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A CANADIAN FIRST: SUPREME COURT RECOGNIZES DUTY OF HONEST PERFORMANCE OF ALL CONTRACTUAL OBLIGATIONS

Richards Buell Sutton Insurance Newsletter

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In the landmark decision of *Bhasin v. Hrynew*, 2014 SCC 71, the Supreme Court of Canada has for the first time recognized that parties to any contract owe each other a duty of honesty in the performance of their contractual obligations. In reaching this conclusion the Supreme Court ends some uncertainty and incoherence in Canadian common law and moves it toward developments in the United States, the United Kingdom and Australia. In doing so, the Supreme Court also sets the table for the development of years of jurisprudence on what the new duty means as well as how and in what circumstances it is breached.

The Facts

The defendant "Can-Am" markets education savings plans through dealers known as enrollment directors. The plaintiff had been one of Can-Am's enrollment directors since 1989 and by 1999 had built up a lucrative business selling Can-Am's products. The relevant contract was created in 1998 and had a term of three years after which it would automatically renew unless one of the parties gave six months' written notice to the contrary.

The other defendant, Hrynew was also one of Can-Am's enrollment directors and a competitor of the plaintiff. In the past, Hrynew had proposed to the plaintiff on a number of occasions the prospect of a merger of their respective agencies. The plaintiff steadfastly refused these proposals and Hrynew subsequently encouraged Can-Am to take steps to force the merger.

By late 1999, the Alberta Securities Commission had become concerned about compliance issues among Can-Am's various enrollment directors and required Can-Am to appoint a single provincial trading officer ("PTO") to conduct audits of its enrollment directors to ensure their compliance with securities laws. Can-Am appointed Hrynew to the position of PTO and the plaintiff subsequently refused to provide his confidential business records for audit by his competitor.

Due to concerns that the Commission might revoke its license, Can-Am began considering a restructuring of its agencies in Alberta. In discussions with the Commission in June 2000, Can-Am outlined its plan for restructuring its Alberta agencies, which included the plaintiff working for Hrynew's agency. These plans

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were not made known to the plaintiff, who was repeatedly misled by Can-Am throughout this process.

The plaintiff's continued refusal to allow Hrynew to audit his records lead Can-Am to threaten the termination of the 1998 contract and in May 2001 Can-Am gave notice of non-renewal pursuant to contract terms. At expiry of the contract the plaintiff lost the entire value of his business and the majority of his sales agents began working for Hrynew.

The trial judge found that it an implied term of the contract that decisions about whether to renew had to be made in good faith and that Can-Am was in breach of that implied term. The Alberta Court of Appeal reversed and dismissed.

The Ruling

The court began its analysis by stating that although the notion of good faith has deep roots in contract law and permeates many of its rules, the common law's resistance to acknowledging any generalized and independent doctrine of good faith performance of contracts had resulted in a body of law that is unsettled, incoherent and piecemeal. To make the law of contract more coherent and just the court felt that two incremental steps were required.

The first step was to acknowledge that good faith contractual performance is a general "organizing principle" of the common law of contract. As a corollary of the organizing principle of good faith, the second "incremental step" was to recognize that there is a common law duty which applies to all contracts to act honestly in the performance of contractual obligations. The general duty of honesty in contractual performance "means simply that parties must not lie or otherwise knowingly mislead each other about matters linked directly to the performance of the contract." The court explained that this new duty should not be confused with a duty of disclosure or fiduciary loyalty and does not require a party to subordinate its own interests to that of the other contracting party. Rather, the duty requires "a minimum standard of honesty in contractual performance". The court indicated that the "precise content of honest performance will vary with context" and suggested that in some circumstances parties would be free to relax the requirements of the doctrine so long as they respect its minimum core requirements.

Practical Considerations for the Insurance Industry

Insurance law has long implied a duty of good faith in the performance of contractual obligations and as such *Bhasin* will not have much impact on the industry in the context of first party claims. However, the decision will have significant ramifications in the litigation and handling of third party claims that are based wholly or partly on breach of contract.

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We expect that allegations of failure to honestly perform obligations will, at the outset, become boilerplate in breach of contract claims. Such pleadings will entail broader discovery and more issues for trial. This will create greater cost and more uncertain liability exposure. While the court in *Bhasin* envisions that the law in this area will be guided by existing doctrines governing the situations and relationships which require "honest, candid, forthright or reasonable performance" the scope of the new duty is likely to remain uncertain for the foreseeable future.

In the long run, *Bhasin* will be of tremendous assistance in the development of contract law but all those involved in the litigation process will bear additional costs and uncertainty associated with such development.

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