

**Business**

## Supreme Court expands duty of good faith in performance of contracts

By **Bradley Phillips**

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(January 12, 2021, 1:56 PM EST) -- The recent decision of *C.M. Callow Inc. v. Zollinger* 2020 SCC 45, by the Supreme Court of Canada, has expanded the duty of good faith in the performance of contracts by broadening the types of conduct that can lead to a finding of a breach of that duty.

The impact of this decision means that parties will have broader arguments available to them when they believe a counterparty to their contract has not performed the contract fairly.

### The facts

In *Callow*, a group of condominium corporations (Baycrest) entered into a two-year winter maintenance contract and a separate summer maintenance contract with the plaintiff, C.M. Callow Inc. (Callow).

Pursuant to clause 9 of the winter maintenance contract, Baycrest was legally permitted to terminate the contract with Callow *for any reason* upon 10 days' written notice (the Termination Clause).

In early 2013, Baycrest decided to terminate the winter maintenance agreement, but chose not to inform Callow of its decision at that time. And in fact, during the summer of 2013, Callow performed work above and beyond its summer maintenance contract at no charge, which it hoped would act as an incentive for Baycrest to renew the winter maintenance agreement.

Baycrest informed Callow of its decision to terminate the winter maintenance agreement in September 2013. Callow then filed a statement of claim for breach of contract.

The Supreme Court of Canada was not asked to hear any of the traditional arguments that might have been made to challenge the Termination Clause. Callow didn't argue that this term was a "mistake" in drafting that should be rectified by the court. It didn't suggest that Baycrest had induced Callow to sign the contract by way of an intentional or negligent misrepresentation. It didn't argue that the clause should be declared void because Callow was unduly influenced to sign the contract with those terms by Baycrest.

Rather, it argued that Baycrest, by its conduct, had acted in bad faith in performing the contract and sought damages arising from this conduct.

### The courts' reasoning

At trial, the judge found in favour of Callow and held that Baycrest had "actively deceived" Callow from the time it had decided to terminate until it gave notice several months later. Specifically, the judge concluded that Baycrest had acted in bad faith by withholding that information to ensure Callow performed the summer maintenance contract and by continuing to represent that the winter contract was not in danger despite knowing that Callow was taking on extra tasks to bolster the chances of the winter maintenance contract being renewed. The court awarded damages to Callow in order to place it in the same position as if the breach had not occurred.

The Court of Appeal set aside the judgment at first instance, holding that the trial judge erred by improperly expanding the duty of honest performance beyond the terms of the winter maintenance agreement. Further, it held that any deception in the communications during the summer of 2013 related to a new contract not yet in existence, namely the renewal that Callow hoped to negotiate, and therefore was not directly linked to the performance of the winter contract.

At the Supreme Court, a majority allowed the appeal, finding that Baycrest's conduct amounted to active deception in relation to the exercise of the Termination Clause.

In relying upon the Supreme Court's earlier decision in *Bhasin v. Hrynew* 2014 SCC 71, the majority of the court expanded upon its previous statements that there was a general organizing principle of good faith in contract performance, which means that "... parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily ..."

The court reiterated that this organizing principle was "not a free-standing rule, but instead manifests itself through existing good faith doctrines, and that this list may be incrementally expanded where appropriate." [Emphasis added.]

In the present case, the Supreme Court found that the applicable good faith doctrine that applied, was the duty of honesty in contractual performance. While the Supreme Court noted that the Termination Clause was, on its face, "an unfettered right to terminate the winter maintenance agreement on 10 days' notice," it found that this right had to be exercised in keeping with the duty to act honestly, i.e. Baycrest could not "ie or otherwise mislead" Callow "about matters directly linked to the performance of the contract."

One of the key considerations in this case was that Baycrest never actually told Callow that his winter contract would be renewed. The court noted that while it was established that parties to a contract cannot outright lie or tell half-truths in a manner that knowingly misleads a counterparty, the failure to disclose a material fact, without more, would not be contrary to this standard.

To overcome this fact, the Supreme Court broadened the scope of conduct that would amount to dishonesty. Specifically, it found that in certain circumstances a party could mislead another by silence or omission. And in this particular case, by "leading Callow on" in not telling him his contract was going to be terminated and taking advantage of the (free) extra work he performed under the summer contract, combined with its earlier suggestions that a renewal was a likely possibility, the court found that this amounted to the type of omission that amounted to dishonesty.

Of significant note, the Supreme Court also went on to find that the damages arising from this breach of contract should be based upon the reasonable expectation of the party whose contract was breached. In other words, even though Baycrest had the legal right to terminate the winter maintenance contract on 10 days' written notice, because their dishonest conduct delayed Callow's opportunity to seek alternate contracts for the winter, he was entitled to damages equal to this lost opportunity. (Of note, the trial judge in fact awarded Callow damages equal to the profit he would have received as a result of the renewal of the contract.)

### **Concluding thoughts**

Notwithstanding the Supreme Court's suggestion that the expansion of the doctrine of good faith will not open up the interpretation of contracts to greater uncertainty, given the court's own words that at the end of the day, "Whether or not a party has *knowingly misled* its counterparty is a highly fact-specific determination, and can include lies, half-truths, omissions, and even silence, depending on the circumstances," leaves the court able to broadly interpret the conduct of parties in the performance of a contract. [Emphasis added.]

Even in the *Callow* case itself, query what would have happened with just a minor change in the facts. If for example Baycrest had told Callow that it wasn't necessary for him to undertake additional work under his summer contract, but he insisted on doing it anyway, would that have amounted to an omission simply because Baycrest didn't outright tell him that he probably wasn't going to have the winter maintenance contract renewed? Or was the fact that they told him he didn't need to do extra work sufficient disclosure to avoid a finding of dishonesty?

It is therefore evident that parties may well now have a further “arrow in their quiver” when dealing with a contractual party’s conduct in performing a contract, even if the express wording in that contract is restrictive or one-sided in the opposing party’s favour. The Supreme Court of Canada heard the *Callow* appeal jointly with another case, *Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage District* 2019 BCCA 66, which is still under reserve. That case may provide further guidance concerning the organizing principle of good faith in the performance of contracts.

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