



Posted on: March 11, 2015

THE SUPREME COURT OF CANADA RECOGNIZES NEW COMMON LAW DUTY TO ACT HONESTLY

Richards Buell Sutton Commercial Leasing Newsletter

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Implications for Landlords and Tenants

In the recent decision of *Bhasin v. Hrynew*, 2014 SCC 71, the Supreme Court of Canada (“SCC”) recognized “good faith” as a “general organizing principle” of Canadian contract law and a new duty of “honest performance”, which requires every party to a contract to perform its contractual obligations honestly and with regard to the legitimate interests of the other party. This duty cannot be avoided by express agreement between the parties. The SCC’s decision will have a ripple effect across Canada as businesses, courts and litigants seek to interpret the scope of this new duty. Landlords and tenants will need to consider their performance obligations and behaviour when entering into or renewing leasing arrangements.

Background

This decision involved the relationship between the plaintiff, Mr. Bhasin, and defendants, Canadian American Financial Corp (“Can-Am”) and Mr. Hrynew. Can-Am was a marketer of educational savings plans to investors through independent retail dealers, known as enrollment directors. Both Mr. Bhasin and Mr. Hrynew were enrollment directors and competitors. Can-Am had contracted with Mr. Bhasin since 1998. The most recent contract was for a three year term that would automatically renew unless either party gave written notice to the contrary. Mr. Hrynew wanted to take over Mr. Bhasin’s market and had previously approached Mr. Bhasin about a possible merger and encouraged Can-Am to pressure Mr. Bhasin into the merger. Mr. Bhasin refused.

In May 2001, Can-Am exercised the non-renewal provision, giving Mr. Bhasin the required six months’ notice. While this was in accordance with the express terms of the contract, the SCC found Can-Am liable due to its dishonest conduct in performing the contract. Specifically, the court found that Can-Am had treated Mr. Bhasin unfairly in the context of their contractual rights and responsibilities and had repeatedly misled or deceived Mr. Bhasin; which, at the end of the contract, resulted in a loss in value of Mr. Bhasin’s business.



The Law

Prior to the SCC decision, the Court noted that the concept of good faith performance of contracts in Canadian common law was “piecemeal, unsettled and unclear”. It stated that two incremental steps were in order to make the common law more coherent and just:

1. A General Organizing Principle. The Court recognized that good faith contractual performance is a “general organizing principle of the common law of contract which underpins and informs the various rules in which the common law, in various situations and types of relationships, recognizes obligations of good faith contractual performance”. And that this organizing principle is “not a free-standing rule, but rather a standard that underpins and is manifested in more specific legal doctrine and may be given different weight in different situations.”
2. A Duty to Act Honestly in the performance of contractual obligations. The Court explained: “Under this new general duty of honesty in contractual performance, parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract. This does not impose a duty of loyalty or of disclosure or require a party to forego advantages flowing from the contract; it is a simple requirement not to lie or mislead the other party about one’s contractual performance.”

The SCC was clear that the new duty of honest performance was not an implied contractual term, “but a general doctrine of contract law that imposes as a contractual duty a minimum standard of honest contractual performance. It operates irrespective of the intentions of the parties” and an entire agreement clause in a lease would not be an impediment to the contractual duty that arises nor are the parties free to exclude it.

So What Does it Mean for Landlords and Tenants?

Hopefully nothing if both parties are acting in good faith and honestly. But the following points may be worthwhile keeping in mind:

1. Negotiations. The decision does not apply in the context of negotiation, but rather only in the context of the performance of contractual obligations. Nevertheless, it is not inconceivable that the principle will be applied in certain situations. For example, if the parties have agreed to negotiate future rights in good faith, such as a lease renewal, while they may not be required to disclose their negotiating positions; it is likely they will be required to avoid any actions that could be viewed as actively misleading or could be interpreted as deceitful.
2. Defining the Scope of Duty. It may be possible to limit, but not eliminate, the scope of application of



the duty of honest performance of contractual obligations. The Court recognized that “the precise content of honest performance will vary with context and the parties should be free in some contexts to relax the requirements of the doctrine so long as they respect its minimum core requirements”.

Consideration should be given to including provisions that establish a set standard of good faith performance for the purpose of the lease.

3. Relational Context. The context surrounding the parties’ contractual relationship will be far more important. The context of the relationship will be central to determining what good faith requires of the parties. Long term landlord tenant relationships will likely be held to a higher standard than one off purchase contracts.
4. Lease Drafting. The lease itself will be part of the context and may influence the scope of good faith obligations to which each is subject. Increased specificity in lease terms may be advisable. Instead of clauses that gives the landlord or tenant sole discretion with respect to a matter, it may be advisable to enumerate under what circumstances the discretion can be exercised.
5. Documenting Decisions. While the SCC was of the view that the recognition of a duty of honest performance was a “modest, incremental step” in the law of contract and does not pose a risk to commercial certainty, it seems likely that allegations of failure to perform contractual obligations honestly will regularly arise in breach of lease claims. It may be prudent for parties to put in place systems to document the process by which they arrived at discretionary decisions or exercise contractual rights in order to refute that such decision was made “capriciously or arbitrarily”.
6. Communications between Landlord and Tenant. Parties will need to consider the form and nature of what they communicate to each other; particularly if they are concerned about how such communications may be interpreted. Until there is more clarity on the application of this new duty of honest performance, parties may elect to adopt policies that reduces communication in order to reduce litigation risk.
7. What it Does Not Mean. The duty of honest performance does not impose a duty of loyalty, or of disclosure, or require a party to forgo advantages flowing from the contract. Nor does it impose a fiduciary duty or a general duty to subordinate personal interest to that of the other party.

Conclusion

Time will tell how the expanded duty of honest performance of existing contractual obligations as articulated by the SCC will play out in leasing agreements and the courts. Parties will have to carefully consider the potential scope of these new duties in the context of specific leasing relationships. It seems likely that this new principle will affect the manner in which landlords and tenants structure their leases, the way they exercise existing rights, negotiate future rights and generally communicate with each other.