

*Bhasin v. Hrynew***SCC establishes duty of honesty between contracting parties**

BY DAVID DIAS

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In perhaps the most important contract decision of the past 20 years, the Supreme Court of Canada established a general doctrine of good faith between parties and a specific duty of honesty.

The ruling, *Bhasin v. Hrynew*, involved a dispute between Harish Bhasin, a retailer, and Canadian American Financial Corp., the wholesaler. Larry Hrynew was a competitor of Bhasin's working with Canadian American Financial.

Bhasin and Canadian American Financial had entered into a three-year contract that entitled him and his sales agents to retail the company's products. The contract would automatically renew unless one of the parties gave at least six months' notice prior to the end of the period.

The case outlines the rather convoluted tale of how Hrynew attempted to capture Bhasin's clientele, at first by suggesting a merger and then by working with Canadian American Financial to mislead Bhasin and pressure him into a merger. In the end, Canadian American Financial terminated Bhasin's contract and his sales agents jumped ship to work with Hrynew.

Bhasin sued both parties, claiming a conspiracy and that Canadian American Financial's conduct constituted a failure to act in good faith. The trial judge agreed, but Canadian American Financial and Hrynew won at the Alberta Court of Appeal on the basis that the contract renewal terms were unambiguous and the document didn't provide for a duty of good faith.

On Nov. 13, the Supreme Court — in a unanimous decision written by Justice Thomas Cromwell — reversed the appeal court ruling and established a new good-faith doctrine and a duty of honesty between contracting parties.

The decision states: "Two incremental steps are in order to make the common law more coherent and more just. The first step is to acknowledge that good



The Supreme Court's decision leaves a lot of grey areas around the definition of honesty, says Eli Lederman.

faith contractual performance is a general organizing principle of the common law of contract which underpins and informs the various rules in which the common law, in various situations and types of relationships, recognizes obligations of good faith contractual performance. The second step is to recognize, as a further manifestation of this organizing principle of good faith, that there is a common law duty which applies to all contracts to act honestly in the performance of contractual obligations. Taking these two steps will put in place a duty that is just, that accords with the reasonable expectations of commercial parties and that is sufficiently precise that it will enhance rather than detract from commercial certainty.

"There is an organizing principle of good faith that parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily. An organizing principle states in general terms a requirement of justice

from which more specific legal doctrines may be derived. An organizing principle therefore is not a freestanding rule, but rather a standard that underpins and is manifested in more specific legal doctrines and may be given different weight in different situations. It is a standard that helps to understand and develop the law in a coherent and principled way.

"The organizing principle of good faith exemplifies the notion that, in carrying out his or her own performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner."

Brandon Kain, a litigator at McCarthy Tétrault LLP who represented Bhasin, says the case has "massive implications" for businesses across Canada. The ruling creates new law around an overarching doctrine of good faith from which many specific duties may extend.

"That overarching principle can give rise to various duties, and the court doesn't define what the outer limits of those duties are," he says.

"In this case, one of those duties is a duty of honest performance in contracting, which means basically that parties can't lie or knowingly mislead each other with respect to the performance of their contractual obligations."

Neil Finkelstein, who worked with Kain on the file, says the establishment of a general duty of good faith in performance contracts is entirely new law, something that may explain why the Alberta Court of Appeal had ruled as it did.

"The other side followed the letter of the contract and since there was nothing in the contract about good faith, they weren't going to imply a duty into it," says Finkelstein.

"What the Supreme Court here said is, 'No, that's wrong. . . . There's an obligation of good faith and that includes at least honest dealing.'"

While the decision lacks a specific test for what constitutes dishonesty and therefore leaves discretion in the hands of

trial judges to weigh reasonableness and honesty in the context of each case, contracting parties have little to worry about, says Kain.

"Concepts like reasonableness and honesty are frequently invoked in other areas of the law and judges have shown themselves perfectly well equipped to deal with them."

Finkelstein also points out that the duty is about honesty, which isn't the same as a fiduciary obligation or one of loyalty.

"I think most people have a pretty good idea of what honesty is when you exclude that you don't have to positively disclose things that are against you. Unless you're asked, you can't lie."

Eli Lederman, however, isn't so sure. The lawyer at Lenczner Slaght Royce Smith Griffin LLP, who represented Hrynew and Canadian American Financial, says the Supreme Court's decision leaves a lot of grey areas around the definition of honesty that create uncertainties that are bound to result in a wave of lawsuits.

"What this decision does is it adds a certain layer of contractual risk that any contracting party will have to be careful when they exercise what they think is a clear and unambiguous right, that they have not done anything that may be perceived by the counter party as being dishonest when they exercise that right," says Lederman.

In fact, rather than creating a more open and honest exchange between contracting parties, Lederman says they may go out of their way to keep quiet about their reasons or intentions when exercising a right granted within a contract.

"I think there certainly is that risk that contracting parties will feel as a result of this decision that, when they exercise a termination right or non-renewal right, they may feel compelled or inclined to be silent as to the reasoning for that lest they risk being challenged that it was not a truly honest explanation or description or disclosure of the reasoning for that exercise."