# GOOD FAITH AS AN ORGANIZING PRINCIPLE IN CONTRACT LAW: *BHASIN V HRYNEW* – TWO STEPS FORWARD AND ONE LOOK BACK

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*Over the last three decades Canadian contract law has wrestled with the question of whether there should be a formal recognition of duty to act in good faith. Outside the context of Quebec civil law, the Supreme Court has declined to recognize a pre-contractual duty to bargain in good faith. In the 2014 decision in Bhasin v Hrynew, the Court did fashion a modest role for the good faith performance of contractual obligations, leaving to be answered the question of whether this good faith requirement can trump the specific provisions of a contract. Despite its limited scope, the precedential significance of the decision in Bhasin v Hrynew should not be underestimated, as it lays a solid foundation upon which the tenets of the good faith doctrine can be applied in such a manner that the certainty and predictability of the law are preserved.*

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*Au cours des trois dernières décennies, on débat de la question de savoir si l'obligation d'agir de bonne foi doit être reconnue de façon formelle dans le contexte du droit des contrats au Canada. En dehors du cadre du droit civil québécois, la Cour suprême a refusé de reconnaître l'existence d'une obligation précontratuelle de négocier de bonne foi. En 2014, dans l'arrêt Bhasin c. Hrynew, la Cour a, à tout le moins, précisé le rôle modeste de l'obligation d'exécuter honnêtement les obligations contractuelles, mais n'a pas réglé la question de savoir si cette obligation de bonne foi peut l'emporter sur les stipulations précises d'un contrat. En dépit de sa portée limitée, l'importance de la valeur de précédent de l'arrêt Bhasin c. Hrynew ne doit pas être minimisée, car ce jugement établit une solide assise à partir de laquelle il est possible d'appliquer les principes fondamentaux de la doctrine de bonne foi tout en assurant la prévisibilité et le caractère certain du droit.*

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## *1. Introduction*

Over the last three decades Canadian contract law has wrestled with a question easier to state than to answer: Should the law formally recognize a duty requiring all parties to act in good faith? The simplicity of the

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question masks its potential ambit. The duty could apply to matters involving the negotiation and formation of the contract and, in turn, to matters involving its performance and enforcement. Yet outside the context of Quebec's civil law, the Supreme Court has refused to recognize a pre-contractual duty to bargain in good faith.[1] One need only isolate a solitary sentence anchored within *Martel Building Ltd v Canada* to support that blunt understanding of the common law.[2] Whatever the reasons for the sustained resistance to a requirement of good faith bargaining, the law continues to rely on other principles to regulate unacceptable behaviour.[3] Those embracing the concepts of deceit, misrepresentation, and unconscionability come readily to mind.

Once the matter of good faith bargaining is moved aside, the imposition of a common law duty to act in good faith must focus on matters of contractual performance and enforcement. Curiously, the topic of good faith enforcement has generated little attention in this country.[4] Presumably, cases in which the lender elects to call-in a demand loan without giving the borrower reasonable time to pay, before seizing and selling assets given as security for the loan, are in breach of the good faith requirement. At least that is one way of explaining the Supreme Court's decision in *RE Lister Ltd v Dunlop Canada Ltd*.[5] All of this leads to the

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1 Although the *Civil Code of Lower Canada* contained no express provision dealing with "good faith," the Supreme Court implied such a general duty in *National Bank of Canada v Soucisse*, [1981] 2 SCR 339. See also text accompanying note 162.

2 2000 SCC 60 at para 73, [2000] 2 SCR 860 [*Martel Building Ltd*]: "As noted by the courts below, a duty to bargain in good faith has not been recognized to date in Canadian law." However, reference should also be made to *Lac Minerals Ltd v International Corona Resources Ltd*, [1989] 2 SCR 574 at para 189: "The institution of bargaining in good faith is one that is worthy of legal protection in those circumstances where that protection accords with the expectations of the parties."

3 It is as though such an obligation might be mistakenly used as a springboard for requiring the mutual disclosure of too much information, in circumstances where the common law does not impose a general duty of disclosure. Such reasoning, however, does not or should not apply in those cases where the parties are contractually obligated to negotiate, for example, the renewal of an existing contract. In that regard, the analysis offered in Angela Swan and Jakub Adamski, *Canadian Contract Law*, 3rd ed (Markham, Ont: LexisNexis, 2012) at paras 9.188–189, represents a persuasive challenge to judicial opinion, as does Leon E Trakman and Kunal Sharma, "The Binding Force of Agreements to Negotiate in Good Faith" (2014) 73:3 Cambridge LJ 598.

4 The notable exceptions are Edward P Belobaba, "Good Faith in Canadian Contract Law" in *Commercial Law: Recent Developments and Emerging Trends* (Don Mills, Ont: De Boo, 1985) 73 at 85ff; Swan and Adamski, *supra* note 3 at 928–29. The matter of good faith enforcement is discussed in the text below commencing at note 152.

5 [1982] 1 SCR 726 [*Lister*]. This case and others are discussed below commencing at note 152 in support of the understanding that the good faith *enforcement*

observation that most of the jurisprudence and commentary in this country has focused on the topic of good faith *performance*.

In *Bhasin v Hrynew*, the Supreme Court of Canada was asked to decide whether the common law should recognize a generalized duty on parties to perform their contractual obligations in good faith.[6] Instead, the Court articulated an organizing principle of good faith and, correlatively, adopted and applied a "new" stand-alone duty of honest performance. But the precedential significance of *Bhasin* should not be underestimated. Nestled within the Court's extensive reasons are the tenets of a good faith performance obligation that has a modest role to play in contract law: filling in contractual gaps. Yet those same reasons raise and leave unanswered some important questions. In particular, one cannot help but ask whether there are circumstances in which the good faith obligation is capable of overriding a contract's express and unambiguous provisions. In short, the full impact of *Bhasin* remains to be seen. This commentary explores such issues while offering an historical and comparative analysis of the good faith performance obligation, together with a critical analysis of the Court's application of the good faith doctrine to the issues presented in *Bhasin*.

## *2. Overview*

Prior to *Bhasin*, Canadian law accepted that a few contractual "relationships" are subject to a carefully circumscribed requirement of good faith performance. The obligation falls under the umbrella of a term implied-in-law and applies most certainly to employment and insurance agreements.[7] As well, tendering contracts are subject to a good faith requirement in the sense of fair dealing, but this time the obligation qualifies as a term implied-in-fact.[8] There are also isolated Supreme Court precedents alluding to the equivalent of an implied obligation to perform in good faith. Those precedents fall easily within the category of a term

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obligation operates as a stand-alone duty – one capable of overriding an express and unambiguous provision of the agreement.

6 *Bhasin v Hrynew,* 2014 SCC 71, [2014] 3 SCR 495 [*Bhasin*].

7 In *Bhasin, ibid*, the Court inexplicably expanded the "short list" of contractual relationships to include franchise agreements. However, this is not to suggest that such agreements should be deleted from the short list. Arguably it should be expanded to include, for example, dealership agreements.

8 *Ibid at* para 56, citing *Martel Building Ltd, supra* note 2 at para 88, and referring to *MJB Enterprises Ltd v Defence Construction (1951) Ltd*, [1999] 1 SCR 619; *Tercon Contractors Ltd v British Columbia (Transportation and Highways)*, 2010 SCC 4 at paras 58–59, [2010] 1 SCR 69 [*Tercon*]; and Anne C McNeely, *Canadian Law of Competitive Bidding and Procurement* (Aurora, Ont: Canada Law Book, 2010) at 245–54.

implied-in-fact. One can extrapolate from the jurisprudence, as had McCamus, three situations in which the good faith performance obligation comes into play: (1) where the parties must cooperate in order to achieve the contract's objectives; (2) where one party exercises a contractual discretion; and (3) where one party seeks to evade contractual duties.[9] But otherwise there had been a palpable silence resonating from within the Supreme Court over whether the common law of contracts should include a generalized duty requiring all parties to perform their obligations in good faith. By contrast, trial courts were not shy in answering the question. Of particular note is the trial decision in *Gateway Realty Ltd v Arton Holdings Ltd.*[10] For over twenty years that decision remained the mainstay for those intent on ensuring the common law would make room for a good faith performance obligation.

*Bhasin* is the Supreme Court's first formal incursion into an area of contract law desperately in need of guidance. As the Court aptly observed: "Canadian common law in relation to good faith performance of contracts is piecemeal, unsettled and unclear."[11] *Bhasin* involved a dealership agreement, which provided that either party could terminate by giving six months' notice prior to the expiration of successive three-year renewable terms. If the required notice was not given, the agreement was renewed automatically. During the third year of the agreement, the defendant decided not to renew and gave the required notice. In point of fact, the defendant's decision to issue the notice of non-renewal was intended to force an unwanted merger of the plaintiff's dealership with that of another dealer also under the defendant's control. The plaintiff sued and argued two fold. First, all contracts are subject to an implied duty requiring the parties to perform their contractual obligations in good faith. Second, as the decision to terminate was made "for an improper purpose," the defendant had breached its implied obligation. In short, the plaintiff argued the defendant had no legitimate business reason for not renewing the agreement and had therefore abused a contractual discretion in breach of the implied obligation of good faith performance. The trial judge found for the plaintiff.[12] However, burrowed within the trial judge's reasons for

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9 See John D McCamus, "The Use of Discretion, Failure To Cooperate and Evasion of Duty: Unpacking the Common Law Duty of Good Faith Contractual Performance" (2004) 29 Adv Q 72 [McCamus, "Use of Discretion"]. The analysis offered therein has since undergone refinement; see John D McCamus, *The Law of Contracts*, 2nd ed (Toronto: Irwin Law, 2012) ch 21 at 835–68 [McCamus, *Law of Contracts*].

10 (1991), 106 NSR (2d) 180 (SC) [*Gateway Realty*], aff'd on other grounds (1992), 112 NSR (2d) 180 (CA).

11 *Bhasin, supra* note 6.

12 2011 ABQB 637, 526 AR 1 [*Bhasin TJ*].

decision can be found discrete findings with respect to dishonest conduct on the defendant's part, including barefaced lies.

The Alberta Court of Appeal reversed the trial judge's decision, principally because the law did not recognize the good faith obligation being advanced.[13] That ruling had the effect of presenting the Supreme Court with its first opportunity to decide whether the common law should adopt a general rule imposing a duty on all contractual parties to perform their obligations in good faith. To much surprise, the Court answered "no." Instead, it offered a guarded and defensible approach to the good faith doctrine. The approach involves recognition of two "incremental steps" in the development of the law.

The first step involves acceptance of a general "organizing principle" that embraces the understanding that "parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily."[14] Accordingly, a contracting party must give appropriate regard to the "legitimate contractual interests of the other party"[15] when carrying out his or her own performance. For greater certainty, the Court declared the organizing principle was not a freestanding rule, but rather a standard that manifests itself "through the existing doctrines about the types of situations and relationships in which the law requires honest, candid, forthright or reasonable contractual performance."[16] In other words, one must look to the earlier jurisprudence to see whether a good faith obligation had been recognized and then determine whether the case at hand falls within those "situations" or "relationships" outlined above. Consequently, it should no longer be necessary to fret over the proper definition of "good faith." The Court also cautioned that claims of bad faith would not generally succeed if they fall outside the earlier case law.[17] Fortunately, the list of "situations" and "relationships" is not closed. Room is made for incremental developments that are "consistent with the structure of the common law of contract and give due weight to the importance of private ordering and certainty in commercial affairs."[18]

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13 2013 ABCA 98, 84 Alta LR (5th) 68 [*Bhasin CA*].

14 *Bhasin, supra* note 6 at para 63.

15 *Ibid* at para 65.

16 *Ibid* at para 66.

17 *Ibid.*

18 *Ibid*. In recent years the Supreme Court has been consistent in maintaining that the law should move forward in an incremental fashion at least in the fields of private law. Critiques of that approach have been offered by John D McCamus, "The Future of the Canadian Common Law of Contract" (2014) J Contract L 131; and Paul M Perell, "Changing the Common Law and Why the Supreme Court of Canada's Incremental Change Test Does Not Work" (2003) 26 Adv Q 345.

Parenthetically, the first incremental step is not novel. Good faith as an organizing principle is consistent with the view the American "good faith" scholar, Summers, first articulated in 1968[19] and which found its way into the American *Restatement (Second) of Contracts*.[20] In Canada, Edward Belobaba championed Robert S Summers' framework in an influential article published in 1985.[21] In turn, John McCamus recognized both when analyzing the Canadian jurisprudence in his equally influential article published in 2004.[22] Subsequently, the substance of that article was woven into his text.[23] That text, in turn, provided the Supreme Court with a partial blueprint for its approach to the duty of good faith performance in *Bhasin*.

By contrast, the second incremental step adopted by the Supreme Court in *Bhasin* is novel. The Court formally recognized a "new" common law duty that applies to "all contracts" as a manifestation of the general organizing principle of good faith. The new duty is one of "honest performance." This means that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract.[24] The Court characterized this development as "modest" and "incremental."

The Supreme Court was emphatic in declaring the duty of honest performance not to be the product of an implied term and not to be confused with "estoppel" or the civil tort of fraud (deceit). The duty is a general doctrine of contract law and, like the doctrine of unconscionability, the parties are not free to exclude it.[25] While the Court acknowledged the improbability of a contract permitting dishonest behaviour, it did not rule out the ability of the parties to agree to terms that would influence the

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19 Robert S Summers, "'Good Faith' in General Contract Law and the Sales Provisions of the Uniform Commercial Code" (1968) 54 Va L Rev 195 [Summers, "'Good Faith' in General Contract Law"]. See also Robert S Summers, "The General Duty of Good Faith: Its Recognition and Conceptualization" (1982) 67 Cornell L Rev 810 [Summers, "General Duty"]. Summers' approach is discussed below in text commencing at note 73.

20 As adopted and promulgated by the American Law Institute in 1979 and published in 1981 [*Second Restatement*].

21 See Belobaba, *supra* note 4 at 79 - 80. The topic is addressed in text below commencing at note 121.

22 See McCamus, "Use of Discretion," *supra* note 9 at 8 - 9.

23 See McCamus, *Law of Contract*, *supra* note 9, ch 21 at 835ff.

24 *Bhasin, supra* note 6 at para 73.

25 *Ibid* at para 75. Consequently, the "entire agreement clause" anchored within the dealership agreement was unable to displace the duty of honest performance. On the topic of "entire agreement clauses," see text below accompanying note 205.

scope of the duty in a particular context.[26] As to damages for breach of the duty, the Court confirmed that contractual principles apply.[27]

The opening paragraph of the Supreme Court's decision frames the leading issue in narrow terms: "Does Canadian common law impose a duty on parties to perform their contractual obligations honestly?" That the Court would provide a positive response is hardly surprising. Intuitively, the answer has to be "yes," even if one is unsure as to the meaning or scope of "dishonest conduct." Of course, the answer is self-evident if the allegation of dishonesty captures barefaced lies, as was true in *Bhasin*. As the trial judge had found the principal defendant guilty of acting dishonestly toward the plaintiff, during the time leading up to termination of the agreement, the Supreme Court held that liability for breach of the duty of honest performance had been established.

*Bhasin* is essential reading for those intent on understanding the scope of the good faith doctrine in contract law even though the issue ultimately decided was relatively narrow. For the legal pragmatist, Angela Swan's compressed summary of the practical significance of *Bhasin* is memorable: "Just don't tell lies!"[28] McCamus' observation that the case "marks an important milestone in the development of the Canadian common law of contract"[29] is equally apt. At the same time, this commentary identifies two aspects of *Bhasin* that remain troubling. Both relate to the duty of honest performance. The first impinges on the Court's finding that the duty had been breached.[30] The second is rooted in the Court's assessment of damages.[31] From the plaintiff's perspective, the amount awarded by the Supreme Court ($87,000) is a far cry from the amount awarded at trial ($455,000).[32] A pyrrhic victory indeed!

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26 *Ibid* at para 77.

27 *Ibid* at para 88.

28 Angela Swan, "The Obligation to Perform in Good Faith: Comment on *Bhasin v Hrynew*" (2015) 56 Can Bus LJ 395 at 395.

29 John D McCamus, "The New General Principle of Good Faith Performance and the New 'Rule of Law' of Honesty in Performance in Canadian Contract Law" (2015) 32 J Contract L 103 at 118 [McCamus, "New General Principle"].

30 It is argued herein that the Court's reasons are problematic in regard to two matters: the lack of reliance on the plaintiff's part and the significance of the defendant's failure to respond fully to the plaintiff's questions regarding the defendant's future intentions regarding non-renewal. The latter point is raised by McCamus, "New General Principle," *ibid* at 112 and 114. These issues are dealt with the text below commencing at note 221.

31 Discussed below in the text commencing at note 230.

32 The trial judge's decision in *Bhasin* set out an award of $380,597. Following trial, a further hearing was held and the amount was increased to reflect simple interest in the amount of $74,497. Formal judgment was entered on July 20, 2012, for $455,064.

This commentary, however, is more than a case comment. Aside from the historical and comparative analysis offered below, it seeks to show that *Bhasin* is equally important for what was not formally decided. There is *obiter dictum* to support the understanding that the plaintiff's good faith performance argument was doomed to fail had the Court not based its decision on the duty of honest performance.[33] The Court shunned the defendant's good faith argument because the dealership agreement did not fall within the type of contractual "relationships" in which the law already recognized a duty of good faith performance.[34] Furthermore, the Court counselled that it would be difficult to imply the performance obligation on the basis of the parties' intentions having regard to the "entire agreement clause" anchored within the agreement ("no implied terms").[35] To those observations was added a third: no damages flowed from the alleged breach.[36] Finally, the Court discerned that it would be a significant extension of the law to classify the right of non-renewal as the exercise of a contractual discretion so as to come within those "situations" in which the duty of good faith performance had been earlier recognized.[37] The latter observation raises a fundamental question: What type of decision qualifies as the exercise of a contractual discretion subject to the good faith performance obligation?[38] To the legal practitioner and judge alike, that question alone may well over shadow the precedential significance of the new duty of honest performance.[39] The question warrants consideration

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33 I agree with the thrust of McCamus's observation: "Cromwell J essentially rejected the [plaintiff's] argument that [the defendant] had breached an implied term requiring [the defendant] to exercise contractual discretions in good faith." See McCamus, "New General Principle," *supra* note 29 at 107. This topic is dealt with below commencing at note 221.

34 *Bhasin, supra* note 6 at para 72. The possibility of expanding the short list of contractual relationships, subject to the duty of good faith performance, to include dealerships agreement was not considered. The analogy between franchise and dealership agreements is hopefully one that will be explored in a subsequent case.

35 *Ibid.* This issue is discussed below in the text commencing at note 204.

36 *Ibid* at para 90.

37 *Ibid* at para 72. The *obiter* comments are discussed below in the text commencing at note 199.

38 On the facts of *Bhasin* the critical issue was whether a right of non-renewal should be treated differently that a right of termination. The question is addressed below in the text commencing at note 204.

39 Arguably much of the Canadian jurisprudence surrounding the duty of good faith contractual performance has involved the defendant's decision to exercise a contractual right and an allegation of "abuse of discretion" together with an inquiry into the defendant's motives, see e.g. *Gateway Realty*, *supra* note 10, discussed in text below commencing at note 145.

even though the *obiter* is culled from a few paragraphs of the Court's extensive reasons.[40]

*Bhasin* is also important for leaving unanswered another fundamental question: whether the good faith performance obligation is capable of overriding an express and unambiguous provision of the contract, as effectively happened in *Gateway Realty*. That was a case in which the trial judge articulated a robust role for the obligation to perform contracts in good faith, one that supports the understanding that the good faith obligation is capable of overriding the express terms of the contract so long as the defendant has acted contrary to "community standards of honesty, reasonableness or fairness."[41]

*Bhasin* acknowledged the robust model of good faith articulated in *Gateway Realty* and the criticism it attracted.[42] Commentators were convinced that such a model would create commercial uncertainty and undermine fundamental precepts associated with freedom of contract. As well, two influential appellate court decisions had politely rejected the prospect of a stand-alone obligation of good faith performance operating independently of an agreement's express terms.[43] To the extent the good faith performance obligation arises as an implied term of the agreement, one must recognize that the common law does not permit an implied term to override an express one.[44] And this holds true irrespective of whether the term is implied-in-law or implied-in-fact.[45] However, the Supreme Court stopped short of rejecting outright *Gateway Realty's* model of good faith contractual performance.[46] Instead, the Court cautioned that the law should be developed in an "incremental fashion" and in circumstances where the ramifications of the development are "not incapable of assessment."[47]

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40 See *Bhasin, supra* note 6 at paras 70, 72, 90 and 91 and the discussion in the text below commencing at note 128.

41 *Gateway Realty, supra* note 10 at para 58.

42 See *Bhasin, supra* note 6 at paras 38–39.

43 *Mesa Operating Ltd Partnership v Amoco Canada Resources Ltd* (1994), 149 AR 187 (CA) [*Mesa*], discussed below commencing at note 100 and again at 140, and *Transamerica Life Canada Inc v ING Canada Inc* (2003), 68 OR (3d) 457 (CA) [*Transamerica*] discussed below at note 100.

44 Regrettably, the Court in *Bhasin, supra* note 6 at para 74, expressly declined the opportunity to decide whether the duty of good faith arises as a matter of fact or as a term implied by law. The Court, however, was adamant that the duty of honest performance was not the product of an implied term.

45 This issue is dealt with below in the text commencing at note 102.

46 See *Bhasin, supra* note 6 at paras 38–39.

47 *Ibid* at para 40.

At this point, it is instructive to observe that in the United States there is a general consensus that the implied obligation of good faith contractual performance plays a modest role in the law, namely, filling in contractual gaps. As Posner J succinctly stated: "The concept of the duty of good faith […] is a stab at approximating the terms the parties would have negotiated had they foreseen the circumstances that have given rise to the dispute."[48] Above all, the leading American scholars contend that it is not the role of courts to rewrite contracts in a manner that accords with vague concepts of fairness in commercial dealing.[49] In particular, the good faith doctrine cannot be used to by-pass the terms of a contract because they are the product of an inequality in bargaining power or because a contractual provision is so one-sided as to bear the markings of an unconscionable deal. Nevertheless, there are fissures along the support walls restraining the "general consensus." Those fissures are particularly prominent in the context of franchise or dealership agreements and, not surprisingly, demand loans. These are the types of contractual relationships where abuse of a contractual right is likely to be litigated.

In contrast to the American model of good faith performance, the civil law of Quebec has long recognized a robust model that even extends to matters of contract formation. Moreover, the development of that model has not been dependent on specific provisions of the *Civil Code*.[50] Better still, the Supreme Court's decision in *Houle v Canadian National Bank* goes further.[51] Under the doctrine of "abuse of contractual rights" parties must not only act in good faith, they must exercise their contractual rights in a "reasonable" manner. *Houle* is an obligatory read for those interested

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48 *Market Street Associates Ltd Partnership v Frey,* 941 F (2d) 588 at 595 (7th Cir 1991) [*Market Street Associates*], quoting *AMPAT/Midwest, Inc v Tool Works, Inc*, 896 F (2d) 1035 at 1041 (7th Cir 1990) (Posner J).

49 Reference has already been made to the contribution of Summers: see *supra* note 19. The other prominent "good faith scholar" is Burton. His contribution to the scholarship is universally accepted, beginning with a seminal article published in the Harvard Law Review; see Steven J Burton, "Breach of Contract and the Common Law Duty to Perform in Good Faith" (1980) 94 Harv L Rev 369 [Burton, "Breach of Contract"], and also Steven J Burton and Eric J Andersen, *Contractual Good Faith: Formation, Performance, Breach and Enforcemen*t (New York: Little, Brown and Company, 1995) [Burton & Andersen].

50 The duty of good faith was subsequently included in the revisions leading to the enactment of the *Civil Code of Québec,* CQLR, c C-1991. Art 6 requires everyone to exercise his or her civil rights in good faith. Art 7 states that no right may be exercised with the intent of injuring another or in an unreasonable manner, which is contrary to the requirements of good faith. Art 1375 requires parties to conduct themselves in good faith at the time the obligation is created, performed, and extinguished.

51 [1990] 3 SCR 122 [*Houle*]. See also *Bank of Montreal v Bail Ltée*, [1992] 2 SCR 554.

in comparative law and those who tire easily with the common law's reluctance to accept change on the ground of commercial uncertainty. The reality is that Canada's civil and common law traditions remain inconsistent both prior to and after *Bhasin*.[52] This is so even though *Bhasin* acknowledged that the Quebec experience shows that "even broad conceptions of the duty of good faith have not impeded contractual activity or contractual stability."[53]

Ultimately, however, one must accept that the Supreme Court sees the duty of good faith performance as playing the modest role of filling in contractual gaps. This understanding is hard to dispel once reminded of the reasons underscoring *Bhasin's* indirect rejection of the plaintiff's good faith performance argument. Fortunately, the Court's observations are not penned as absolutes and the door has been left open for incremental changes. Surely, there are cases where the modest role assigned to the duty of good faith contractual performance is troubling, to say the least.

Admittedly, a good faith doctrine that would allow the performance obligation to override an express provision of a contract would have to acknowledge that, in some instances, the source of the perceived injustice lies not in the manner in which a contractual right has been "performed" but rather from the fact the right was agreed to in the first place. This is what happened in *Gateway Realty*.[54] Defendants cannot be faulted under the good faith doctrine for performing in a manner that is entirely consistent with the contract's express terms. It is not as though the contract qualifies as an unconscionable bargain. Arguably, what is unconscionable is the provision upon which the defendant's contractual right is anchored.[55] This leads one to ask whether the good faith doctrine will become a surrogate for an unconscionability doctrine that makes little room for setting aside a contractual provision that is manifestly one-sided (e.g.

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[52] However, the two systems are *ad idem* when it comes to the enforcement of contractual rights governing the repayment of demand loans. Both accept that the lender's obligation to provide the borrower with reasonable time to pay arises as a matter of judicial policy and overrides the contract's express provisions. See discussion below in text commencing at note 152.

[53] *Bhasin, supra* note 6 at para 85, citing to Jean Pineau, "La discrétion judiciaire a-t-elle fait des ravages en matière contractuelle?" in Service de la formation permanente du Barreau du Québec, *La réforme du Code civil, cinq ans plus tard*, vol 113 (Cowansville, Que: Yvon Blais, 1998) 141. This acknowledgment undermines the argument that a robust model of good faith performance would "permit *ad hoc* judicial moralism to undermine the certainty of commercial transactions" See *Bhasin, supra* note 6 at para 79.

[54] Discussed in text below commencing at note 128.

[55] This theme is discussed in text below commencing at note 73, and is informed by McCamus's analysis; see McCamus, *Law of Contract*, *supra* note 8.

termination clauses anchored within a franchise or dealership agreement). It is not difficult to slide quickly from the unconscionability doctrine to the good faith doctrine in order to question the reasonableness of the defendant's decision to exercise a contractual right or discretion to the plaintiff's detriment.[56]

On the other hand, there are cases where the defendant is guilty of "opportunistic behaviour" that falls too neatly within the four corners of the agreement. The notion of opportunism brings to mind Fried's description of the good faith obligation in terms of condemning deception, chicanery, and sharp practice in the carrying out of contractual obligations.[57] The reference to sharp practice coincides nicely with the incisive observations of Swan and Adamski[58] and the engaging, but controversial, decision of Posner J in *Market Street Associates Ltd Partnership v Frey*.[59] In brief, not all good faith cases are easily decided, and the Supreme Court's decision in *Bhasin* does not pretend otherwise. These are the kind of matters addressed in this commentary and for good reason.

With the release of every ground breaking Supreme Court decision there is an exponential increase in the number of reported decisions seeking to advance the law far beyond the furrows the Court had thought it had carefully staked out. It is a certainty that too many cases involving breach of contract will contain an added plea of "bad faith performance" grounded on *Bhasin*. Judges will have to sift the meritorious claims from those filed out of an abundance of caution. The starting point of any analysis is to look to the jurisprudence pre-dating *Bhasin* to see whether the law had already recognized a good faith obligation. Above all, one must look back before gazing forward to appreciate where the law is and where it may be headed after *Bhasin*. That is the direction in which this commentary is now headed.

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56 This theme was captured by Elisabeth Peden, "When Common Law Trumps Equity: The Rise of Good Faith and Reasonableness and the Demise of Unconscionability" (2005) 21 J Contract L 226, cited in *Bhasin, supra* note 6 at paras 43 and 79. See also SM Waddams, "Good Faith, Unconscionability and Reasonable Expectations" (1995) 9 J Contract L 55.

57 Charles Fried, *Contract As Promise: A Theory of Contractual Obligation* (Cambridge, Mass: Harvard University Press, 1981) at 85 [Fried].

58 Swan and Adamski, *supra* note 3 at para 8.158.1.

59 *Market Street Associates*, *supra* note 48.

### *3. The American Model*

It is helpful to start with an appreciation of the American framework for dealing with the good faith performance obligation, since the United States has produced more relevant case law and academic literature than any other jurisdiction. That the Americans would have a head start is a fact worth recognizing. Indeed, long ago the Ontario Law Reform Commission sought guidance from the American model, as have many Canadian commentators. It is not surprising that the Canadian and American jurisprudence follows a common path, yet there are important deviations. The following is a compressed overview of the American experience.

The American preoccupation with the concept of good faith in contractual performance surfaced in the 1960s with state legislatures adopting the model law set out in the Uniform Commercial Code (UCC). This was followed by judicial acceptance of the legal principles set out in the *Second Restatement*. Both documents contain provisions requiring all parties to perform their contractual obligations in good faith. However, these sources deliberately abstain from defining good faith or do so in a manner that is really too vague to be of practical assistance. Thus, it falls on the courts to delineate the boundaries between good and bad faith conduct in a manner that promotes consistency in decision-making. At the same time, it is necessary to acquire a basic understanding of the American approach to good faith contractual performance. As will become evident, the common law assigned a modest role to the concept and nothing really changed with state adoption of the UCC or judicial application of the principles set out in the *Second Restatement.*

Prior to the promulgation of the UCC and the *Second Restatement,* the obligation of the contracting parties to act in good faith was one that arose by implication under the common law. The judicial practice of implying contract terms expanded greatly following Cardozo J's seminal opinion in *Wood v Lucy, Lady Duff-Gordon*.[60] The facts are simple and well known to every American law student.

The plaintiff, Lady Duff-Gordon, was a fashion designer who entered into an agreement with the defendant, Otis Wood, an advertising agent. Wood was granted the exclusive right to market and license her designs and to place her endorsement on the designs of others. They agreed to divide the profits derived from contracts Wood might make. However, Lady Duff-Gordon breached their agreement twice by entering into design agreements with two other parties. She kept all of the profits from those transactions without disclosing any of this information to Wood. Once he

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[60] 222 NY 88 (Ct App 1917).

learned of the transgressions, he sued for damages for breach of the agreement.

Lady Duff-Gordon demurred on the ground that the agreement lacked mutuality. Simply put, Wood made no promise that he would promote her designs and, therefore, the agreement was unenforceable for want of consideration. While the New York Supreme Court (Appellate Division) dismissed Wood's action, the 4-to-3 majority of the New York Court of Appeals reversed. Writing for the majority, Cardozo J reasoned:

> It is true that [Mr Wood] does not promise in so many words that he will use reasonable efforts to place the defendant's indorsements and market her designs. We think, however, such a promise is fairly to be implied. The law has outgrown its primitive stage of formalism when the precise word was the sovereign talisman, and every slip was fatal. It takes a broader view to-day. A promise may be lacking, and yet the whole writing may be "instinct with an obligation," imperfectly expressed [citations omitted]. If that is so, there is a contract.[61]

In the next paragraph, Cardozo J explained that the implied promise was one supported by the terms of the contract. And without an implied term requiring Wood to use reasonable efforts to market Lady Duff-Gordon's designs she would gain nothing: "the transaction cannot have such business 'efficacy as both parties must have intended that at all events it should have' (Bowen LJ, in *The Moorcock*, 14 PD 64, 68)."[62] This led to the ultimate conclusion: "His promise to pay the defendant one-half of the profits and revenues resulting from the exclusive agency and to render accounts monthly, was a promise to use reasonable efforts to bring profits and revenues into existence."[63]

The decision in *Wood v Lucy, Lady Duff-Gordon* illustrates the judicial technique of implying a term based on what the so-called officious bystander would regard as consistent with the intention of the parties. Without the implied term the agreement made no sense. That the court would imply an obligation on the part of Mr. Wood to make "reasonable efforts" to market the designs of her Ladyship is also consistent with the notion of business efficacy referred to in Cardozo J's reasons and which now permeates the Canadian jurisprudence beginning with the Supreme Court's decision in *Canadian Pacific Hotels Ltd v Bank of Montreal*.[64] Without the obligation to make reasonable efforts at marketing Lady Duff-Gordon's designs, she would have been unable to make a living having

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61 *Ibid* at 90.

62 *Ibid*.

63 *Ibid.*

64 [1987] 1 SCR 711 [*Canadian Pacific Hotels*].

regard to the exclusive nature of the agency agreement. With the passage of time, Cardozo J's "reasonable efforts" obligation would be regarded as the paradigmatic example of the implied obligation to perform a contract in good faith.

The judicial practice of implying contract terms expanded greatly following Judge Cardozo's famous opinion in *Wood v Lucy, Lady Duff-Gordon.* For some time, courts implied terms on *ad hoc* basis, but starting in 1933 the New York Court of Appeals began the practice of implying the reasonable efforts obligation under the rubric of the implied covenant of good faith and fair dealing based on what was decided in *Kirke La Shelle Co v Armstrong Co.*[65]

The implied covenant of good faith in American law received a significant boost with promulgation of the Uniform Commercial Code (UCC) in 1951. By the end of the 1960s, nearly every US jurisdiction had adopted the statutory obligation of good faith and fair dealing. That obligation applies to many commercial transactions, but not all. The UCC applies to the sale and leasing of goods, the use of negotiable instruments, banking transactions, letters of credit, documents of title for goods, investment securities, and secured transactions.[66] However, there are also many business-related contracts that the UCC does not cover, including real estate, service, and employment contracts.[67]

For those contracts falling within the ambit of the UCC, Article 1-304 sets out the good faith obligation: "[e]very contract or duty imposes a duty of good faith in its performance or enforcement." Article 1-201(19) defines good faith as "honesty in fact in the conduct or transaction concerned". And in Article 2-103(1)(b), which deals with the sale of goods by merchants, the definition of good faith requires parties to act not only with "honesty in fact" but also in the observance of "reasonable commercial standards of fair dealing in the trade." Although contracting parties may be successful in limiting or defining the scope of the obligations owed by the duty of good faith, it is widely recognized that the duty cannot be completely waived or bargained away. Specifically, Article 1-102(3) provides that the

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65 188 NE 163 (NY Ct App 1933), cited in *Bhasin*, *supra* note 6 at para 85, holding that every contract includes an implied covenant of good faith and fair dealing.

66 The complete list is found online Uniform Law Commission: <www.uniformlaws.org/Act.aspx?title=UCC%20Article%201,%20General%20Provisions%20(2001)>.

67 With respect to employment contracts and the duty of good faith, see James J Brudney, "Reluctance and Remorse: The Covenant of Good Faith and Fair Dealing with American Employment Law" (2010-2011) Comp Lab L & Pol'y J 773.

good faith obligation may not be disclaimed by agreement. However, the parties may agree on the standard by which the performance of such obligations is to be measured, provided the standard is not manifestly unreasonable.[68]

One of the leading American "good faith" scholars, Burton, has been candid in his observation that courts have largely ignored the definitions found within the UCC. He explains:

> On their face, the U.C.C. good faith requirements are stated in the vaguest of terms, supported by definitions either too limited to be taken seriously in the performance and enforcement context (honesty in fact), or as opaque as good faith itself (reasonable commercial standard of fair dealing in the trade). In practice, most courts find their way to a reasonable construction of the obligation following the litigation. Great resources, however, may be consumed in the process. A few courts have used the doctrinal vagueness as a pretext to impose unprecedented liability on commercial parties, notably lenders and suppliers to dealers or franchises. Just enough unorthodox judgments occur to inspire ever-optimistic plaintiffs' counsel to keep the law-suits coming.[69]

Finally, it is worth noting that the modest role assigned to the good faith doctrine under the UCC is reinforced by the views expressed by one its architects, Karl Llewellyn. During the 1954 hearings of the New York Law Revision Commission, he commented that "good faith has been part of mercantile law since American law began."[70] Edwin Patterson provided the same Commission with an analysis showing that the obligation was well established in New York case law.[71] The more recent comments of Burton perhaps best summarize the American position:

> The drafters of the U.C.C. did not think they were doing anything novel by codifying requirements of good faith. Judicial practice over the years generally has favoured the drafter's understanding. With rare exception, the courts use the U.C.C. good faith requirements in aid and furtherance of the parties' agreement, not to override the parties' agreement for reasons of fairness, policy, or morality. Judicial practice has followed the counterpart common law obligation, often without clearly distinguishing from common law authorities.[72]

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68 It is worth noting that the Supreme Court in *Bhasin* acknowledged that its approach in regard to waiver of the duty of honest performance was "similar in principle" to Article 1-102(3). See *Bhasin, supra* note 6 at para 77.

69 Steven J Burton, "Good Faith in Articles 1 and 2 of the UCC: The Practice View" (1994) 35 Wm & Mary L Rev 1533 at 1535.

70 *Ibid* at 1533, n 2.

71 *Ibid.*

72 *Ibid* at 1533.

The other prominent source of the good faith obligation is the *Second Restatement.* Initially, the American Law Institute was hesitant to adopt a good faith and fair dealing requirement for fear that if drafted too broadly it might be used by courts to rewrite contracts. The hesitancy dissipated in 1981 with publication of the *Second Restatement.* Section 205 affirmed that "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and in its enforcement." However, no attempt was made to define the term "good faith" as it was believed that its meaning is dependent on the context in which it is being used. Instead, the drafters observed that good faith "emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party."

The failure of the *Second Restatement* to define good faith was deliberate. The reality is that the words "good faith" are as remarkable for what they hide as for what they reveal. Hence, the search for a practical definition remained elusive and those that were identified seemed too vague for purposes of doctrinal predictability. To avoid that criticism, commentators looked at other approaches to replace the futility of seeking a universally acceptable definition for bad faith. Of the lead scholars, it was Burton who introduced the use of economic analysis (the "foregone opportunities" approach).[73] But it was Summers, one of the architects of the *Second Restatement,* who introduced the "excluder analysis" in order to overtake the inherent difficulty of the identifying and applying a definitional framework for good faith conduct. Summers was insistent that good faith not be regarded as a rule but "more in the nature of a principle or maxim"[74] that cannot be reduced to a "vacuous general definition."[75] He posited:

> In point of fact, our law recognizes many kinds of non-rules as law. Why not similarly recognize the principle requiring contractual good faith? Furthermore, if we are to have doctrines which, among other things, perform safety valve functions, then isn't

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[73] See Burton, "Breach of Contract," *supra* note 49. Elements of his approach are discussed below in text commencing at note 217. For a concise analysis of the leading models of the implied obligation of good faith and fair dealing see Emily Houh, "The Doctrine of Good Faith in Contract Law: A (Nearly) Empty Vessel?" (2005) Utah L Rev 1.

[74] Summers, "General Duty," *supra* note 19 at 821. In his now seminal article, Burton began by noting "A Majority of American jurisdictions, the *Restatement (Second) of Contracts*, and the Uniform Commercial Code (U.C.C.) now recognize the duty to perform a contract in good faith as a general principle of contract law" [citations omitted]; see Burton, "Breach of Contract," *supra* note 49 at 1.

[75] Summers, "'Good Faith' in General Contract Law," *supra* note 19 at 206, 264–65.

> it inevitable that they will take rather general form? Of course, in their specific applications, they will generate rules.[76]

Summers argued that open-ended equitable doctrines such as good faith operate as important supplements to existing legal rules.[77] These doctrines function not only as independent bases for liability but also to "limit and quantify specific legal rules and contract terms."[78] Central to Summers' theory of good faith is the notion that good faith performance cannot be reduced to a definable and specific set of appropriate and acceptable behaviours. Rather "[g]ood faith is an excluder […] [a] phrase without general meaning or meanings of its own and serves to exclude the wide range of heterogeneous forms of bad faith."[79] Hence, the more productive approach is to look to the jurisprudence to see what qualifies as bad faith conduct. Summers' analysis involved the delineation and acceptance of four broad categories of bad faith: "Bad Faith in the Negotiation and Formation of Contracts,"[80] "Bad Faith in Performance,"[81] "Bad Faith in Raising and Resolving Contract Disputes,"[82] and "Bad Faith in Taking Remedial Action."[83]

Summers had already undertaken the task of cataloguing various recurring but "heterogeneous" forms of bad faith conduct, culled from an expansive review of the then-existing case law. In generating the catalogue with respect to "Bad Faith in Performance," Summers was careful to point out that his list of subcategories was not exhaustive: "Evasion of the Spirit of the Deal," "Lack of Diligence and Slacking Off," "Wilfully Rendering Only 'Substantial Performance,'" "Abuse of Power to Determine Compliance" and "Interfering With or Failing to Cooperate in the Other Party's Performance."[84]

The explanatory comments to the *Second Restatement* contain an indirect reference to Summers' contribution to the development of the law. The Institute admitted it was not possible to provide an exhaustive list of what conduct qualified as bad faith performance but that a number of recurring themes could be extracted from the jurisprudence. Those recurring themes nearly mirror, word-for-word, those Summers had identified: evasion of the spirit of the deal or bargain; lack of diligence on

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76 *Ibid* at 265.
77 *Ibid* at 198.
78 *Ibid*.
79 *Ibid* at 203.
80 *Ibid* at 220–32.
81 *Ibid* at 232–43.
82 *Ibid* at 243–48.
83 *Ibid* at 248–52.
84 *Ibid* at 243–43.

the part of one of the parties; intentionally rendering performance that does not conform to the requirements of the contract; abuse of the power to specify express terms; and interference or failure to cooperate with the other party's performance.

There is one aspect of the American approach to the duty of good faith in contractual performance that resonates throughout the literature: the implied obligation cannot be used for the purpose of rewriting contracts. Accordingly, the implied obligation is not to be confused or equated with the tenets of unconscionability doctrine. As Burton bluntly observed, the implied obligation has nothing to do with "meaningful choice" or "one-sided terms."[85] On the judicial front, it was Posner J who memorably observed: "The contractual duty of good faith is thus not some newfangled bit of welfare state paternalism or the sediment of an altruistic strain in contract law."[86]

According to Burton, there is a general consensus that the implied obligation has a modest role to play in contract law: filling-in contractual gaps. In other words, "the implied Covenant makes explicit an obligation implicit in the parties' express agreement."[87] Burton explains that the need for the implied obligation stems from the realization that express agreements are commonly incomplete expressions of the parties' agreement. Parties may not state the obvious, such as that one party may not prevent the other from performing its obligation. Burton also explains that in some case the parties' express agreement is incomplete because it leaves one of the parties with the discretion to determine the scope of his or her own obligation or that of the other party: "the law requires a party to exercise good faith in exercising an unlimited discretionary power over a term of the contract if necessary to effectuate the parties' intent and save a contract from being held illusionary."[88] In short, the implied obligation does not create new obligations outside the scope of the contract. Like any implied term the aim is to implement the parties' unstated intentions and to protect their reasonable expectations.

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85 See Burton, "Breach of Contract," *supra* note 49 at 383–4; and Burton & Andersen, *supra* note 49 at 50.

86 *Market Street Associates, supra* note 48 at 595. The same point was made in *Bhasin, supra* note 6 at para 70 where the Court held: "The development of the principle of good faith must be clear not to veer into a form of *ad hoc* judicial moralism or 'palm tree' justice." And at para 79 of the same decision, the Court recognized the argument against an increased role for the good faith duty because it would "permit *ad hoc* judicial moralism to undermine the certainty of commercial transactions."

87 Steven J Burton, "Good Faith Performance of a Contract within Article 2 of the Uniform Commercial Code" (1981) 67 Iowa L Rev 1 at 4–5.

88 *White Stone Partners, LP v Piper Jaffray Companies, Inc*, 978 F Supp 878 at 882 (D Minn 1997) [*White Stone*].

### *4. Towards A Canadian (Common Law) Model*

In Canada, a renewed interest in the good faith duty surfaced with the Ontario Law Reform Commission's 1979 *Report on the Sale of Goods*[89] and its 1987 *Report on Amendment of the Law of Contract*.[90] Within each of those law reform documents is found a recommendation for the adoption of an implied duty of good faith performance modelled on the American sources discussed above. During the 1980s, Canadian scholars argued for and against recognition of a good faith doctrine that would recognize an implied duty of good faith performance in all contracts. The scholarly writings of Belobaba,[91] Michael Bridge,[92] Don Clark,[93] Philip Girard,[94] Reuben Hasson,[95] and John Swan[96] were prominent and are still cited in the jurisprudence. On the judicial front, cases such as *Gateway Realty* served as the cornerstone for courts willing to recognize and apply the implied duty. As noted at the outset, that was a case in which the trial judge was not shy in defining "bad faith" as conduct that is contrary to "community standards of honesty, reasonableness or fairness". And that is a case where the implied duty was applied to override an express provision of the contract.

Eventually, Canadian law evolved to where courts were generally willing to imply a contractual duty to perform in good faith. But no one knew for certain whether it arose as a matter of judicial policy (implied-in-law) or as an implied term based on the presumed intention of the parties and, correlatively, the reasonable expectation of the parties (implied-in-

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89 Ontario Law Reform Commission, *Report on Sale of Goods*, vol 1 (Toronto: Ministry of the Attorney General, 1979), ch 7.

90 Ontario Law Reform Commission, *Report on Amendment of the Law of Contract* (Toronto: Ministry of the Attorney General, 1987), ch 9.

91 Belobaba, *supra* note 4.

92 Michael G Bridge, "Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?" (1984) 9 Can Bus LJ 385. See also E Allan Farnsworth, "Comment on Michael Bridge's Paper" (1984) 9 Can Bus LJ at 426.

93 Don Clark, "Some Recent Developments in the Canadian Law of Contracts" (1993) 14 Adv Q 435.

94 Philip Girard, "'Good Faith' in Contract Performance: Principle or Placebo" (1983) 5 SCLR 309.

95 Reuben A Hasson, "Good Faith in Contract Law: Some Lessons from Insurance Law" (1987) 13 Can Bus LJ 93 where it is suggested that the good faith obligation has produced "bizarre" results in insurance law while questioning the wisdom of extending the doctrine throughout contract law.

96 John Swan, "Whither Contracts: A Retrospective and Prospective Overview", in *Special Lectures of the Law Society of Upper Canada* (Don Mills, Ont: De Boo, 1984) at 125.

fact).[97] And having regard to the ruling in *Gateway Realty,* some appellate courts were concerned that the implied obligation would be transformed into a stand-alone duty of good faith, one that would be applied independently of what the contract had to say. In *Mesa Operating Ltd Partnership v Amoco Canada Resources Ltd,*[98] Kerans JA cautioned against blurring the distinction between those cases where a rule of law imposes a duty upon the parties "despite their agreement," as is true for example with respect to unconscionable contracts, and those cases where the court imposes a rule that "fulfills" the contract.[99] And in *Transamerica Life Canada Inc v ING Canada Inc,*[100] it was O'Connor ACJ who observed that Canadian courts had not recognized "a stand-alone duty of good faith that was independent from the terms expressed in a contract or from the objectives that emerge from those provisions."[101]

Assuming the obligation of good faith contractual performance is not a stand-alone duty, the performance obligation has two possible common law sources. Either it is classified as a term implied-in-fact or as a term implied-in-law.[102] While there is a clear distinction between the two sources, there is also a common denominator. In both instances the implied term must be consistent with and not override an otherwise express and unambiguous provision of the agreement. The following analysis addresses those propositions.

Aside from those terms that are implied based on custom or usage in commercial practice, it is possible to imply a term as a matter of fact or as a matter of law. Briefly, terms implied-in-fact are based on the presumed intentions and reasonable expectations of the parties and are said to be necessary on the particular facts of a case.[103] There are two overlapping tests for determining whether a term can be implied: business efficacy and

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97 In *Bhasin, supra* note 6 at para 74, the Court acknowledged that there was a long-standing debate about whether the duty of good faith arises as term implied in fact or law, but that it was unnecessary "to resolve this debate fully."

98 *Mesa, supra* note 43.

99 *Ibid* at para 15.

100 *Transamerica, supra* note 43.

101 *Ibid* at para 53.

102 The relevant jurisprudence was fully and competently addressed by Shannon Kathleen O'Byrne, "The Implied Term of Good Faith and Fair Dealing: Recent Developments" (2007) 86 Can Bar Rev 193, cited with approval in *Bhasin, supra* note 6 at para 47.

103 I am mindful of the legal debate and jurisprudence dealing with terms that are implied-in-fact. The decision of the Judicial Committee of the Privy Council in *Attorney General of Belize v Belize Telecom Ltd*, [2009] 1 WLR 1988, [2009] 2 All ER 1127 (PC) is on point as is the commentary penned by Brandon Kain, "The Implication Of Contractual Terms in the New Millennium" (2011) 51 Can Bus LJ 170. As well, I would

officious bystander. This understanding is the product of Le Dain J's reasons in *Canadian Pacific Hotels*[104] where he characterized the test for implying a term "as necessary to give business efficacy to a contract or a otherwise meeting the 'officious bystander' test as the term the parties would say, if questioned that they had obviously assumed."[105] Recall that in *Wood v Lucy, Lady Duff-Gordon*[106] Cardozo J had used the business efficacy test to imply what subsequently would be labeled a good faith obligation of contractual performance. In short, the defendant in that case had to use his best efforts to promote the plaintiff's business. However, it was axiomatic that any terms implied as a matter of fact must be consistent with and not override an unambiguous term of the contract.

The decision in *Canadian Pacific Hotels* makes room for a third category of implied term, namely, those which are implied as a matter of law and not dependent on the presumed intention of the parties. As McLachlin J aptly noted in *London Drugs Ltd v Kuehne & Nagel International Ltd*,[107] "The court, where appropriate may as a matter of policy imply a term in particular type of contract, even where it is clear that the parties did not intend it."[108] Thus, terms implied in law are said to be legal incidents of particular kinds of contractual relationships. All of this leads one to ask what kinds of contracts qualify or, more precisely, what legal test is to be applied when determining whether a type of contract is subject to a good faith performance obligation which is implied-in-law and, therefore, as a matter of judicial policy. The answer is restated in *Bhasin*: "Terms implied by law redress power imbalances in certain classes of contracts such as employment, landlord-lessee, and insurance contracts."[109] In brief, contracts marked by an inequality of bargaining power and resemble contracts of adhesion ("take or leave it") are apt to be subject to terms that are implied-in-law.

Take, for example, the influential decision of the House of Lords in *Liverpool City Council v Irwin*.[110] In that case the landlord was under no obligation, contractual or otherwise, to maintain the common areas of a residential tenement in repair and failed to do so. In response, the residential tenants withheld rent while alleging the landlord was under an

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be remiss not to draw attention to the incisive analysis of the issue found within Swan and Adamski, *supra* note 3 at 718–22.

104 *Supra* note 64..

105 *Ibid* at 775.

106 *Supra* note 60.

107 [1992] 3 SCR 299.

108 *Ibid* at 457.

109 *Bhasin, supra* note 6 at para 55.

110 [1977] AC 239, [1976] 2 All ER 39 (HL).

implied obligation to maintain the common areas. The House of Lords agreed: it was reasonable and necessary to impose such an obligation on the landlord. As McCamus succinctly put it: "Terms are implied in law, then, to ensure the fair functioning of agreements in the context of standard transaction such as contracts of employment, insurance, leases, and so forth."[111]

In regard to employment relationships, it is important to recognize that in *Bhasin* the Supreme Court did not go so far as to declare that all aspects the employment relationship are subject to the implied duty of good faith. Instead, the Court turned to its decision in *Honda Canada Inc v Keays*[112] where the Court had held that in all employment contracts there is an implied term of good faith governing the manner of termination. Citing an earlier decision, *Wallace v United Grain Growers Ltd,*[113] the Court held that an employer should not engage in conduct that is "unfair or is in bad faith by being, for example, untruthful, misleading or unduly insensitive."[114]

Insurance contracts are also on the Supreme Court's list on their list of contracts in which the duty of good faith performance is implied as a matter of judicial policy. The duty requires an insurer to deal with its insured's claim fairly, both with respect to the manner in which it investigates and assesses the claim and to the decision whether or not to pay, as noted in *Fidler v Sun Life Assurance Co of Canada.*[115] Breach of the duty in those circumstances may support an award of punitive damages: *Whiten v Pilot Insurance Co*.[116] Moreover, the duty of good faith is reciprocal; the insurer must act in good faith by disclosing facts material to the issuance of the insurance policy.

To the extent that the obligation of good faith contractual performance is a term implied-in-fact that term is reflection of the parties' presumed intentions and, therefore, must be consistent with the express provisions of the agreement. This leads one to ask whether this is also true in regard to those terms that are implied-in-law. Having regard to the reality that terms so implied are not dependent on identifying the parties' presumed intentions, but rather on ensuring the fair functioning of an agreement that is marked by a power imbalance, it would be easy to jump to the conclusion that the implied obligation of good faith contractual

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111 McCamus, *Law of Contract*, *supra* note 9 at 790.

112 2008 SCC 39, [2008] 2 SCR 362.

113 [1997] 3 SCR 701.

114 *Ibid* at para 98.

115 2006 SCC 30, [2006] 2 SCR 3.

116 2002 SCC 18, [2006] 1 SCR 595.

performance should trump an otherwise express provision of the agreement. But the law is otherwise.

Certainly, none of the cases in which the Supreme Court has declared that a contract is subject to a good faith performance obligation, as a term implied-in-law, has resulted in the Court overriding an express provision. Moreover, the Supreme Court's decision in *Machtinger v HOJ Industries Ltd*[117] effectively forecloses the argument that an implied term prevails over an express and unambiguous one. In that case, the Court held that in employment contracts for an indefinite period the employer was required, absent express contractual language to the contrary, to give reasonable notice of an intention to terminate in those cases where the dismissal is without cause. In her concurring reasons, McLachlin J made the distinction between a term implied-in-law and one implied-in-fact as articulated in *Canadian Pacific Hotels.* She reached the same conclusion as the majority on the basis that the implied term of reasonable notice arose as matter of law and, therefore, it was unnecessary to be concerned with the parties' presumed intentions. However, she acknowledged that the implied duty to give reasonable notice could be displaced by an express agreement. Finally, it is noteworthy and comforting to observe that both McCamus[118] and Swan and Adamski,[119] in their respective texts, conclude that neither a term implied-in-law nor a term implied-in-fact can be inconsistent with an express provision of the agreement.

In summary, Canada's common law has reached the point where the duty to perform one's contractual obligations in good faith has two immediate sources. Either it qualifies as a term implied-in-fact or a term implied-in-law. But in either case the implied term cannot override an otherwise express term of the agreement. Aside from statutory requirements of good faith, the only other source of the good faith performance obligation is for the common law to treat the obligation as a stand-alone duty in which case the obligation could override an express provision of the agreement. But as noted at the outset, the decision in *Bhasin* neither rejects nor endorses such a robust model of the good faith performance obligation. From that one may gleam that the Supreme Court was unwilling to close the door to incremental developments in the law. What qualifies as "incremental" is another question.

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117 [1992] 1 SCR 986.

118 McCamus, *Law of Contract*, *supra* note 9, ch 19 at 775 and 790.

119 S*upra,* note 3 at paras 8.132.22 and 9.189.

### *5. Good Faith Performance and the McCamus Analysis*

Much of the early Canadian jurisprudence focused on isolating a workable definition of the concept of good faith performance (such as, community standards of reasonableness and fairness). As observed earlier, the words "good faith" are as remarkable for what they hide as for what they reveal. Hence, the search for a practical definition remained elusive even if the definition were as broadly drafted as the one articulated in *Gateway Realty.* Above all, the possible definitions remain too vague for purposes of doctrinal predictability. To avoid that criticism, academic commentators such as Burton introduced the use of economic analysis.[120] But, as discussed earlier, it was Summers, one of the architects of the *Second Restatement,* who introduced "excluder analysis" in order to overtake the inherent difficulty of identifying and applying a definitional framework for good faith conduct. In short, the doctrine of good faith can only really be understood by reference to the bad faith conduct that it excludes.

On the Canadian scene, Belobaba championed Summers' approach to the good faith doctrine by insisting that the focus should be on conduct that qualifies as bad faith behaviour.[121] In his influential article, Belobaba would go on to identify three reasons why good faith is best understood as a "bad faith excluder." He then identified seven doctrinal techniques used to "police" against bad faith behaviour. Three techniques are of particular significance: (1) the use of the implied term of good faith to prevent one party from evading what the court believes to be the "spirit of the deal"; (2) the use of the implied due diligence or best efforts obligation to ensure that parties live up to their obligation to take all steps that are reasonably required; and (3) the implied obligation of "contractual co-operation" where one party wrongfully interferes with the contractual performance of the other party.[122]

Belobaba published his article adopting Summers' excluder analysis in 1985. In 2004, McCamus acknowledged Belobaba's earlier work and his argument that the law should formally recognize the generalized duty of good faith that had "migrated" into Canadian case law. In response, McCamus undertook an analysis of the "leading cases" with a view to identifying recurring themes in the factual patterns of cases with a view to "demystifying" the good faith doctrine in regard to the good faith performance obligation. That analysis lead to the identification of three recurring themes in the jurisprudence that closely paralleled those

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120 Burton, "Breach of Contract", *supra* note 49.

121 Belobaba, *supra* note 4.

122 *Ibid* at 83–85. Recall that Summers had identified five heterogeneous forms of bad faith conduct: see earlier discussion commencing at note 73.

identified by Summers and Belobaba: (1) good faith as a duty to use best efforts and a duty to cooperate; (2) good faith to control the exercise of discretionary powers; and (3) good faith and the duty not to evade contractual obligations.[123] That analysis also led McCamus to observe:

> […] it is a striking fact that in not one of these cases is the analysis of the good faith performance obligation necessary to the decision in question. In each case, the result could have been and, indeed, was explicitly grounded in the application of traditional contract doctrine. On the basis of these authorities, then, it would be difficult to make a compelling argument that duty of good faith performance has now been recognized at common law in Canada.[124]

McCamus also observed that the lead Canadian cases appeared to deal with situations quite similar to those covered by the good faith performance "rubric" in American law and discussed by a leading American scholar, Farnsworth, and identified in the commentaries to the *Second Restatement*. This led McCamus to conclude: "Accordingly, it appears that much, though possibly not all, of the work being accomplished by the good faith doctrine in the United States is being accomplished in Canadian common law by more traditional means."[125]

Fast forwarding to the Supreme Court's decision in *Bhasin*, the precedential significance of McCamus' 2004 publication cannot be ignored. The Court's analysis begins with the understanding that the obligation of good faith is an organizing principle that manifests itself "through the existing doctrines about the types of situations and relationships in which the law requires honest, candid forthright or reasonable contractual performance."[126] In other words, one must look to the earlier jurisprudence to see whether a good faith performance obligation had been recognized and then determine whether the case at hand falls within those earlier "situations" or "relationships."

This commentary has already identified those contractual relationships that the Supreme Court identified as being subject to a good faith performance obligation. The present list is not long: insurance, employment, franchise, and tendering contracts.[127] This leaves for consideration those "situations" in which the law has effectively imposed

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123 McCamus, "Use of Discretion," *supra* note 9.

124 *Ibid* at 90.

125 *Ibid* at 91.

126 *Bhasin, supra* note 6 at para 66.

127 As noted earlier, the Court in *Bhasin, supra* note 6, gave no explanation as to why franchise agreements were added to the list. This is not to suggest that such agreements should be deleted: to the contrary.

a good faith obligation of contractual performance. In that regard, the Court in *Bhasin* observed that McCamus had identified three broad types of situations in which a duty of good faith performance had been found to exist. The Court then examined a Supreme Court decision that fit within each of the situations. Not surprisingly, each case fell neatly within the category of a term implied-in-fact. However, none of the cases endorses a result that conflicts or overrides an express term of the agreement. The implied obligation simply filled in contractual gaps in the same way the "business efficacy" or "officious bystander" tests are used to imply terms with respect to a contract that is otherwise incomplete.

Before turning to the relevant case law, it is important to recognize that the three recurring themes that McCamus had identified translate into three rules falling under the organizing principle of good faith. In turn, each of the three rules may be regarded as an implied term of every contract. These rules are as follows. First, parties must make reasonable efforts to fulfill their contractual obligations. Second, deliberate and defective performance in order to evade contractual obligations is not permitted. Finally, parties must exercise a contractual discretion on the objective standard of reasonableness.

The first of McCamus' recurring themes (best efforts and duty to cooperate) is tied to a Supreme Court decision pre-dating the debate surrounding recognition of an implied duty of good faith performance: *Dynamic Transport Ltd v OK Detailing Ltd.*[128] The essential facts are not complicated. The case involved an action for specific performance of an agreement of purchase and sale with respect to a portion of the vendor's land. The agreement was subject to a condition precedent that subdivision approval be obtained. However, the agreement was silent as to which of the parties would seek the necessary approval.

The Supreme Court concluded that as the only party legally capable of applying for subdivision approval was the owner of the land, the law would imply an undertaking on the part of the vendor to make the application. As is readily apparent, the implied undertaking is consistent with the presumed intention or reasonable expectations of the parties, otherwise the contract simply made no commercial sense. In short, the term being implied with respect to the party responsible for applying for subdivision approval was consistent with the business efficacy or officious bystander test articulated in the Court's subsequent jurisprudence. But in *Dynamic Transport,* the Court went one step further by implying yet another term: "the vendor is under a duty to act in good faith and to take

[128] [1978] 2 SCR 1072 [*Dynamic Transport*].

all reasonable steps to complete the sale".[129] This holding was based on a substantial body of case law standing for the general proposition that "the court will readily imply a promise on the part of each parties to do all that is necessary to secure performance of the contract."[130]

The Supreme Court's reasoning in *Dynamic Transport* is but a reflection of the reasoning of in *Wood v Lucy, Lady Duff-Gordon* discussed earlier.[131] The Canadian decision differs only to the extent that Dickson J expressly refers to both "good faith" and "reasonable efforts" in the same sentence. Cardozo J referred only to "reasonable efforts." What is important is that, without the obligation to make reasonable efforts to secure the performance of the contract, the rights of the compliant party became illusionary and the bilateral agreement of purchase and sale begins to resemble an option contract.[132]

In *Bhasin*, the Supreme Court cited *Mason v Freedman*[133] in support of McCamus' second recurring theme (duty not to evade contractual obligations). In *Mason*, the vendor in a real estate transaction regretted the bargain he had made. He then sought to avoid liability by claiming his wife would not provide a bar of dower. The issue was whether he could take advantage of a clause permitting him to terminate the transaction in the event that he was "unable or unwilling" to remove this defect in title, even though he had made no efforts to have his wife release her interest in the lands. The Court held that the clause did not "enable a person to repudiate a contract for a cause which he himself has brought about" or permit "a capricious or arbitrary repudiation."[134] On the contrary, "[a] vendor who seeks to take advantage of the clause must exercise his right reasonably and in good faith and not in a capricious or arbitrary manner."[135]

Arguably, *Mason v Freedman* is one of those cases that is compatible with those where the court has imposed an obligation on the defendant to make good faith efforts to achieve the contract's objectives. In other words, the Court's decision could be explained on the basis the vendor was under an implied obligation to make good faith efforts to remove a valid

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129 *Ibid* at 1084.

130 *Ibid.*

131 Earlier discussion of this case is found commencing at note 60 of text.

132 In *Bhasin, supra* note 6 at para 49, the Court observed that is was not completely clear whether the duty in *Dynamic Transport, supra* note 128, was imposed as a matter of law or implied based on the parties' intentions (implied-in-fact). The answer has to be "implied-in-fact". Contracts for the purchase and sale of land do not possess the same attributes as employment and insurance contracts.

133 [1958] SCR 483.

134 *Ibid* at 477.

135 *Ibid*.

objection to title before sheltering behind the "unable and unwilling" clause to avoid an action for breach of contract. It would have been open to the vendor to establish, for example, that he was unwilling to remove the defect in title because his wife had demanded an unreasonable amount in lieu of dower. Alternatively, the vendor could have explained that he was unable to remove the defect because his wife simply refused to provide the necessary release. Above all, the vendor's failure to provide valid reasons for the failure to deliver marketable title meant that the clause in the agreement could not be invoked to avoid contractual liability.

The third of McCamus' recurring themes (good faith exercise of contractual discretion) is discussed in *Bhasin* by reference to the Court's decision in *Mitsui & Co (Canada) Ltd v Royal Bank of Canada*.[136] The case involved the lease of a helicopter, which included an option to buy at the "reasonable fair market value of the helicopter as established by Lessor." The Court held the lessor did not possess the right to make any offer it felt appropriate. Instead, the lessor was "contractually bound to act in good faith to determine the reasonable fair market value of the helicopters, which is the price that the parties had initially agreed would be the exercise price of the option." While the Court did not identify the basis for the implied term, it was suggested that, in the absence of a reasonableness requirement, the option would be a mere agreement to agree and thus unenforceable for a lack of certainty with respect to an essential term (price). As noted in *Bhasin*, the implied term of good faith was necessary to give "business efficacy" to the agreement.[137]

Although the Court in *Bhasin* did not refer to other precedents involving the exercise of contractual discretion, McCamus discussed others that reinforce the ambit of the implied duty of good faith performance within this category, such *Mesa*[138] and, in turn, *Greenberg v Meffert*.[139] Both decisions warrant consideration.

In *Mesa*, the underlying contract sale involved a sale of oil and gas properties. The agreement reserved a continuing royalty to the seller. However, the buyer retained the contractual right to fix the amount of the royalty by "pooling" properties. The litigation arose from the buyer's decision to calculate the royalty by pooling one of the properties it had purchased from the seller with one of the buyer's other properties, which had the effect of reducing the royalty otherwise payable by one half. The trial judge concluded that the chosen method of pooling was contrary to

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136 [1995] 2 SCR 187 [*Mitsui*].

137 *Bhasin, supra note* 6 at para 50.

138 *Mesa*, *supra* note 43.

139 *Greenberg v Meffert* (1985), 50 OR (2d) 755 (CA) [*Greenberg*].

industry practice and also that the "discretion" to pool properties was not "unfettered." The buyer was obligated to act in good faith.

On appeal, Kerans JA agreed with the trial judge who had held that the common law duty to perform in good faith is breached when a party acts in bad faith, that is, "in a manner that substantially nullifies the contractual obligations or causes significant harm to the other party, contrary to the original purposes or expectations of the parties."[140] But as already noted Kerans JA also cautioned against blurring the distinction between those cases where a rule of law imposes a duty upon the parties "despite their agreement," as is true for example with respect to unconscionable contracts, and those cases where the court imposes a rule that "fulfills" the contract. He went on to observe that a general obligation expressed in terms of good faith was not an obvious part of contract law, but declined to go further as the case turned on a rule founded in the agreement of the parties. This meant that the contractual right to fix the amount of the royalty was subject to the reasonable expectations of the parties, which had to take into account commercial context and the traditions and practices within the oil and gas industry. Within that framework, it was held the trial judge did not err in deciding as he did.

In *Greenberg*, the employment contract provided that real estate agents were entitled to commissions only if the sale occurred during the course of their employment. Commissions on properties listed by an agent but sold after termination of the employment were to be "disbursed at the company's discretion." On the facts, the plaintiff had obtained listing for a property that had been sold after the termination of his employment. The selling agent then bribed the office manager to pay to the selling agent the commission money that would otherwise have been paid to the plaintiff. The plaintiff sued for that commission and the employer defended on the basis that its discretion to pay was absolute in character. The Ontario Court of Appeal rejected that the argument. As a matter of contractual interpretation, and having regard to the intention of the parties as disclosed by their contract, and in the absence of explicit language to the contrary, the discretion clause could only be interpreted as being subject to a reasonableness requirement. However, the Court went on to hold that "a discretion must be exercised honestly and in good faith" and that on the facts of the case the decision to deprive the plaintiff of his commission did not meet that threshold.[141]

Before leaving this topic, it is important to draw a distinction between those cases where the contractual provision involves the exercise of

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140 *Mesa, supra* note 43 at para 14, quoting the trial judge.

141 *Greenberg, supra* note 139 at 556.

discretion and those that involve the exercise of an unambiguous right expressly conferred by contract, as was true in *Gateway Realty*. The significance of the distinction becomes apparent when attention turns to the brief observation made in *Bhasin* that it would be a significant extension of the law to classify the right of non-renewal as the exercise of a contractual discretion so as to come within those "situations" in which the duty of good faith performance is recognized.[142] This leads one to ask a fundamental question raised in the introduction to this commentary. What type of decision qualifies as the exercise of a contractual discretion that is subject to the good faith performance obligation? Eventually, the question is addressed below.[143]

In summary, the decisions in *Mitsui, Mesa,* and *Greenberg* support the understanding that the implied obligation of good faith contractual performance has a gap-filling role. The implied obligation does not create new obligations outside the scope of the contract. Like any implied term, the obligation aims to implement the parties' unstated intentions thereby protecting their reasonable expectations. In each case it could be reasonably assumed that at the time the parties entered into their respective contracts, the defendant would not be permitted to exercise its discretion in a manner that it thought best and, in particular, when it comes to fixing the compensation to be paid. As Burton observed "the law requires a party to exercise good faith in exercising an unlimited discretionary power over a term of the contract if necessary to effectuate the parties' intent and save a contract from being held illusionary."[144]

### *6. Gateway Realty*

In light of the Supreme Court's comments in *Bhasin,* with respect to the precedential significance of *Gateway Realty*, it is worth revisiting that decision, because the trial judge applied the good faith performance obligation in such a manner as to override an express provision of the lease. The trial decision in *Gateway Realty* is the one decision consistently cited in the Canadian jurisprudence as recognizing an implied duty on parties to perform their contractual obligations in good faith.[145] More importantly, the decision is premised on the existence of a general duty of

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[142] *Bhasin, supra* note 6 at para 72. The Court also offered other grounds for rejecting the plaintiff's argument, which are discussed below commencing at note 204.

[143] See text below commencing at note 199.

[144] Burton, "Breach of Contract," *supra* note 49 at 380, quoting from *White Stone*, *supra* note 88.

[145] For a compilation of those decisions which have quoted *Gateway Realty's* definition of good faith see Shannon Kathleen O'Byrne, "The Implied Term of Good Faith and Fair Dealing: Recent Developments" (2007) 86 Can Bar Rev 193 at 197, n 12.

good faith that establishes minimum standards of acceptable commercial behaviour (conduct that is contrary to community standards of honesty, reasonableness, or fairness qualifies as bad faith). Of course, the duty as formulated would, on its face, allow courts to ignore the express terms of the contract.[146]

The contract in *Gateway Realty* involved a lease of space in a shopping mall in which Zellers was the anchor tenant and Gateway was the landlord. In fact, Zellers had leased nearly one-half of the leasable space in the mall. In such commercial arrangements, and at the time the lease was negotiated, it was the anchor tenant and not the landlord that was best able to dictate favourable lease terms. As the trial judge observed: "the leasing of department store space in the 1960s was pretty much one-sided."[147] Anchor tenants, such as Zellers, would attract to the shopping mall other commercial tenants and, of course, the public.

Indeed, in *Gateway Realty* the landlord, and not the tenant, was the vulnerable party. The defendant, Arton Holdings Ltd, owned a rival shopping centre and was Gateway's main competitor. Arton was able to convince Zellers to move its business to the Arton mall. In turn, Zellers assigned its lease with Gateway to Arton. The assigned lease had 17 years to run. Critical to the litigation was clause 6(d) of the lease. That clause allowed Zellers to make an assignment without obtaining the consent of Gateway. The same clause also stipulated that should Zellers vacate the leased premises, or cease selling merchandise, Zellers would continue to pay rent now calculated in accordance with the clause. Thus, the clause implied that the tenant (now Arton) could leave the premises in darkness. Of course, the Gateway/Zellers lease lacked a "continuous occupation clause."[148] Expert evidence was led and accepted that the successful operation of Gateway's shopping centre necessitated the Zellers space being effectively used by a retail tenant in a manner that was complimentary to the other tenants in the mall.

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146 See *Bhasin, supra* note 6 at paras 38–39.

147 *Gateway Realty, supra* note 10 at para 27. The trial judge also noted, in the same paragraph, that the "[m]ore modern leases provides that if tenant discontinues its use the landlord can require the tenant to chose between continued operation of its store or termination of the lease."

148 In *Nickel Developments Ltd v Canada Safeway Ltd*, 2001 MBCA 79, 156 Man R (2d) 170, the Manitoba Court of Appeal was able to imply a term of continuous use in circumstances where the implied term did not conflict with any express term of the lease. The decision makes eminent good sense and is clearly distinguishable from *Gateway Realty*. In the latter case the court efrectively used the good faith obligation to override a caluse that allowed the tenant to discontinue using the premsies so long as the tenant continued to pay rent.

To complicate matters, subsequent to the assignment, Arton and Gateway entered into a separate agreement whereby both parties agreed to use their best efforts to find a suitable tenant with respect to the space formerly occupied by Zellers. Gateway sued Arton once it was discovered that Arton was refusing to sub-let to prospective tenants that Arton considered would give gateway a competitive advantage. Zellers was not made a party to the action and, therefore, the fact that it had assigned the leased premises to Gateway's main competitor, Arton, was technically not a matter that had to be resolved.

The trial judge decided in favour of Gateway on two distinct grounds. First, he held that while Arton had the discretion to assign or sublet the premises, this discretion had to be exercised in good faith, which meant that Arton had to make good faith efforts to find a tenant for the unoccupied space. Arton's failure to do was sufficient to justify termination of the assigned lease. However, the trial judge did not indicate the source of the good faith obligation. There is no indication the obligation comes in the form of an implied term or as a stand-alone duty. And yet the ruling has every appearance of being in direct conflict with Clause 6(d) of the head-lease, a clause that allowed Zellers and any assignee, such as Arton, to leave the premises in darkness while continuing to pay rent.[149] Moreover, the trial judge effectively held that the good faith obligation transformed a right to assign or sublet into an obligation to make good faith efforts to do so. The second ground on which the trial judge allowed the action was tied to Arton's alleged breach of its subsequent agreement with Gateway. On the facts, the trial judge held that Arton had simply failed to make reasonable efforts to find a tenant while excluding those who it believed to be a competitor.

The Nova Scotia Court of Appeal dismissed the appeal by upholding the trial judge on the second ground without passing judgment on the first.[150] Had the Court of Appeal addressed the first ground, it might have been asked to decide whether the good faith performance obligation trumps an express provision of the leasing contract, in particular, the non-occupation clause. But why should it? The true conundrum is that Gateway made a conscious decision to accede to the contractual demands of Zellers in order to attract that national retailer to its mall. Gateway could have insisted that the lease contain a "continuous occupation clause." Instead, Gateway agreed to a provision that would allow Zellers to keep the premises in darkness while continuing to pay rent. The trial judge characterized the

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[149] The trial judge in *Gateway Realty*, *supra* note 10 at para 24, did observe that "[Clause 6(d)] also appears to contemplate that Zellers may leave the premises 'dark', that is empty."

[150] *Supra* note 10.

lease as one-sided. That being so, one must ask whether the law would be served had the trial judge declared the non-occupation clause an unconscionable term and, therefore, unenforceable.[151] Of course, such holding would require an extension of the unconscionability doctrine in the same way that "exclusion clauses" are accorded special treatment in the law. That Gateway had to know of the potential financial impact of that clause and yet was willing to gamble that it would never be invoked in order to secure Zellers as a tenant are matters that would not escape the legal realist.

### *7. Good Faith & Contractual Enforcement*

To this point, and save for *Gateway Realty*, the law seems clear: the duty of good faith contractual performance cannot override an express provision of the agreement. This leads one to ask whether the good faith doctrine permits of exceptions. The answer is "yes," at least when it comes to the *enforcement* of contractual rights (remedies). Admittedly, there is little in Canadian case law and literature with respect to the matter of good faith enforcement of contractual remedies. Fortunately, Swan and Adamski address this topic,[152] as did Belobaba in his influential article published in 1985.[153]

In the United States, both the UCC and the *Second Restatement* recognize the implied obligation of good faith enforcement, but as in Canada the topic has not generated the same amount of interest as the topic of good faith performance. However, in recent years the American jurisprudence reveals fissures along the walls of the general consensus that the good faith doctrine played the modest role in contract law of filling in contractual gaps. Some courts have been prepared to apply the doctrine so as to override the express provisions of the agreement. Not surprisingly, the dissidents were dealing with the enforcement of demand loans and in some cases with the lender's refusal to extend further credit.[154] With respect to demand loans, the court was faced with an agreement that provides that the loan is payable on demand such that the debtor has no time to pay and, therefore, the creditor is entitled to immediately seize and sell any property taken as security for the loan. Fortunately, this is the point where American and Canadian law diverge.

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[151] Further discussion of this point will be at note 167 below and see *Tercon*, *supra* note 8.

[152] *Supra* note 3.

[153] Belobaba, *supra* note 4 at 85–87. Note, however, that the concept of contractual enforcement outlined therein is, indeed, quite broad.

[154] See William H Lawrence and Robert D Wilson, "Good Faith in Calling Demand Notes and in Refusing to Extend Additional Financing" (1988) 63 Ind LJ 825.

Both the civil law of Quebec and Canada's common law are consistent when it comes to the enforcement of demand loans. Following the demand for payment the Canadian borrower is to be given a reasonable time in which to repay the indebtedness before the lender is entitled to seize and sell those assets that the borrower had given as security for the loan. And this remains so regardless of what the loan agreement states. Of course, what constitutes reasonable time to pay is largely a factual determination that requires the balancing of the interests of both the lender and borrower.

Admittedly, the decision of the Supreme Court in *Lister*[155] did not expressly hold that the legal obligation to provide the borrower with reasonable time to pay following the lender's demand for immediate repayment of the demand loan was based on a duty of good faith enforcement. The Court simply implied the term of reasonable time to pay based on *Massey v Sladen*,[156] the *dictum* of Cockburn CJ in *Toms v Wilson and Another*,[157] and the concurring reasons of Blackburn J, who had held that "when by the express terms of the instrument creating the debt, payment is to be made 'immediately upon demand in writing,' it must be construed to mean within a reasonable time."[158]

The more recent case of the Ontario Court of Appeal in *Kavcar Investments Ltd v Aetna Financial Services Ltd*[159] is reflective of the law in Canada. McKinlay J, writing for the Court, held, "In my view, the law has developed to the point where, regardless, of the wording of a debenture security, it cannot be enforced without first, the making of the demand, and second, the giving of reasonable time within which to pay the indebtedness."[160] The observations of Swan and Adamski are equally instructive. In their view, *Kavcar* illustrates the function and operation of good faith even though the doctrine is not referred to in the reasons for decision. As they so aptly stated, the obligation imposed is "indistinguishable from one requiring the creditor to act fairly and in good faith, irrespective of the wording of the debenture or credit agreement."[161]

It is not surprising that the civil law of Quebec would also hold that demand loans are subject to a requirement that the debtor be given a reasonable amount of time to repay the indebtedness following the making

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155 *Supra,* note 5.
156 (1868), LR 4 Ex 13 at 19.
157 (1863), 4 B & S 442, 122 ER 524 (CA).
158 *Ibid* at 529.
159 (1989), 70 OR (2d) 225 (CA).
160 *Ibid* at 240.
161 Swan and Adamski, *supra* note 3 at para 9.189.

of the demand for payment. The Supreme Court's decision in *Houle*[162] confirms that understanding. That was a case in which the creditor made a valid demand for payment but also sold the debtor's assets within three hours of the creditor making the demand. But *Houle* takes the civil law of Quebec one step further. First the Court recognized that the doctrine of the "abuse of contractual rights" is consistent with the fundamental principles of Quebec civil law where good faith and reasonableness permeate the theories of rights and contractual obligations.[163] Second, the Court held that the doctrine was also consistent with the general philosophy that the debtor is to be favoured in contractual relationships.[164] Finally, the Court held that the time has come to assert that "malice or the absence of good faith should no longer be the exclusive criteria to assess whether a contractual right has been abused."[165] Instead, the less stringent standard of "the reasonable exercise" of a right can ground liability resulting from an abuse of contractual rights. The conduct of the creditor would be assessed on an objective standard that of the "prudent and reasonable individual." The precedential significance of *Houle* is enormous so far as the civil law of Quebec is concerned. Where the law is today is beyond the scope of this commentary. That the common law would have great difficulty in accepting that the exercise of any and all contractual rights is subject to a reasonableness standard is more than an understatement.

### *8. Should Good Faith Trump Contractual Provisions?*

Assuming the application of the good faith *performance* obligation must be consistent with the express terms of the contract, the question remains whether the law should make room for exceptions. In support of that position, one might focus on the reality that the good faith *enforcement* obligation, discussed above, does exactly that. Moreover, the civil law of Quebec goes much further than imposing a good faith obligation with respect to the enforcement of contractual rights. There is a requirement that contractual rights be exercised in a manner that comports with an objective standard of reasonableness. Those who would oppose the prospect of the common law moving in that direction would most certainly shelter behind the Supreme Court's constant reminders that the common law must be developed incrementally for the sake of doctrinal predictability. On the other hand, those who favour such an approach might well insist that there are no valid policy reasons for allowing the common law to operate differently from the civil law of Quebec.

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162 *Supra* note 51.

163 *Ibid* at para 61.

164 *Ibid* (referring to Arts 1070, 1141, and 1152 of the *Civil Code of Lower Canada*).

165 *Ibid* at para 100.

If there were any type of contractual relationship in which serious consideration should be given the possibility of the good faith performance obligation overriding an express provision, it has to be in the context of franchise agreements and its close cousin, the dealership agreement. Too often such contracts bear the hallmarks of a contract of adhesion ("take it or leave it") and some of its terms may be nothing short of draconian manifestations of an inequality of bargaining power. Understandably, plaintiffs never allege the entire agreement is unenforceable under the doctrine of unconscionability. Instead, they attack the unconscionability of a contractual provision under the guise the defendant breached its good faith performance obligation. This is particularly evident in those cases where the defendant franchisor elects, for example, to terminate the agreement without cause and without notice pursuant to an express provision to that effect. The financial consequences of termination for someone who, for example, has invested a lifetime in a contractual relationship, but leaves with nothing, is as draconian as the lender who calls in a demand loan on a revolving line of credit without giving reasonable time to secure alternative financing for an ongoing commercial venture. This partially explains why three provinces have adopted reform legislation in regard to franchise agreements.[166]

If the law according to *Tercon Contractors Ltd v British Columbia (Transportation and Highways)*[167] is prepared to oversee the enforcement of clauses limiting or excluding the liability of a party, then arguably the common law can regulate other provisions of the contract that are downright oppressive, without the innocent party having to seek rescission of the entire agreement. McCamus deals competently with this issue in his text ("The Unconscionable Term").[168] Whether the common law is prepared to formally reform the unconscionability doctrine or permit the good faith doctrine to override the express provisions of the contract is an issue that is unlikely to go away. In the interim, the reasons for decision in *Bhasin* have not foreclosed the possibility of such a development, at least in the case of long-term relational contracts. Here is what the Court said:

> The approach of recognizing an overarching organizing principle but accepting the existing law as the primary guide to future development is appropriate in the development of the doctrine of good faith. Good faith may be invoked in widely varying contexts and this calls for a highly context-specific understanding of what honesty and reasonableness in performance require so as to give appropriate consideration to the legitimate interests of both contracting parties. For example, the

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166 See *Franchises Act*, RSA 2000, c F-23; *Arthur Wishart Act (Franchise Disclosure),* SO 2000, c 3; and *Franchises Act*, RSPEI 1988, c F-14.1.

167 *Supra* note 8.

168 McCamus, *Law of Contract*, *supra* note 9 at 440–46.

> general organizing principle of good faith would likely have different implications in the context of a long-term contract of mutual cooperation than it would in a more transactional exchange: Swan and Adamski, at § 1.24; B. Dixon, "Common law obligations of good faith in Australian commercial contracts – a relational recipe" (2005), 33 *A.B.L.R.* 87.[169]

There are also cases where the modest role of the implied duty of good faith contractual performance is troubling, to say the least. These are the cases where the defendant is guilty of "opportunistic behaviour" that nonetheless falls so neatly within the four corners of the agreement. The notion of opportunism brings to mind Fried's description of the good faith obligation in terms of condemning deception, chicanery and sharp practice in the carrying out of contractual obligations. In turn, the reference to sharp practice coincides nicely with the incisive observations of Swan and Adamski:

> The recognition by the courts that an obligation of good faith performance exists would do as much as could be done to encourage cooperation between contracting parties. It is a reproach to the law (and occasionally to the legal profession) that people sometimes think that games can be played with agreements and that sharp practice, committed as if it were in the interstices of an agreement, is what the law encourages or applauds (and what lawyers do). The problem with the existing state of the law is not that *as a matter of fact* sharp practice will often succeed, but that Canadian courts have not adopted a forth right principle, stated in general terms.[170]

*Fortune v National Cash Register Co* highlights the extent to which the good faith doctrine is arguably incapable of remedying opportunistic behaviour (playing games) so long as the good faith performance obligation can be displaced by a contractual term that authorizes the defendant to engage in the very conduct being challenged.[171] *Fortune* was a case in which the employer exercised an express "termination-at-will" clause in the employment contract to justify dismissing a sales employee, with twenty-five years' standing, the day after his name appeared on a $5 million sales order. It was clear the employment contract reserved to the employer an explicit power to terminate the contract without cause on written notice. It was also clear that under the express terms of the contract the employee had received all the bonus commissions to which he was entitled. However, had the employee not been terminated the commission payable would have exceeded the amount actually paid. The employee sued for the difference and the employer responded by claiming it had not breached the contract. The Court agreed that on a literal reading of the

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169 *Bhasin, supra* note 6 at para 69.

170 Swan and Adamski, *supra* note 3 at para 8.158.1.

171 373 Mass 96 (Sup Ct 1977) [*Fortune*].

contract the employer was correct. However, the Court found the employer's motives (or reasons) for the dismissal were relevant to the issue at hand and, therefore, a matter properly before the jury. The jury had held that the reason for the dismissal was to pay the employee as little as possible with respect to the commissions that had otherwise been earned.

Armed with the reasons underlying the dismissal, the Court held the employment contract contained an implied covenant of good faith and fair dealing and that a dismissal not made in good faith constitutes a breach of contract. The Court admitted that an employer is entitled to be motivated by and to serve its own legitimate business interests: "We do not question the general principles […] that an employer must have wide latitude in deciding whom it will employ in the face of the uncertainties of the business world; and that an employer needs flexibility in the face of changing circumstances."[172] After recognizing the employer's need for significant control over its work force, the Court held in those cases where commissions for work performed by the employee are at issue the employer's decision to terminate its at-will employee had to be made in good faith. It was not so made and awarded damages in an amount sufficient to compensate the employee for the unpaid commission.[173]

Parenthetically, it bears noting the obvious. The Court in *Fortune* did not question the right to the employer to dismiss the at-will employee for whatever reasons the employer deemed relevant.[174] Nor did the court award damages with respect to the dismissal itself. The claim for relief rested solely on the allegation that the employee had failed to obtain a commission for reasons that did not comport with the good faith performance obligation.[175]

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[172] *Ibid* at 104, quoting from *Monge v Beebe Rubber Co*, 114 NH 130 (Sup Ct 1974).

[173] The court citing to the *Second Restatement*, "Agency", § 454, and Comment a (1958), held: "Where the principal seeks to deprive the agent of all compensation by terminating the contractual relationship when the agent is on the brink of successfully completing the sale, the principal has acted in bad faith and the ensuing transaction between the principal and the buyer is to be regarded as having been accomplished by the agent."

[174] Obviously, there is a recognized exception in regard to dismissals that are based on discriminatory grounds.

[175] A similar fact pattern arose in *Doucet v Spielo Manufacturing Inc*, 2011 NBCA 44, 372 NBR (2d) 1. However, this case also involved the application of s 241(1) of the *Canada Business Corporations Act*, RSC 1985, c C-44. That provision prohibits a corporation from engaging in conduct that is oppressive, unfairly prejudicial, or unfairly disregards the interests of a minority shareholder. In *Doucet*, the shareholders were employees of the corporation who had been dismissed.

The decision in *Fortune* takes us back to the notion of bad faith promulgated in *Gateway Reality* and adopted in *Mesa.* Therein, bad faith performance had been equated with acting "in a manner that substantially nullifies the contractual obligations or causes significant harm to the other party, contrary to the original purposes or expectations of the parties." Surely, the prospect of an employee losing his or her job because it was cheaper to fire the employee than pay a commission earned must be at least troubling even for those who believe that the good faith performance obligation has a modest role to play in contract law. However, for those who insist that the good faith doctrine should embrace the robust model there is a further complication to any argument that good faith should, in some circumstances, trump an express term of the contract.

In *Bhasin*, the Court unexpectedly observes that "[…] the organizing principle of good faith should not be used as a pretext for scrutinizing the motives of contracting parties."[176] Presumably, that isolated comment was meant to apply to the defendant's decision in *Bhasin* not to renew the dealership agreement. The Court left little doubt that the defendant's decision not to renew should not be equated with the exercise of contractual discretion: "Classifying the decision not to renew the contract as a contractual discretion would constitute a significant expansion of the decided cases under that type of decision."[177] This leaves for consideration the question of whether the motives of a contracting party could or should be relevant in cases where the bad faith obligation is tied to the defendant's opportunistic behaviour. And as earlier discussed, this is so in regard to those cases where the defendant is attempting to avoid contractual liability by failing to adopt reasonable efforts to ensure compliance with his or her contractual obligations.[178]

Another decision that bears upon the matter of a party's motives and the allegation of opportunistic behaviour is Posner J's engaging and controversial decision in *Market Street Associates Ltd Partnership v Frey*.[179] Admittedly, it is not a case where the court was being asked to allow the good faith performance obligation to override an express term of the contract. It was a case in which the court was effectively being asked to imply a term based on good faith considerations in circumstances where the defendant's motives were pivotal to the outcome of the case. The essential facts are as follows. Market Street Associates ("Market Street"), an assignee of JC Penney, sued for specific performance of a contract to convey a shopping centre owned by General Electric Pension Trust (the

176 *Supra* note 7 at para 70.

177 *Ibid* at para 72.

178 See earlier discussion in text commencing at note 128.

179 *Market Street Associates*, *supra* note 48.

"Trust"). The reasons for decision describe the relevant contract terms with precision.

> In 1968, J.C. Penney Company, the retail chain, entered into a sale and leaseback arrangement with General Electric Pension Trust in order to finance Penney's growth. Under the arrangement Penney sold properties to the pension trust which the trust then leased back to Penney for a term of 25 years. Paragraph 34 of the lease entitles the lessee to "request Lessor [the pension trust] to finance the costs and expenses of construction of additional Improvements upon the Premises," provided the amount of the costs and expenses is at least $250,000. Upon receiving the request, the pension trust "agrees to give reasonable consideration to providing the financing of such additional Improvements and Lessor and Lessee shall negotiate in good faith concerning the construction of such Improvements and the financing by Lessor of such costs and expenses." Paragraph 34 goes on to provide that, should the negotiations fail, the lessee shall be entitled to repurchase the property at a price roughly equal to the price at which Penney sold it to the pension trust in the first place, plus 6 percent a year for each year since the original purchase.[180]

Market Street claimed that in 1988 it had requested financing to build a new store on the premises and that the request was flatly turned down. Market Street claimed that it was therefore entitled to repurchase the shopping centre at the price calculated in accordance with paragraph 34 of the lease. It is safe to presume that the property's fair market value greatly exceeded the repurchase price and that is why the Trust resisted the application for summary judgment brought in regard to Market Street's application for an order of specific performance. The Trust now realized it should not have rejected the financing request outright. Instead, it should have entered into negotiations with Market Street Associates.

The district judge took it as a given that if the Trust were wrong in failing to enter into discussions, with respect to the possibility of granting the requested financing, the transfer of the property should follow. In response, the Trust argued that it was not in the wrong because the extreme consequences of failing to negotiate had not been brought to its attention. In fact, the evidence supported the understanding that the Trust's officer failed to realize the existence of paragraph 34 of the lease, which had been signed twenty years earlier. The district judge held that, under the good faith doctrine, a provision should be read into the lease requiring Market Street to remind the Trust of paragraph 34. As the reminder had not been sent, the district judge granted the Trust summary judgment so as to defeat Market Street Associate's application for specific performance. Writing for the Appeals Court, Posner J held: "The office of the doctrine of good faith is to forbid the kinds of opportunistic behaviour that a mutually dependent,

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180 *Ibid* at 591.

cooperative relationship might entail in the absence of rule."[181] He then held that "[t]he dispositive issue […] is simply whether Market Street Associates tried to trick the pension trust and succeeded in doing so."[182] This led Posner J to conclude that "[t]he essential issue […] was Orenstein's (the lessee's representative) state of mind, a type of inquiry that ordinarily cannot be concluded on summary judgment, and could not be here."[183] The end result was that the Appeals Court set aside the order for summary judgment thereby allowing the matter to proceed to trial.

Much has been written about the correctness of Posner J's approach to resolving the legal conundrum presented in *Market Street Associates.* Todd Rakoff suggests that if Posner J had a chance to "do it over again" he "would write an opinion that would affirm, rather than reverse, the trial judge."[184] But there are those who believe that the case is a "stark example of a court misapplying the duty of good faith and fair dealing and imposing social morals on two sophisticated parties."[185] Ultimately, it has to be conceded that not all good faith performance cases are easily decided. But this will not hold true, if the Supreme Court of Canada's admonition to refrain from scrutinizing the motives of a contracting party is interpreted too broadly. Surely, the law should be able to regulate opportunistic behaviour by examining a party's motives in the same way the law permits the court's to scrutinize the motives of those who are alleged to have acted in a manner designed to evade a contractual obligation. Cases such as *Fortune* support the argument that modest role assigned to the good faith performance obligation should embrace exceptions. There are cases where the implied obligation of good faith performance should be capable of overriding an express term of the contract.

### *9. Revisiting Bhasin - A Critical Analysis*

The overview to this commentary sets out three thesis-like observations. First, there is sufficient *obiter* in *Bhasin* to support the understanding that the plaintiff's good faith performance argument would have been formally rejected had the Court not seized on the duty of honest performance. Second, the Court's finding of a breach of the duty of honest performance remains problematic. Finally, the Court's methodology for assessing

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181 *Ibid* at 595.

182 *Ibid* at 596.

183 *Ibid* at 598.

184 Todd D Rakoff, "Good Faith in Contract Performance: *Market Associates Ltd. Partnership v. Frey*" (2007) 120 Harv L Rev 1187.

185 See William A Walsh, "Good Faith and Fair Dealing: New Issues And Nagging Concerns" (American College of Real Estate Lawyers, no date) at 23–24, online: <www.acrel.org/Documents/Seminars/a002186.pdf>.

damages is materially flawed. This is the point where greater attention to the facts in *Bhasin* is required. This includes the factual findings of the trial judge and those that the Supreme Court deemed relevant to its disposition of the issues.

*A) The Factual Context*

Canadian American Financial Corp ("Can-Am") markets, throughout Canada, education savings plans to investors through retail dealers known as enrolment directors. Bhasin acted as one of those directors since 1989 and had since built a successful and prize-winning sales force throughout the Calgary area. Apparently, the governing contract was for an indefinite term.[186] In 1998, Can-Am entered into negotiations with its directors with respect to a new agreement that had features typically found in franchise agreements.[187] One of the stumbling blocks pertained to the proposed termination clause. Aside from those provisions that allowed for termination for cause, Clause 3.3 provided that the contract would automatically renew at the end of the three-year term unless one of the parties gave six months' written notice to the contrary. When Can-Am was preparing the 1998 Agreement, it met with "certain" enrolment directors across Canada who expressed concern about the non-renewal provision.[188] The evidence at trial disclosed that these persons were told that Clause 3.3 would never be used without good cause as, for example, in case where the enrolment director was suffering "mental incompetence" or involved in "child pornography."[189] Eventually, Bhasin signed the 1998 Agreement, as did most enrolment directors.[190] However, one enrolment director did not sign – Hrynew, who was also a defendant in the underlying action.

Over the course of his involvement with Can-Am, Hrynew's business grew as a result of mergers with other Can-Am agencies in the Calgary area such that he had the largest Can-Am agency in Alberta. More importantly, Hrynew wanted to capture Bhasin's lucrative niche market. Hrynew not only approached Bhasin about a possible merger, Hrynew encouraged Can-Am to force the merger and made veiled threats that he would leave if no merger took place. The trial judge found that the

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186 See *Bhasin, supra* note 6 at para 4.

187 *Bhasin TJ, supra* note 12 at para 6.

188 *Ibid* at para 106.

189 The applicability of the "parol evidence rule" was dealt with in *Bhasin TJ*, *supra* note 12 at paras 119–25.

190 *Ibid* at paras 7 and 50. Apparently, the enrolment directors were represented by legal counsel during the negotiations, a fact which is referenced to in the submissions filed by the respondents with the Supreme Court of Canada.

proposed "merger" was in effect a hostile takeover of Bhasin's agency. Throughout, Bhasin steadfastly refused to participate in any merger.

The Alberta Securities Commission (the "Commission"), concerned about compliance issues surrounding Can-Am's employment directors, required Can-Am to appoint a single provincial trading officer ("PTO") to review its enrolment directors to ensure compliance with securities laws. In September 1999, Can-Am appointed Hrynew. As the PTO, he was required to conduct audits with respect to each of Can-Am's directors. Under the 1998 Agreement, Can-Am retained the right to impose business audits. Nevertheless, Bhasin, and one other director, objected to having Hrynew, a competitor, review their confidential information. Consequently, Hrynew was unable to conduct the required audit. At the same time, Can-Am became worried that the Commission might revoke its license. Discussions with the provincial regulator about compliance were numerous. In June 2000, Can-Am outlined its plans to the Commission. That plan embraced the understanding that Bhasin would be working for Hrynew's agency. Bhasin knew none of this.

When Bhasin persisted with his refusal to allow Hrynew to audit his business, Can-Am threatened to terminate the 1998 Agreement. The threat was carried out in May 2001. Can-Am gave the required six months' notice. After the notice was sent out and during the next six months, Hrynew and Can-Am made several more attempts to push the merger on Bhasin. Again, Bhasin resisted. The 12-year business relationship ended on November 4, 2001. As a result, Bhasin lost most of his sales force to Hrynew. Bhasin went on to "start all over again" with a competitor of Can-Am.[191]

At trial, Bhasin argued that Can-Am was obligated to perform its contractual obligations in good faith. The trial judge agreed. Since the trial judge ruled that the 1998 Agreement did not qualify as a "franchise" agreement, the statutory duty of fair dealing provided for in s 7 of the *Franchises Act* did not apply.[192] However, the trial judge also found that at the time the agreement was signed there was an "inherent power imbalance" between the parties and, for this reason, the obligation of good faith performance could be implied as a matter of law.[193] For greater certainty, the trial judge also found that the same obligation arose as a matter of fact in order "to give business efficacy to the whole 1998 Agreement."[194]

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191 *Ibid* at para 53.

192 *Franchises Act*, RSA 2000, c F-23.

193 See *Bhasin TJ, supra* note 12 at paras 67–86.

194 *Ibid* at paras 87–109.

Bhasin argued that Can-Am breached the implied obligation when it appointed Hrynew as the Provincial Trading Officer and when it triggered the non-renewal clause.[195] Again, the trial judge agreed. With respect to the appointment of Hrynew as the PTO, the trial judge concluded that the appointment provided Hrynew with access to Bhasin's business records and that the appointment therefore breached the good faith performance obligation. She also observed that the attempts to force Bhasin to submit to the audits were "particularly unconscionable."[196] With respect to the non-renewal of the 1998 Agreement, the trial judge treated Clause 3.3 as a discretionary right to terminate the dealership agreement and not as an "unrestricted right."[197] She held that Can-Am acted in bad faith by issuing the notice of termination because of Bhasin's refusal to submit to an audit by Hrynew and "to force Bhasin into a position where he had to either merge agencies with Hrynew or leave the organization."[198] In short, the trial judge accepted Bhasin's argument that the non-renewal provision had been exercised for an improper purpose—that is to say, for no legitimate business reason.

The Alberta Court of Appeal[199] allowed the appeal principally on the basis the law simply did not recognize the duty of good faith performance that had been advanced at trial. On appeal to the Supreme Court, Bhasin again argued that Clause 3.3 did not grant Can-Am an unfettered discretion to terminate the dealership agreement. Correlatively, Bhasin argued the discretion was exercised in the manner that the trial judge described as arbitrary, capricious, and unconscionable and in such a way as to undermine the purpose of the 1998 Agreement. In short, the discretion was exercised for an improper purpose: to force an unwanted merger of two dealerships.

*B) The Issue of Good Faith Performance*

The common law would have been blessed if the Supreme Court had dealt fully with the issue outlined above. Instead, it focused on the "new" duty of honest performance. However, there are four paragraphs lodged within the Court's extensive reasons that support the understanding that the Court effectively rejected Bhasin's good faith performance argument.[200] The rejection begins with the Court's observation that Bhasin's plea of bad faith did not fit within the "situations" or "relationships" in which the duty of

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195 *Ibid* at para 147.

196 *Ibid* at para 222.

197 *Ibid* at para 142.

198 *Ibid* at para 261.

199 *Bhasin CA, supra* note 13.

200 *Bhasin, supra* note 6 at paras 70, 72, 90 and 91.

good faith performance had been earlier recognized.[201] Specifically, the contractual relationship between the plaintiff and defendant did not qualify as either an employment or franchise relationship. However, nothing was said about the analogy the trial judge had drawn between a franchise and a dealership agreement with a view to expanding the list of contractual relationships subject to the good faith performance obligation. The law does allow for incremental developments. But in fairness to the Supreme Court, it must be remembered that it was not deciding the case on the basis of good faith performance.

Equally damaging to Bhasin's good faith argument was the Court's observation that the case did not fall within the "situations" that McCamus had identified and that the Court endorsed in *Bhasin.* The Court was not prepared to classify the decision to terminate Bhasin's dealership agreement as involving the exercise of contractual discretion. The Court stated: "Classifying the decision not to renew the contract as a contractual discretion would constitute a significant expansion of the decided cases under that type of situation. After all, a party almost always has some amount of discretion in how to perform a contract."[202] I shall come back to this aspect of the *Bhasin* ruling shortly. For the moment, it bears noting, that if the decision not to renew the agreement had been classified as a discretionary one, surely the trial judge would have been justified in scrutinizing the motives of Can-Am in order to decide whether the discretion had been abused in the sense of being exercised for an improper purpose.[203]

In summary, the Supreme Court effectively held the dealership agreement was not subject to the duty of good faith performance when it came to Can-Am's decision not to renew the 1998 Agreement. But the Court went further by suggesting that any implied duty of good faith would have been displaced by the "entire agreement clause" also anchored within the contract ("no representations, warranties, terms, conditions or collateral agreements, express, implied or statutory, other than expressly set out in this Agreement").[204]

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201 *Ibid* at para 72.

202 *Ibid*.

203 This would be so even though the Court had earlier stated (*Bhasin, supra* note 6 at para 70) that "the principle of good faith should not be used as pretext for scrutinizing the motives of contracting parties."

204 This was so to the extent the good faith performance obligation was regarded as an implied term consistent with the intention of the parties. See also earlier text commencing at note 206.

A cursory review of the jurisprudence reveals that most entire agreement clauses fail to expressly deal with the matter of implied terms let alone the implied term of good faith performance.[205] In other words, as a matter of contractual interpretation, the clause fails to oust the right of either party to rely on an implied term, be it one of fact or law. However, the same does hold true of the entire agreement clause that presented itself in *Bhasin*. Clause 11.2 of the dealership agreement stated there were "no representations, warranties, terms, conditions or collateral agreements, express, implied or statutory, other than expressly set out in this Agreement."[206] Based on the Ontario jurisprudence, the trial judge in *Bhasin* concluded that Clause 11.2 did not bar the review of the defendant's decision, not to renew the dealership agreement, with a view to determining whether the "non-renewal power" was exercised "unfairly" or "abusively."[207]

The Supreme Court made only two references to Clause 11.2. First, the Court stated: "It would also be difficult to say that the duty of good faith should be implied in the case based on the intention of the parties given the clear terms of the an entire agreement clause in the Agreement."[208] Second, it held that the duty of honest performance could not be displaced by the clause: "As the duty of honest performance is a general doctrine, like the doctrine of unconscionability, the parties are not free to exclude it."[209] In support of that proposition the Court cited to paragraph 52 of *CivicLife.com Inc v Canada (Attorney General)*.[210]

With respect, it is not clear whether the various propositions found within paragraph 52 of *CivicLife.com* are on point. In that regard, the Ontario Court of Appeal made two rulings. First, as the entire agreement clause under consideration in that case made no reference to the exclusion of implied terms, the clause had no application to the good faith issue being decided. Second, the Court of Appeal held that even if the entire agreement clause did cover the conduct at issue, the court has discretion to refuse to enforce it where to do so would be "unconscionable, unfair, unreasonable or otherwise contrary to public policy."[211] In support of that proposition the Court of Appeal cited its earlier decision in *Shelanu Inc v Print Three*

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205 O'Byrne deals with the issue in the context of the duty of honest performance: see Shannon Kathleen O'Byrne and Ronnie Cohen, "The Contractual Principle of Good Faith and the Duty of Honesty in *Bhasin v. Hrynew*, 2014 SCC 71" [forthcoming].

206 *Bhasin TJ*, *supra* note 12 at para 110.

207 *Ibid* at para 118.

208 *Bhasin, supra* note 6 at para 72.

209 *Ibid* at para 75.

210 [2006] OJ No 2474(2006), 215 OAC 43 [*CivicLife.com*].

211 *Ibid* at para 52.

*Franchising Corp.*[212] More recently, in *High Tower Homes Corporation v Stevens,*[213] the same court interpreted *Bhasin* as holding that good faith should not be thought of as implied term and, therefore, as a general doctrine, the parties cannot exclude it by way of an entire agreement clause.[214]

In brief, if guided by Ontario law, there is an apparent hostility towards the enforcement of entire agreement clauses that seek to oust the application of the good faith doctrine. As a matter of contractual interpretation, it is more likely than not that most clauses will be imperfectly drafted. Clauses that merely state there are "no implied terms" are now ambiguous in light of *Bhasin*. Frankly, it is difficult to envisage a court holding that an entire agreement clause is capable of ousting the organizing principle of good faith and its attendant rules whether those rules are implied-in-law or implied-in-fact. The notion that a contractual provision would enable both parties to the contract to perform their obligations in bad faith is antagonistic to principles of common sense. This is particularly so in those instances where the application of the good faith performance obligation does not override the agreement's express terms.

In *Bhasin*, the Supreme Court went on to identify two other flaws in the trial judge's decision to hold Can-Am liable for breach of the duty of good faith performance. Both rest on the trial judge's decision to award damages to Mr. Bhasin for lost earnings approaching a nine-year period: from the date of termination until the date Mr. Bhasin would have turned 65 and, presumptively, would have retired from the business (subject to discounting to reflect the possibility of the lease being terminated upon a subsequent renewal). This led the Court to observe that the trial judge's "broadly" conceived duty of good faith would turn a three-year contract into one of roughly nine year's duration. As well the Court, found merit in the Alberta Court of Appeal's observation: "[t]he parties did not intend or presume a perpetual contract, as they contracted that either party could unilaterally cause it to expire on any third anniversary."[215] Finally, the Supreme Court stated that even if there had been a breach of a broader duty of good faith, Can-Am's contractual liability would still have to be measured by reference to the least onerous means of performance, which

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212 (2003), 64 OR (3d) 533 at paras 30–35.

213 2014 ONCA 911, 328 OAC 265.

214 *Ibid* at para 35. In *Bhasin, supra* note 6 at para 74, the Court held: "There is a longstanding debate about whether the duty of good faith raises as a term implied as a matter of fact or a term implied by law […]. I do not have to resolve this issue debate full, which as I reviewed earlier, casts a shadow of uncertainty over a good deal of the jurisprudence."

215 *Bhasin CA*, *supra* note 13 at para 32.

in the circumstances of the case would have embraced Can-Am electing not to renew the 1998 Agreement. This led the Court to summarily conclude that no damages flowed from the breach of the broader duty of good faith that the trial judge had applied.[216]

With respect, the Supreme Court's critique of the trial decision with respect to the latter two points is not convincing. Presumably, the reference to assessing damages in accordance with the least onerous means of performance (non-renewal) is an oblique reference to the Court's decision in *Hamilton v Open Window Bakery Ltd.*[217] That was a case in which the parties had entered into a 36 month contract that could be terminated by the defendant for cause and without notice or early termination upon the giving of three month's notice after the expiry of the 19th month. The defendant terminated the contract for what it believed to be "cause" and subsequently by giving the three months' notice. The trial judge concluded the defendant did not have cause for termination and awarded damages based on the assumption the contract would have endured for the entire 36-month term (discounted 25% to reflect the possibility of early termination). The court of appeal reversed and the Supreme Court affirmed that in cases where a contract may be performed in several ways the mode that is least profitable to the plaintiff and the least burdensome to the defendant is to be adopted. Hence, the plaintiff was entitled to damages based on the least onerous method of performance – that is to say, in accordance with the giving of three months' notice.

Admittedly, the facts of *Bhasin* appear to fit nicely within those in *Open Window Bakery.* Can-Am did give Mr. Bhasin notice that it was in a position to terminate the dealership for cause (the more onerous method of performance) and Can-Am soon thereafter elected to terminate the 1998 Agreement by giving the required six months' notice (the least onerous method of performance).[218] However, the two cases differ in one important respect. The issue of good faith performance was not raised in the earlier decision. In *Bhasin*, it was open to Mr. Bhasin to argue that Can-Am's decision not to renew the dealership agreement was subject to the good faith performance obligation and that Can-Am had exercised a discretionary right in an unreasonable manner (for an improper purpose). Assuming those arguments had merit, it could have been argued that Can-Am's notice of non-renewal was invalid. Consequently, the dealership agreement must be deemed to have been renewed for an additional three years. As the agreement was wrongly terminated, damages could be calculated on the basis of lost earnings for the three-year renewal term,

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216 *Bhasin, supra* note 6 at para 90.

217 2004 SCC 9, [2004] 1 SCR 303 [*Open Window Bakery*].

218 *Bhasin TJ, supra* note 12 at paras 206–11.

subject to mitigation principles. That approach would undermine the contention that the dealership agreement was being converted to a perpetual or nine-year contract. In brief, notwithstanding the Court's decision in *Open Window Bakery,* Mr. Bhasin was entitled to argue that Can-Am's decision not to renew the Agreement was made in bad faith. That issue forces one to ask whether the non-renewal decision involved the exercise of contractual discretion subject to the good faith performance standard of reasonableness.

*C) The Exercise of Contractual Discretion*

The Supreme Court's observation that Can-Am's decision not to renew the 1998 Agreement did not involve the exercise of a discretionary power, so as to come within those "situations" in which the law recognizes a duty of good faith contractual performance, is immensely important.[219] The observation was made after due regard to the American experience with non-renewal and termination clauses.[220] In some instances, a non-renewal clause would be treated like a termination clause and in others the two clauses would be treated differently. In response to this reality, our Supreme Court observed that "[…] even in jurisdictions that embrace a broader role for the duty of good faith, plaintiff's have met with only mixed success in alleging bad faith failure to renew a contract."[221] There may be several reasons for the "mixed success." For example, it is not difficult to envisage a court distinguishing between a clause that permits termination of a contract "without cause and without notice" from one that provides that either party may elect not to renew the contract for a further fixed term after giving advance and presumably sufficient notice. The reality is that, from the outset, termination clauses in franchise agreements and the like have been a constant source of irritation in American law[222] and the same is true in Canada.

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219 *Bhasin, supra* note 6 at para 72.

220 In *Bhasin, ibid* at para 91, the Court referred to the following cases in which non-renewal had been treated as the equivalent to termination and thus subject to a duty of good faith: *Shell Oil Co v Marinello*, 294 A (2d) 253 (NJ Super Ct 1972), aff'd 307 A (2d) 598 (NJ Sup Ct 1973); *Atlantic Richfield Co v Razumic*, 390 A (2d) 736 (Pa Sup Ct 1978) at 741–42. The Court also referenced other cases that have treated non-renewal as fundamentally different, in particular, in those cases where the express terms of the contract contemplate the expiry of contractual obligations and leave no room for any sort of duty to renew: *JH Westerbeke Corp v Onan Corp*, 580 F Supp 1173 (D Mass 1984) at 1184; and *Pitney-Bowes, Inc v Mestre*, 517 F Supp 52 (SD Fla 1981), *certiorari* denied by 464 US 893 (11th Cir 1983).

221 *Bhasin, supra* note 6 at para 91.

222 In Burton, "Breach of Contract," *supra* note 49 at 390, n 96, Burton discusses one such case while citing two articles dealing with "modern franchise termination": *Isbell v Anderson Carriage Co*, 170 Mich 304, 136 NW 457 (Sup Ct 1912); Ernest

Coming back to the question initially posed: What type of decision qualifies as the exercise of a contractual discretion that is subject to the good faith performance obligation? Regrettably, the answer to that question is not found in the Canadian cases discussed earlier (*Mitsui*, *Mesa,* and *Greenberg*).[223] Again, the American experience is instructive, particularly if regard is had to Burton's scholarship. His thesis is not complicated. The underlying premise is that a party fails to perform in good faith when it uses its discretion to recapture foregone opportunities. In turn, discretion in performance arises in one of two ways: "The parties may find it to their mutual advantage at formation to defer decision on a particular term and to confer decision-making authority as to that term on one of them. Discretion may also arise, with similar effect, from a lack of clarity or from an omission in the express contract."[224]

With respect to the second source of discretion, Burton references a set of cases involving actions by commercial tenants under percentage leases in which the implied covenant of good had been applied. In each case, the lease provided for rentals to be paid primarily as a percentage of gross sales. In each case, the tenant altered its business in a way that reduced sales and therefore that amount of rent payable. This was accomplished by moving a lucrative part of the business to other premises leased from the same lessor on a flat rental basis and by opening competing stores in the same neighbourhood or by diverting customers to other stores.[225] For the purposes of this commentary, those cases are relevant because they did involve the application of the good faith doctrine in a manner that was inconsistent with the wording of the leasing contracts. The contracts were simply silent as to the validity of the tenant's actions. The leasing contracts neither authorized nor denied the tenant the right to act in the way it did. And that is why the tenant's actions were subjected to the good faith performance obligation: to see whether the discretion exercised had been abused in the sense of undermining the contract's underlying objectives.

With respect to the other source of contractual discretion, Burton includes those contracts in which such matters as "quantity," "price," "time," and "conditional aspects" of the agreement are left within the hands of one of the parties. The American jurisprudence is replete, for example, of cases involving a buyer under a requirements contract and a seller under an output contract. However, Burton also refers to deferred

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Gellhorn, "Limitations on Contract Termination Rights: Franchise Cancellations" (1967) Duke LJ 465 and Charles M Hewitt, "Good Faith or Unconscionability: Franchisee Remedies for Termination" (1973) 29 Bus Lawyer 227.

223 See discussion in earlier text commencing at note 136.

224 Burton, "Breach of Contract," *supra* note 49 at 380.

225 *Ibid* at 384.

decisions as "to the time of performance". These are the cases where the contract allows one party to determine when it shall perform, when the other party shall perform or when the contract shall terminate.[226]

Returning to the decision in *Bhasin,* one is forced to ask whether the distinction that the Supreme Court drew between a fixed term contract with a right of renewal and a contract of indefinite duration with a right of termination is justified when it comes to scrutinizing the motives of the party whose conduct is impugned. The answer to that question may well turn on whether the type of renewal clause found in *Bhasin* is classified as an unconscionable term. The reasons of the trial judge in that case lead one to believe that she thought so. On the other hand, the fact that both parties possessed the right to withdraw from the contract on written notice suggests that a finding of unconscionability would have been difficult to sustain based on conventional legal principles. If that is so, the distinction that the Supreme Court drew between renewal and termination clauses is sound. Not all decisions made by a party pursuant to contractual right should be subjected to judicial scrutiny on the ground that the decision constitutes an abuse of discretion and a breach of the good faith performance obligation.

*D) Breach of the Duty of Honest Performance*

Finally, consideration must be given to the Supreme Court's recognition and application of the '"new" duty of honest performance, one that requires the parties to be honest with each other in relation to the performance of their contractual obligations. On the basis of the trial judge's factual findings, the Court was able to identifying instances in which Can-Am had lied to Bhasin during the period leading up to its exercise of the non-renewal clause. Those lies pertained to Can-Am's own intentions and with respect to Hrynew's role as PTO. The Court went to conclude that but for those lies "Mr. Bhasin would have been able to retain the value of his business rather than see it, in effect, expropriated and turned over to Mr. Hrynew."[227] All of this leads to the inference that had Bhasin not been told lies he could have taken steps to dispose of his agency/dealership, prior to the expiration of the 1998 Agreement. If those were the facts of the case, there would be little need to pursue the analysis that follows. Respectfully, the Court's reasoning is at odds with what was argued and decided at trial.

It is true that the trial judge's reasons for decision are extensive (529 paragraphs) and that references are found therein to dishonesty on the part

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226 *Ibid* at 382.

227 *Bhasin, supra* note 6 at para 109.

of Can-Am. However, the reality is that Bhasin neither pled nor argued dishonest performance as a basis of liability at trial, nor on appeal to the Alberta Court of Appeal, nor in his written submissions filed with the Supreme Court. Apparently, it was during the course of oral argument that greater reliance was placed on Can-Am's dishonesty.[228] To complicate matters further, the Court's assessment of damages is based on a misapprehension of what the trial judge decided.

As a starting point, one must ask how the stand-alone duty of honest performance in contract law differs from the tort of civil fraud[229] (deceit) and the principle of estoppel. The Supreme Court answered that question as follows.

> Unlike promissory estoppel and estoppel by representation, the contractual duty of honest performance does not require that the defendant intend that his or her representation be relied on and it is not subject to the uncertainty whether estoppel can be used to found an independent cause of action [citations omitted]. As for the tort of civil fraud, breach of the duty of honest contractual performance does not require the defendant to intend that the false statement be relied on, and breach of it supports a claim for damages according to the contractual rather than the tortious measure [citations omitted].[230]

In short, the duty of honest performance differs from estoppel and the tort of civil fraud in one material respect. To establish a breach of the duty of honest performance it is unnecessary to establish that the defendant "intended" the plaintiff would rely on the falsehood. However, one can safely presume that it is still necessary to establish that the plaintiff relied on the falsehood and as a consequence suffered a financial loss. This is the point where the Supreme Court's analysis becomes problematic. The trial judge made no specific findings with respect to whether Bhasin had relied on the falsehoods.

From the trial judge's reasons for decision, the Supreme Court extracted two recurring threads of dishonest conduct on the part of Can-Am. The first thread was a series of barefaced lies in regard to the appointment of Hrynew as the PTO.[231] Can-Am persisted with the lie that

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228 *Ibid* at para 30 where the Court stated: "Mr. Bhasin's second position, emphasized in oral argument, is that the Court should at least recognize a duty of honest performance of contractual obligations: transcript, at pp. 8, 10 and 24."

229 The constituent elements of the tort are set out in *Bruno Appliance and Furniture Inc v Hryniak*, 2014 SCC 8, [2014] 1 SCR 126. Unfortunately, the Court in that case did not discuss the element of "reliance."

230 *Bhasin, supra* note 6 at para 88.

231 *BhasinTJ, supra* note 12 at para 221.

the Alberta Securities Commission mandated Hrynew's appointment and that Hrynew's contract required confidentiality and segregation activities in the course of an audit. All of this led the trial judge to conclude that Can-Am's dishonesty showed a complete disregard for Bhasin's interests.[232] However, the trial judge's reasons reveal that Bhasin persistently refused to allow Hrynew to conduct the audit. In other words, Bhasin did not rely on the falsehoods.

The second thread of dishonest conduct on the part of Can-Am is tied to events leading up to its decision not to renew the 1998 Agreement. The Supreme Court focused on paragraph 246 of the trial judge's decision. Therein, she spoke of Can-Am's dishonesty in not telling Bhasin of the proposed reorganization of its business (merger of agencies) that had been submitted to the Commission. Indeed Bhasin did not hear of the merger until August 2000. Here is how the Supreme Court describes the acts of dishonesty:

> In August 2000, Mr. Bhasin first heard of Can-Am's merger plans for him during meeting with Can-Am's regional vice-president. But when questioned about Can-Am's intentions with respect to the merger, the official "equivocated" and did not tell him the truth that from Can-Am's perspective this was a "done deal". The trial judge concluded that the official was "not honest with [Mr.] Bhasin" at that meeting: para. 247."[233]

This is not the first commentary to note the fine line between a failure of one party to respond to questions fully and a party's right not to disclose information with respect to future intentions. Moreover, the above passage was preceded by another in which the Supreme Court acknowledged that there is no "unilateral duty to disclose information relevant to termination."[234] All of this led McCamus to comment:

> At the same time, however, we may note that in *Bhasin*, some of the dishonest statements of Can-Am were held to result from inquiries made by Mr. Bhasin and, in one case at least, crossed the line into breach of the duty of honest performance by equivocating rather than plainly lying about its intentions. Accordingly, the Bhasin doctrine may complicate the task of advising clients with respect to communications relating to termination or renewal rights and perhaps other aspects of contractual performance such as the exercise of other types of options and contractual discretionary powers.[235]

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232 *Ibid* at para 251.

233 *Bhasin, supra* note 6 at para 100.

234 *Ibid* at para 87.

235 McCamus, "New General Principle", *supra* note 29 at 114.

Without question, the Supreme Court interpreted the trial judge's reasons as establishing that as a consequence of Can-Am's dishonest conduct Bhasin lost the value of his business. In other words, had Bhasin not been lied to, it could be reasonably expected that he could have taken steps to dispose of his agency in accordance with and prior to the expiration of the 1998 Agreement.[236] Accepting this to be so, consideration must be given to the assessment of damages. Again, the Supreme Court's decision is problematic. It is true that the trial judge awarded $87,000 for "loss of business value." But that award must be placed in the context in which it was made. A brief explanation is required.

The trial judge assessed damages based on Bhasin's loss of an income stream from the date the 1998 Agreement was wrongfully terminated until he reached age 65 (2001-08 inclusive). In other words, the trial judge calculated damages as though Bhasin had entered into an agreement that would not terminate until Bhasin reached age 65. As would be expected the amount was adjusted to reflect, for example, the fact that Bhasin had mitigated his loss by entering into a contract with a competitor of Can-Am's. To that amount was added $87,000 to reflect the loss of Bhasin's business after he turned 65. Here is what the trial judge concluded: "Given all these considerations, I find the value for Bhasin's agency based on a trailing 12 month period would be $87,000 at the point he turned 65."[237] With great respect, the Supreme Court was in error when it held: "It is clear from the findings of the trial judge and from the record that the value of the business around the time of non-renewal was $87,000."[238] Factually, and with great respect, the $87,000 awarded at trial bears no relationship to the market value of Bhasin's agency prior to the expiration of the 1998 Agreement.

In summary, the Supreme Court's finding of a breach of the duty of honest performance is troubling. The trial judge made no finding that the plaintiff had relied on the falsehoods to his detriment and it is equally clear that the plaintiff refused to act on some of those falsehoods. When push comes to shove, the trial judge's decision supports the understanding that Bhasin had lost the value of his agency because Can-Am exercised its right of non-renewal for an improper purpose: to force Bhasin to merge his agency with that of Hrynew. Fairly interpreted, those same reasons do not support the understanding that the trial judge attributed the loss of the agency to his reliance on falsehoods. Moreover, the Supreme Court's assessment of damages ($87,000) is obviously flawed. There is no causal

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236 In that regard, see the comments of the trial judge: *Bhasin TJ, supra* note 12 at para 451.

237 *Bhasin TJ, supra* note 12 at para 419.

238 *Bhasin, supra* note 6 at para 110.

or rational connection between breach of the duty of honest performance and the damages ultimately awarded. All of this leads to one ask whether the Court should have resisted the opportunity to pursue an issue that had not been advanced at trial or even in the court of appeal.[239] Perhaps Bhasin took some comfort in the $87,000 the Supreme Court awarded after having a judgment for nearly $500,000 set aside by the Court of Appeal. Legal fees being what they are, one cannot help but speculate that the plaintiff's victory came at too great a cost.

### *10. Conclusion*

In strict legal theory the precedential significance of the Supreme Court's decision in *Bhasin* is narrow. This is because the issue ultimately decided was limited in scope: "Does Canadian common law impose a duty on parties to perform their contractual obligations honestly?" So asked the Court. That a positive response was offered is hardly surprising. Surely, no one enters into a contract with the understanding that the law sanctions cheating and lying. That a distinction was drawn between the duty of honest performance and the civil tort of fraud (deceit) and the principles of estoppel are matters that contract and tort scholars are likely to explore. And in time, no one will really care that someone argued that the Supreme Court reached a conclusion inconsistent with findings of the trial judge or that the damages the Supreme Court awarded were based on a perceived misunderstanding of what was decided at trial. What matters is that the law has formally recognized a duty applicable to all contracts: the duty of honest performance.

That the Supreme Court would decide against the adoption of a generalized rule requiring all contractual obligations be performed in good faith is clearly defensible and certainly not novel. The Court willingness to adopt good faith as an organizing principle is a most welcome development in Canadian law. It dispenses with the need to undertake an unrewarding search for a practical definition for the term "good faith." Instead, attention may now focus on the task of identifying conduct that falls within the category of "bad faith." In that regard, everyone agrees there are basic rules (implied terms) to be observed. Parties must make reasonable efforts to fulfill their contractual obligations. Deliberate and defective performance in order to evade contractual obligations is not permitted. And parties must exercise a contractual discretion on the

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[239] The caution, which Swan and Adamski offer in their text (*supra* note 3 at para 1.8) to all judges is worth replication: "A court which ignores the arguments of counsel or which adopts a rule or principle for decision that counsel did not address, whether or not counsel should have done so, denies the possibility of reasoned argument on that point."

objective standard of reasonableness. This means that due regard must be given to the interests of the other party. Fortunately, all of these obligations can be easily justified as a term implied-in-fact. However, it is not clear as to how the duty of good faith performance will play out in those cases where the good faith obligation is one implied-in-law and the issue arises in the context of an employment, insurance or franchise agreement, or one that is analogous thereto (such as dealership agreements).

The Supreme Court's decision in *Bhasin* offers a good faith doctrine that plays a modest role in contract law when it comes to the duty to perform contractual obligations in good faith: filling in contractual gaps. But for the Court's finding that the duty of honest performance was breached, one may safely infer that the Court would have ruled against the plaintiff with respect to the claim that the defendant had breached its duty of good faith performance. The Court's apparent unwillingness to classify the decision not to renew the dealership agreement as one involving the exercise of contractual discretion, let alone one exercised for an improper purpose, would have been fatal to the plaintiff's good faith argument. On this point, the Court's *obiter* rests on a sound footing. On the other hand, we are also left with the inference that the entire agreement clause would have displaced any good faith performance obligation that qualified as an implied term. That is not a welcome development in the law and one antagonistic to the prevailing judicial attitude in Ontario.

That the Supreme Court has fashioned a modest role for the good faith performance obligation is apparent. Whether the law should allow for a more robust model, in carefully circumscribed circumstances, has yet to be decided. We do know that the Court has expressly acknowledged that the law is open to incremental developments that are "consistent with the structure of the common law of contract and give due weight to the importance of private ordering and certainty in commercial affairs." This leads one to ask whether there is room in the law for the good faith performance obligation to trump an express and unambiguous provision of the contract. The possibility cannot be ignored as the civil law of Quebec does precisely that. And the same holds true when it comes to the duty of good faith of contractual obligations such as those arising in the context of demand and secured loans. But this is not to suggest that the obligation of good faith performance should be treated as a stand-alone duty as is the duty of honest performance. There may be instances where the law would be better served by recognizing the possibility of declaring a provision of a contract unenforceable (unconscionable) as opposed to the entire contract. After all, limitation of liability clauses receive special treatment in the law of contract. Why shouldn't termination clauses in franchise or dealership agreements receive similar scrutiny? But there will always be

cases where the dividing line between good and bad faith conduct does not fit neatly within the present tenets of the good faith doctrine. One need only look to cases such as *Fortune* to appreciate the significance of that observation.[240]

It would be unrealistic to expect a single decision of our Supreme Court to address all of the nuances and implications of the good faith doctrine in contract law. The Court's decision in *Bhasin* continues on from where earlier precedents left off. Undoubtedly, more will come. But the precedential significance of the decision should not be underestimated. It goes far beyond recognition of a duty of honest performance. There is now a solid foundation upon which the tenets of the good faith doctrine can be applied in such a manner that certainty and predictability in the law are preserved. *Bhasin* moves the law forward while reminding us that we must still look back. A ground-breaking decision indeed and one that remains true to the caution that Cromwell J himself acknowledged: "The development of the principle of good faith must be clear not to veer into a form of *ad hoc* judicial moralism or 'palm tree' justice."[241]

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240 *Fortune*, *supra* note 171.

241 *Bhasin, supra* note 6 at para 70.