''] *C.M. Callow* at 121.

[23][ps2id id='23' target=''] *C.M. Callow* at 134.

[24][ps2id id='24' target=''] *C.M. Callow* at 131-133.

[25][ps2id id='25' target=''] *C.M. Callow* at 133.

[26][ps2id id='26' target=''] *C.M. Callow* at 133.

[27][ps2id id='27' target=''] *C.M. Callow* at 109.

[28][ps2id id='28' target=''] *C.M. Callow* at 139-142.

[29][ps2id id='29' target=''] *C.M. Callow* at 143-145.

[30][ps2id id='30' target=''] *C.M. Callow* at 184.

[31][ps2id id='31' target=''] *C.M. Callow* at 194 and 197-198.

[32][ps2id id='32' target=''] *C.M. Callow* at 201, 207 and 227.

[33][ps2id id='33' target=''] *C.M. Callow* at 214-216 and 235-236.

[34][ps2id id='34' target=''] *C.M. Callow* at 132-133 and 200-201.

[35][ps2id id='35' target=''] *C.M. Callow* at 90.

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.

© McMillan LLP 2020