

# New Development in Contract Law: Supreme Court of Canada Imposes Duty to Perform Contractual Obligations Honestly

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On November 13, 2014, the Supreme Court of Canada released yet another decision dealing with its apparent re-consideration of the law of contract in Canada.

During the summer, the court released a decision in which it re-defined the standard to be applied when reviewing a lower court's interpretation of a contract (*Sattva Capital Corp v. Creston Moly Corp*). Now the court has released a decision in *Bhasin v. Hrynew* which addresses the question: "What standard of conduct applies when a party is performing a contract?"

## A New Direction

Until now, some courts suggested that there was a general duty of good faith (though this may not have applied to all types of contracts); other courts were of the view that there was no general duty of good faith. Writing for the court, Justice Cromwell has made it clear that the test needs to be clarified.

"Good faith" is recognized as an "organizing principle" of modern contract law, however the application of that doctrine has been "piecemeal, unsettled and unclear" [para 59], leading to results that the court referred to as "*ad hoc* judicial moralism or 'palm tree' justice" [para 70].

The comments by the Supreme Court certainly accord with our experience: anyone who has debated "good faith / bad faith" with opposing counsel or the court will know that the law was murky in the way that it was perceived and applied.

The court steers away from the good faith concept by imposing a new standard of performance: a party to a contract has “a duty to act honestly in the performance of contractual obligations.” The court will inquire whether a party has acted with “a minimal standard of honesty” in performing the contract, as elaborated by the following passage [para 86],

“contracting parties must be able to rely on a minimum standard of honesty from their contracting partner in relation to performing the contract as a reassurance that if the contract does not work out, they will have a fair opportunity to protect their interests.”

The court makes it clear that this is a *new* duty [para 72-73], and that the duty applies to *all* contracts.

#### What Does This Mean?

The court describes this decision as an “incremental step,” and focuses on the basic proposition that a party should not “lie to” or mislead another in performing a contract (since this was the factual basis of the case before it). It is also clear from the decision that the court is not creating obligations that are akin to fiduciary obligations, or new disclosure obligations.

It is our view that this decision is likely to have far-reaching consequences in the way that trial courts deal with contract claims.

Until these consequences are known, caution is advisable. Any party to a contract must take care to consider its actions in light of this new duty – particularly if it is faced with a “discretionary” decision, such as the decision to extend a contract into a renewal term or to terminate in the event of a perceived breach.