

## **“Recent Developments in the Concept of Good Faith Under Canadian Law”:**

**A summary and analysis of the Supreme Court of Canada’s decisions in *Bhasin v. Hrynew*, *C.M. Callow Inc. v. Zollinger*, and *Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage***

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### **Introduction:**

In Canada, the concept of good faith in contractual dealings has recently been the subject of two decisions of the Supreme Court of Canada. These decisions broaden the concept of good faith as an organizing principle of contract law that was first recognized in *Bhasin v. Hrynew*, 2014 SCC 71 (*Bhasin*).

In 2020, the Supreme Court developed the concept of good faith in *C.M. Callow Inc. v. Zollinger*, 2020 SCC 45 (*Callow*), a case where the Court determined that a party cannot stay silent if another party acts on a misapprehension arising out of the first party’s deception or misrepresentation.<sup>i</sup>

Most recently, in *Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage*, 2021 SCC 7, (*Wastech*), the Supreme Court dealt with the issue of contractual discretion.<sup>ii</sup> The court determined that a party must exercise its contractual discretion in accordance with the purposes for which that discretion was conferred, otherwise that party may be in breach its duty of good faith.

This article provides a brief summary of each of these cases and a description of their impacts on Canadian contract law. Some practical considerations follow to assist parties who are privy to or who are entering into commercial contracts in light of these developments.

### ***Bhasin v. Hrynew*, 2014 SCC 71 (*Bhasin*)**

It was in this case that the Supreme Court first considered whether parties owed one another a duty of good faith. In its unanimous decision, the Supreme Court recognized the important role of good faith as part of the common law foundations of Canadian contract law. The Supreme Court held that good faith contractual performance constitutes an organizing principle in contracts, meaning that parties to any contract have a duty to act honestly in performing their contractual obligations.

The appellant Bhasin sold investment products for the corporate defendant Can-Am, as did the individual defendant Hrynew. Bhasin’s automatic renewal agreement with Can-Am could be terminated if notice of non-renewal was provided.

Hrynew proposed a merger with Bhasin which Bhasin rejected. Hrynew approached Can-Am to see if they could force a merger.

The Alberta Securities Commission raised concerns about Can-Am’s operations, prompting Can-Am to appoint Hrynew to an auditing position to comply with the Commission’s directions. Can-Am also told the Commission that it planned to restructure and merge Bhasin and Hrynew’s operations, but Can-Am did not inform Bhasin about its intentions. Can-Am was evasive when Bhasin later asked about plans to force a merger.

Can-Am further misled Bhasin about Hrynew’s ability to access Bhasin’s business records as part of Hrynew’s auditing authority. Bhasin subsequently refused to give Hrynew access to their records for an audit. Can-Am then threatened to terminate its contract with Bhasin and later issued a notice of non-renewal. Bhasin then commenced legal action.

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The Supreme Court of Canada determined that Can-Am failed to carry on its agreement with Bhasin in accordance with its duty of good faith because it misled Bhasin about its restructuring intentions. The Court recognized good faith as an organizing principle in contract law, but did not establish good faith as a freestanding rule that can be enforced in its own right. Instead, its breach is enforceable through other recognized and enforceable doctrines.<sup>iii</sup>

The court determined that a duty of good faith does not give rise to a fiduciary relationship, but stated that parties' reasonable expectations of honesty reflect the commercial need for basic honesty in contractual relationships.<sup>iv</sup> The organizing principle of good faith simply requires parties not to lie or mislead the other party in relation to contractual performance.<sup>v</sup>

The Court explicitly stated that parties cannot contract out of their duty of good faith. However, the duty of good faith can be relaxed in certain contexts, including through express contractual provisions, as long as basic components of the duty of good faith are respected.<sup>vi</sup>

### ***C.M. Callow Inc. v. Zollinger, 2020 SCC 45 (Callow)***

In *Callow*, the Supreme Court expanded on the organizing principle articulated in *Bhasin*. This decision established that a contracting party has an obligation to correct a reasonable misapprehension of another party if that misapprehension arises out of deceptive misrepresentations by the first party.

*Callow* dealt with a two-year contract under which *Callow*, the plaintiff, provided winter maintenance services for Baycrest's condominium complexes. The agreement stipulated that Baycrest could unilaterally terminate the agreement with ten days' notice. There were performance complaints in the first year of the contract, which Callow claimed to address. Towards the end of the first winter, Baycrest hired a new property manager who advised that the contract should be terminated. The condominium Board agreed to do so.

Callow was not advised of Baycrest's intention to terminate and believing its contract was going to be renewed provided gratuitous additional services during the summer months in an effort to incentivize renewal of the winter contract. Callow also did not bid on other winter contracts for other possible clients during the offseason based on its belief that it was in good standing with Baycrest following positive discussions about contract renewal.

Baycrest provided its notice of termination in September of that year as required by the contract. Callow sued for breach of contract because Baycrest accepted free summer services, giving a representation to Callow that they were providing satisfactory services when a decision had already been made to terminate the winter contract.

The claim in this case was predicated on a breach of the duty honest performance. The Supreme Court found that Baycrest had an obligation to satisfy a duty of honest performance despite the contract itself only requiring limited notice of termination. That notice obligation had to be exercised in accordance with a duty of honest performance. The Supreme Court turned to evidence showing "active communications" which deceived Callow in finding that Baycrest breached the duty of good faith.<sup>vii</sup>

The Supreme Court determined that Baycrest knowingly misled Callow and intentionally withheld information despite knowing that it intended to act upon the termination clause in the contract. Baycrest was aware that Callow was acting on a misapprehension arising out of Baycrest's misrepresentations. By failing to correct his misapprehension, Baycrest breached its duty of good faith.

The court clarified that the duty of good faith did not require Baycrest to provide any more notice than the contract specifically stipulated. In this regard, the court expressed the importance of upholding “the bargain struck by the parties”.<sup>viii</sup> The duty of good faith only required Baycrest to refrain from creating misapprehensions in anticipation of the notice period in the contract. The Supreme Court made clear that honest contractual performance is not a matter of disclosure, but is rather a matter of ensuring that parties do not misrepresent their intentions about the future of a contractual relationship.<sup>ix</sup>

### ***Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage, 2021 SCC 7, (Wastech)***

In *Wastech*, the Supreme Court of Canada further expanded on *Bhasin* to determine that good faith requires contracting parties with discretionary power to exercise that discretion in accordance with the purposes for which it was conferred.

Wastech and Greater Vancouver Sewerage and Drainage District (Metro) entered into a waste disposal agreement under which Metro had discretion to allocate where Wastech would deliver waste. There were three waste delivery sites under the contract, and Wastech was entitled to a differing compensation depending upon which site the waste was delivered to.

Metro used its contractual discretion to reallocate waste delivery between the three sites in a manner that resulted in Wastech sacrificing significant profits. Wastech claimed that Metro acted in bad faith when reallocating the waste delivery because it exercised its discretion in a manner that deprived Wastech of the opportunity to meet the Target Operating Ratio under the contract.

The Supreme Court of Canada rejected Wastech’s claim, stating Wastech could not use a bad faith argument to create an advantage that was not contained in the contractual bargain. The court recognized the commercial reasonableness of Metro’s discretion under the contract, which was provided to allow Metro to maximize efficiency.

The court laid out the kind of conduct that would breach the duty of good faith where that conduct is a wrongful exercise of discretion. This includes where discretion is exercised in a manner that is capricious or in bad faith; made for purposes outside the scope of the contract; or falling outside reasonable outcomes contemplated by the contract.

Likewise, the court highlighted where an exercise of discretion will **not** breach the duty of good faith. Discretion may not breach the duty of good faith where it is motivated by self-interest; causes financial loss; is contrary to the other party’s commercial interests; is not an advisable business decision.

These parameters reiterate that the duty of good faith does not impose a fiduciary obligation on any party to a contract, and no party is required to subordinate its own interests to those of another party when exercising contractual discretion.

### **Practical considerations in light of these developments:**

Following the court’s decision in *Callow*, contracting parties will need to consider the context and content of communications with other parties. Parties now need to be concerned with accusations of deception, which may stem not only from the content of communications but also the surrounding context of those communications. In commercial contexts, this means that all communications with other parties to a contract, including during the performance of the contract, must be given proper consideration so as not to give rise to any misapprehension.

Discretionary powers should be defined clearly in the contract itself. Clearly setting out the scope of discretion and the purposes for which it can be exercised may assist in demonstrating the commercial reasonableness of discretionary decision making and protect against claims contemplated in *Wastech*.

Recitals should also be drafted carefully in the contract. The jurisprudence in this area, taken as a whole, demonstrates that clearly expressing intentions, entitlements, and powers for each party will assist in ensuring that a party minimizes the risk of inadvertently breaching the duty of good faith.

## **Conclusion:**

The concept of good faith in contracts has developed considerably in Canadian law through these three Supreme Court of Canada decisions. Following the recognition of good faith as an organizing principle in *Bhasin*, the Court has now addressed misapprehension in *Callow* and contractual discretion in *Wastech*. Based on these developments, parties to commercial contracts in Canada should be aware of their obligations, draft contracts accordingly, and understand how their communications with other parties may engage their duty of good faith. These cases have given rise to parties pleading the good faith requirements in many cases and it is likely that the good faith concept will broaden further as different factual circumstances are considered by Canadian Courts.

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<sup>i</sup> *C.M. Callow Inc. v. Zollinger*, 2020 SCC 45.

<sup>ii</sup> *Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage*, 2021 SCC 7.

<sup>iii</sup> *Bhasin v. Hrynew*, 2014 SCC 71 at para 64.

<sup>iv</sup> *Bhasin v. Hrynew*, 2014 SCC 71 at para 60.

<sup>v</sup> *Bhasin v. Hrynew*, 2014 SCC 71 at para 73.

<sup>vi</sup> *Bhasin v. Hrynew*, 2014 SCC 71 at para 77.

<sup>vii</sup> *C.M. Callow Inc. v. Zollinger*, 2020 SCC 45 at para 94.

<sup>viii</sup> *C.M. Callow Inc. v. Zollinger*, 2020 SCC 45 at para 104.

<sup>ix</sup> *C.M. Callow Inc. v. Zollinger*, 2020 SCC 45 at para 40.