

Recent Alberta Court of Appeal Treatment of Good Faith in Contract

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Introduction

In the [seminal case](#) of *Bhasin v Hrynew*, 2014 SCC 71, [2014] 3 SCR 494, the Supreme Court of Canada took “two incremental steps” and unanimously overturned the traditional common law view that no general and independent doctrine of good faith exists in Canadian contract law. *Bhasin* established instead that good faith contractual performance is an “organizing principle” underpinning and informing contract law. The Supreme Court also recognized the novel duty of honest contractual performance as a manifestation of this organizing principle.

Although plainly a landmark case in contract law, *Bhasin*'s implications are unclear. In two recent cases the Alberta Court of Appeal has interpreted *Bhasin* to give more guidance as to how its principles are to be applied in Alberta. In the January 2017 [case](#) of *Styles v. Alberta Investment Management Corp.*, 2017 ABCA 1 Slatter JA for the majority takes a restrictive approach and circumscribes the broad interpretation given by the trial judge, seeking to narrow the application of the *Bhasin* principles; in the more recent May 2017 [case](#) of *IFP Technologies (Canada) Inc. v. EnCana Midstream and Marketing*, 2017 ABCA 157, C.A. Fraser CJA, writing for the majority, also takes a restrictive view. The salient points of both these decisions will be reviewed in detail in this discussion, but we will commence by reviewing the seminal *Bhasin* decision.

Facts

The plaintiff and appellant, Bhasin, was a retail dealer who sold education saving plans to investors for the defendant and respondent, Canadian American Financial Corp. (“Can-Am”). The term of the contract governing this relationship was three years, with a provision that the agreement would automatically renew at the end of the three-year term unless either party gave six months written notice otherwise. The contract contained an “entire agreement clause” stipulating that there were no “agreements, express, implied or statutory, other than expressly set out” in the agreement.

Hrynew was another retail dealer selling education savings plans for Can-Am. Hrynew, a competitor of Bhasin, hoped to take over Bhasin’s lucrative niche business. Although Hrynew proposed a merger of their businesses on several occasions and asked Can-Am to force the merger, Bhasin resolutely refused.

Can-Am appointed Hrynew as a provincial trading officer to review its business for compliance with Alberta’s securities regulations. In this capacity Hrynew was to conduct audits of Can-Am’s retail dealers. However, Bhasin objected to having Hrynew, a competitor, access his confidential business information. Can-Am repeatedly assured Bhasin, *untruthfully*, that Hrynew was obligated to treat this information confidentially. Moreover, Can-Am evaded Hrynew’s inquiries by equivocating when Bhasin asked whether the merger was “a done deal.” Yet, without Bhasin’s knowledge, Can-Am had formulated a merger plan in which Bhasin would become Hrynew’s employee.

Bhasin continued to refuse to allow Hrynew access to his business records and Can-Am eventually gave notice of non-renewal under the agreement. Having been misled by Can-Am, Bhasin had little opportunity to protect the value of his business. As a result, Bhasin suffered considerable loss at the end of the contract term. Bhasin commenced an action alleging, amongst other things, a breach of the duty of good faith.

At trial Can-Am was found in breach of the implied term of good faith, Hrynew was held liable for intentionally inducing breach of contract, and both defendants were held liable for civil conspiracy. Moen J. determined that if Can-Am had been forthright, Bhasin would have been able to preserve the value of his business, valued at \$87,000.

However, the Alberta Court of Appeal overturned this decision on the grounds that the trial judge improperly implied a term of good faith in an unambiguous contract containing an entire agreement clause. In accordance with the traditional common law position, the Alberta Court of Appeal maintained that Canadian law did not impose a general duty of good faith contractual performance. Moreover, even if there were a duty of good faith it would be precluded by the exclusion clause. The Alberta Court of Appeal observed that the parties intentionally included a term allowing either party to unilaterally trigger the contract's expiration, which could be exercised regardless of motive.

The Supreme Court's Reasoning

Bhasin begins with the observation that the common law's resistance to acknowledging a general and independent doctrine of good faith contractual performance has resulted in jurisprudence that is piecemeal, unclear, and incoherent. The status quo is "out of step" with

contract law in Quebec and much of the United States, as well as with “the reasonable expectations of commercial parties.”

Bhasin’s treatment of good faith begins by surveying jurisprudence and academic commentary relating to the adoption of a general duty of good faith in contract law. Cromwell J. notes Canadian courts have taken conflicting positions, as some courts have indicated a general duty of good faith performance exists while others have simply rejected the duty outright. It seems, though, that there has been a piecemeal adoption of the notion of good faith in various contract law contexts. Recognizing that the concept of good faith grounds “many elements of modern contract law”, Cromwell J. writes:

Thus we see, for example, that good faith notions have been applied to particular types of contracts, particular types of commercial provisions and particular contractual relationships. It also underlies doctrines that explicitly deal with fairness in contracts such as unconscionability, and plays a role in interpreting and implying contractual terms.¹

Turning to Supreme Court of Canada judgments, Cromwell J. outlines three situations in which a duty of good faith contractual performance has been recognized. First, there is a duty of good faith where the parties must cooperate in order to bring about contractual objectives. Second, there is a duty of good faith where one party exercises discretionary power under the contract. Third, there is a duty of good faith where one party seeks to evade contractual duties. Cromwell J. then outlines three categories of legal relationships in which a duty of good faith has been found to operate—the employment context, the insurance context, and in the process of tendering bids. Finally, Cromwell J. canvasses recent developments in jurisprudence in both the United

¹ *Bhasin* at para 42

Kingdom and Australia, which suggest an increased role for the idea of good faith performance in contract law.

Having established the current state of contract law is fragmented and unclear, Cromwell J. concludes that this deficient state of the law should be addressed by taking “two incremental steps.” The first step is the recognition of good faith contractual performance as an organizing principle underpinning and informing contract law. The second step is finding a novel duty of honest performance arising from the good faith organizing principle. These steps, Cromwell J. contends, will provide for clarity, coherence, and justice in Canadian contract law in a way that “will bring the law closer to what reasonable commercial parties expect it to be.” The Supreme Court’s conclusions in *Bhasin* are summarized as follows:

- (1) There is a general organizing principle of good faith that underlies many facets of contract law.
- (2) In general, the particular implications of the broad principle for particular cases are determined by resorting to the body of doctrine that has developed which gives effect to aspects of that principle in particular types of situations and relationships.
- (3) It is appropriate to recognize a new common law duty that applies to all contracts as a manifestation of the general organizing principle of good faith: a duty of honest performance, which requires the parties to be honest with each other in relation to the performance of their contractual obligations.²

The Duty of Honest Performance

The narrow holding in *Bhasin* turns on the novel recognition of a general duty of honesty in contractual performance, which “means simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract.” The Supreme Court is careful to note that the duty of honesty does not constitute a duty of loyalty

² *Ibid* at para 93

or disclosure, and does not require one to forego advantages flowing from a contract. As a general duty of contract law, a minimum standard of honest performance is always operating and cannot be excluded through contract. However, contracting parties have latitude to determine the scope of honest performance by expressly stipulating the standard by which honesty is to be measured, so long as the standard is not ‘manifestly unreasonable’.

Geoff Hall observes: “While the duty is new, it is hardly a bold or radical step.”³ Since it only applies to conduct which is actively misleading or deceitful, the duty is straightforward and limited in effect. As such, the duty of honesty is unlikely to have far-reaching implications for Canadian contract law.

The Supreme Court finds that by equivocating about its intentions with Bhasin’s business and lying about Hrynew’s obligations as a provincial trading officer, Can-Am acted dishonestly with Bhasin. Had Can-Am been truthful and upfront, Bhasin would have been able to take steps to retain the value of his business. The entire agreement clause is ineffective against this finding because the parties are unable to exclude the operation of a general contract law duty. Accordingly, *Bhasin* awarded damages in the amount of Bhasin’s business’s value for breach of the duty of honest performance.

³ Hall, Geoff. “*Bhasin v Hrynew*: Towards an Organizing Principle of Good Faith in Contract Law” (2015) 30 BFLR 335 at 341

The Organizing Principle of Good Faith

In contrast to the relatively straightforward duty of honest performance, the Supreme Court's recognition of the good faith organizing principle has unclear and potentially sweeping ramifications.

Before unpacking the Supreme Court's conception of good faith, Cromwell J. distinguishes between an organizing principle and specific legal doctrines. The former underpins and is manifested in the latter. An organizing principle, "states in general terms a requirement of justice from which more specific legal doctrines can be derived." As a flexible principle underpinning specific legal doctrines, the organizing principle is a standard providing for the principled development of practical legal rules.

Turning to the substantive content of the good faith organizing principle, the Supreme Court's first formulation is that the "organizing principle is simply that parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily." The second formulation provides more detail. Cromwell J. writes:

The organizing principle of good faith exemplifies the notion that, in carrying out his or her own performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner. While "appropriate regard" for the other party's interests will vary depending on the context of the contractual relationship, it does not require acting to serve those interests in all cases. It merely requires that a party not seek to undermine those interests in bad faith.⁴

⁴ *Bhasin* at para 65

The good faith organizing principle is manifested in the piecemeal contexts in which contract law has invoked the concept of good faith. Recognizing the organizing principle's reflection in these contexts allows the organizing principle to serve as an umbrella concept. That is to say, the good faith organizing principle provides a single conceptual touchstone that brings together the fragmented situations in which "the law requires, in certain respects, honest, candid, forthright, or reasonable contractual performance." The Supreme Court concludes that while good faith claims typically will fall within these already established categories, the organizing principle is capable of development to allow for new manifestations of the obligation of good faith contractual performance in novel contexts.

It is noteworthy that good faith contractual performance was recognized as an organizing principle rather than a legal duty. Andrea Bolieiro argues this reflects the difference between principles and rules.⁵ The former are too abstract to be conceptualized as actual legal doctrines. Rather, principles are balanced against other principles to inform the development of practical legal rules. Bolieiro suggests good faith necessarily means different things at different times, and is simply meant to be balanced against other abstract principles such as freedom of contract. Viewed in this way, good faith is a value to be weighed against other competing values in order to justify the development of actual legal doctrines. Recognizing that good faith cannot properly be formulated as a clearly defined legal doctrine, the Supreme Court put forward the organizing principle as an open-ended and context-dependent abstract principle.

⁵ Bolieiro, Andrea M. "*Bhasin v Hrynew* and the principle of good faith in contracts: Moving towards a modern view of commercial relationships" (2015) 33(4) *Adv J* 23 at 24

Concerning the lack of good faith's definitional meaning, one might draw on considerable academic literature suggesting that no precise definition can be offered.⁶ Robert Summers writes:

...any but the most vacuous general definition of good faith will...fail to cover all of the many and varied specific meanings that it is possible to assign to the phrase in light of the many and varied forms of bad faith recognized...⁷

Thus, as soon as the meaning of good faith is formulated into a concrete definition, the definition is too narrow to account for the multiplicity of meanings and different contexts in which good faith has been brought to bear.

Recent Alberta Court of Appeal Treatment of Good Faith in Contract

In the first recent Alberta Court of Appeal [case](#) to substantially consider *Bhasin, Styles v. Alberta Investment Management Corp.*, 2017 ABCA 1, Slatter JA for the majority circumscribes the broad interpretation of *Bhasin* adopted by the trial judge. The respondent investment manager had moved from Ontario to Alberta in 2010 to take up a position with the appellant and had entered into a written employment contract providing for a base salary plus potential bonuses. The contract acknowledged that the respondent could be terminated without cause. The bonus incentive plan stipulated that no rights under the plan vested for four years and if a participant's employment lasted less than four years they would never receive a bonus. At a period less than four years the respondent was dismissed and the appellant took the position that he was not

⁶ See discussion of attempts to define good faith in Summers, Robert. "The General Duty of Good Faith—Its Recognition and Conceptualization" (1982) *Cornell Faculty of Law Publications* Paper 1195 810 at 829

⁷ Summers, Robert. "'Good Faith' in General Contract Law and the Sales Provisions of the Uniform Commercial Code"(1968) 54(2) *Virginia Law Review* 195 at 206

entitled to receive bonuses. The respondent sued for the bonuses he felt he was entitled to, relying on *Bhasin* to advance his claim.

The trial court found that the bonuses were payable based on a broad reading of *Bhasin*. The trial judge recognized the general requirement of honesty in the performance of contracts as a “general organizing principle” established in *Bhasin*, but further expanded this concept to include a related “general organizing principle” described as “a common law duty of reasonable exercise of discretionary contractual powers”.

Slatter JA for the majority of the appellate court rejected this broad interpretation and overturned the trial judgment. He stated that the “organizing principle” in *Bhasin* should only be applied to situations where it has previously been invoked, although there is a limited ability to extend the law.⁸ The new duty to act honestly simply meant that the parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract, and was a very narrow concept which did not create any duty of loyalty, disclosure, or forgoing of contractual advantage.⁹ He then noted that, first, the *Bhasin* principle relates to the performance of the contract – it does not relate to the negotiation or terms of the contract. “*Bhasin* does not invite the court to examine the terms of the contract and decide if they are “honest”, “capricious”, or negotiated in “good faith”, much less whether they are “fair and reasonable”. The courts have never concerned themselves with the relative value of the consideration exchange in a contract. ... Unless a contract is unconscionable or contrary to public policy, it is to be enforced in accordance with its terms. ...”¹⁰ Second, *Bhasin* does not make it dishonest, in bad faith, nor arbitrary to require that the other party perform the contract in

⁸ *Styles* at para 45

⁹ *Ibid* at para 47

¹⁰ *Ibid* at para 51

accordance with its terms.¹¹ Even the organizing principle of good faith must not “... veer into a form of *ad hoc* judicial moralism or “palm tree” justice”.¹² Further, expanding the principle of good faith performance of contracts found in *Bhasin* into a principle of “reasonable” performance creates a clear danger of “reverse engineering” in reviewing the performance of contracts.¹³ A contractual discretion can be exercised giving primacy to the best interests of the party exercising the discretion – acting in one’s self interest in a commercial contractual context is neither dishonest, capricious, nor arbitrary.¹⁴ He concluded that the principles set out in *Bhasin* do not enable either party to insist on covenants and provisos that are not set out in writing in the agreement, nor did they allow the parties to ignore the plain wording of this agreement.¹⁵

More recently in this May 2017 [case](#), in *IFP Technologies (Canada) Inc. v. EnCana Midstream and Marketing*, 2017 ABCA 157, the Alberta Court of Appeal again takes a restrictive approach to the application of the *Bhasin* principles, and addresses more fully the concept of “reasonableness” within this context. This case involves the interpretation of the scope of “working interest” within the context of a contract for an oil and gas partnership. The plaintiff had entered into a partnership agreement with the predecessor of the defendant with respect to an Alberta property known as Eyehill Creek. Following the collapse of oil and gas prices in Alberta, the plaintiff sued, alleging that the predecessor to the defendant had granted the plaintiff a 20% working interest in the property in consideration of the plaintiff terminating other overriding royalties arising from other defendant controlled leases. The position of the defendant was that the plaintiff’s interest was limited to an undivided 20% interest in oil and gas produced only through thermal and other enhanced recovery methods. This argument was accepted by the trial

¹¹ *Ibid* at para 52

¹² *Ibid* at para 53

¹³ *Ibid* at para 56

¹⁴ *Ibid* at para 57

¹⁵ *Ibid* at para 64

judge, who was found to be in error on appeal, with C.A. Fraser CJA writing the majority decision.

The Chief Justice commenced her remarks by stating: “Even large multi – national companies are entitled to expect that the contracts they make in Canada will be honoured – and that they will not be subject to the “gotcha” approach to contractual dealings”.¹⁶ “Ensuring that contractual obligations are discharged in good faith and in accordance with the reasonable expectation of the parties is essential to the economic well – being of this country”.¹⁷ She then articulated the business case for certainty in contracts in Canada, and stated:

Companies are entitled to expect that the parties with whom they contract will be honest, reasonable, candid and forthright in their contractual dealings:.. As a corollary to this, they are also entitled to expect that contractual terms intended to protect one contracting party from future liability will not then be turned on their head and used to gut the purpose of the contract. Consequently, the court should be slow – indeed I suggest, unwilling – to permit companies to ignore the contractual obligations on the basis that, after problems start, someone can think of another term that might have been included to put what turns out to be a contentious issue beyond doubt. ...”.¹⁸

The appellate court noted that the trial judge’s decision had predated *Bhasin* and the *Sattiva* [case](#). Fraser CJA referenced back to the early “good faith” Alberta [case](#) of *Mesa Operating Limited Partnership v. Amoco Canada Resources Ltd.*, 1994 ABCA 94, and noted that the concept of good faith and contract had evolved, referencing *Bhasin*. She then stated:

... Decisions like *Mesa*, notes Robertson¹⁹ ... At 839:

¹⁶ *IFP* at para 1

¹⁷ *Ibid.* at para 2

¹⁸ *Ibid.* at para 4

¹⁹ Joseph T. Robertson, “Good Faith as an Organizing Principle in Contract Law: *Bhasin v. Hrynew*-Two Steps Forward and One Look Back” (2015), 93 Can Bar Rev 809

... Support this 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 the reasonable expectations.²⁰

She further stated:

Whether expectations are reasonable can be informed by the commercial context of a contract: *Mesa*, supra at para 20. Reasonable expectations of contracting parties are to be found in the contract itself rather than the court’s abstract perception of what is “fair”. While “reasonable expectations” does not operate as a stand – alone principle divorced from the contract actually agreed to between the parties, this does not diminish its role in informing the duty of “good faith” in contractual performance. In doing so, the reasonable expectations of the parties operate so as to imply a term limiting one party’s ability to perform a contract in a manner which undermines the interests of the other party.²¹

Conclusion

In *Bhasin* the Supreme Court took “two incremental steps” and overturned the traditional common law view that no general and independent doctrine of good faith exists in Canadian contract law. Instead, *Bhasin* established good faith contractual performance as an organizing principle that underpins and informs contract law. *Bhasin* also recognized a novel general duty of honest contractual performance arising from the organizing principle. However, in *Bhasin* the Supreme Court does not clearly develop its understanding of good faith. In two substantive judgments interpreting the *Bhasin* principles, the Alberta Court of Appeal has taken a restrictive view, seeking to circumscribe a broad application of *Bhasin*. From these two appellate decisions, it is clear that there will be no “gotcha” approach to contractual dealings in Alberta, and that: “In the end, contractual interpretation is not an exercise in second-guessing what could have been included in the contract while discounting or dismissing relevant terms of a contract and

²⁰ *IFP* at para 190

²¹ *Ibid* at para 191

uncontradicted contextual information. It is instead an exercise in determining what the parties objectively intended having regard to the entire written text, relevant contextual background and commercial context”.²²

END

²² *Ibid* at para 89