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Mr. Heintzman practiced with McCarthy Tétrault LLP for over 40 years with an emphasis in commercial disputes relating to securities law and shareholders' rights, government contracts, insurance, broadcasting and telecommunications, construction and environmental law. He was an elected bencher of the Law Society of Canada for 8 years and is an elected Fellow of the American College of Trial Lawyers and of the International Academy of Trial Lawyers.

Thomas Heintzman is the author of ***Heintzman & Goldsmith on Canadian Building Contracts,*** 5th Edition which provides an analysis of the law of contracts as it applies to building contracts in Canada.

What Is An "Organizing Principle," a "Duty" And A "Term" of a Contract?

In the last two articles I have been considering the recent decision of the Supreme Court of Canada in ***Bhasin v. Hrynew.*** In its decision, the Supreme Court of Canada established two fundamental principles for the Canadian common law of contract.

First, it is an "organizing principle" of contract law that the parties must perform the contract in good faith.

Second, the parties have a duty to act honestly in the performance of contracts.

In its decision the Supreme Court said that this "organizing principle" and "duty" are not "terms"of the contract, so the parties cannot contract out of them. Yet, the court found that the defendant had breached the contract by acting dishonestly. How could the defendant breach the contract if this obligation or duty are not terms of the contract?

Background

A reminder about the facts which were found by the trial judge. Bhasin and Hrynew were both retail dealers who marketed education savings plans developed by Canadian American Financial Corp. ("Can-Am"). Bhasin's agreement with Can-Am was for a term of three years and automatically renewed unless one of the parties gave six months' notice of termination.

Hrynew was a competitor of Bhasin and wanted to take over Bhasin's agency. He campaigned with Can-Am to direct such a merger of the agencies. Can-Am had discussions with the Alberta Securities Commission about restructuring its agencies. Can-Am did not tell Bhasin about these discussions. Can-Am repeatedly misled B about its future plans for its agencies. Can-Am gave notice of non-renewal of the agreement. As a consequence, Bhasin lost his business and his workforce went to work for Hrynew. Bhasin sued Can-Am and Hrynew.

The trial judge held that a term of good faith performance should be implied based on the intentions of the parties in order to give business efficacy to the agreement. The trial judge found that Can-Am had breached that implied term in its contract with Bhasin. He found that Can-Am had dealt dishonestly with Bhasin.

The Supreme Court of Canada restored the trial judge's finding that Can-Am had breached its contract with Bhasin by dealing with him dishonestly.

Decision of the Supreme Court relating to Organizing Principles and Terms of the Contact

Speaking for a unanimous court, Justice Cromwell stated the following propositions:

"…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. ...a further manifestation of this organizing principle of good faith…is a common law duty which applies to all contracts to act honestly in the performance of contractual obligations." (underlining added)

The Supreme Court explained what it meant by "an organizing principle." Such a principle "states in general terms a requirement of justice from which more specific legal doctrines may be derived. An organizing principle therefore is not a free-standing rule, but rather a standard that underpins and is manifested in more specific legal doctrines and may be given different weight in different situations."

Having recognized the organizing principle of good faith performance of contracts, Justice Cromwell held that the court should now recognize a contractual duty of honest performance:

> "I would hold that there is a general duty of honesty in contractual performance. This means simply that 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. Recognizing a duty of honest performance flowing directly from the common law organizing principle of good faith is a modest, incremental step."

Justice Cromwell then summarized the position:

> "(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." (underlining added)

Justice Cromwell then discussed the nature of these duties and organizing principles. He held that:

> "a new duty of honest performance….should not be thought of as an implied 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 is to this extent analogous to equitable doctrines which impose limits on the freedom of contract, such as the doctrine of unconscionability."

He then noted that;

> "There is a longstanding debate about whether the duty of good faith arises as a term implied as a matter of fact or a term implied by law… I do not have to resolve this debate fully, which…casts a shadow of uncertainty over a good deal of the jurisprudence. I am at this point concerned only with a new duty of honest performance and, as I see it, this should not be thought of as an implied 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……. Viewed in this way, the entire agreement clause in cl. 11.2 of the Agreement is not an impediment to the duty arising in this case. Because the duty of honesty in contractual performance is a general doctrine of contract law that applies to all contracts, like unconscionability, the parties are not free to exclude it." (underlining added)

In any event, he concluded that since "the duty of honest performance interferes very little with freedom of contract, since parties will rarely expect that their contracts permit dishonest performance of their obligations." However, Justice Cromwell did not discount the possibility that the parties might try to limit their obligations of good faith and honesty. He said:

> "I would not rule out any role for the agreement of the parties in influencing the scope of honest performance in a particular context. 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."

When it came time to apply these principles to the actual facts, Justice Cromwell found that "Can-Am breached its duty to perform the Agreement honestly." He concluded that:

> "this dishonesty on the part of Can-Am was directly and intimately connected to Can-Am's performance of the Agreement with Mr. Bhasin and its exercise of the non-renewal provision. I conclude that Can-Am breached the 1998 Agreement when it failed to act honestly with Mr. Bhasin in exercising the non-renewal clause."

Discussion

This decision leaves us asking a number of questions:

Did Can-Am breach a term of the contract? If it didn't, how could it be in breach of the contract? If it did, what term did it breach?

Is the "organizing principle" of good faith performance a term of the contract?

Is the duty of honest performance a term of the contract?

The answer to the last two questions seems to be No. The Supreme Court differentiated between an "organizing principle" and a duty and a term. It held that good faith performance fell into the first category, an organizing principle. It held that honesty fell into the second category, a duty. It held that neither the "organizing principle" of good faith nor the "duty" of honest performance amounted to a term, with the result that the parties cannot contract out of them and the entire agreements clause does not apply to them.

If that is so, it is hard to see how a breach of these non-terms can amount to a breach of the contract. In addition, how should drafters of contracts deal with these non-terms? The parties may want to define what is permissible conduct so that no argument can be made that it is in bad faith or dishonest. While Justice Cromwell said that the parties are entitled to "relax the requirements of the doctrine" of honest performance as long as they respect the "core requirements" of the doctrine, how do they do so since these concepts are, according to the Supreme Court, not part of the contract? Will the terms that the parties write into the contract be effective, and to what degree?

The concept of "organizing principles" has been adopted by the Supreme Court in various areas of the law. For instance, it has been used by that court in the law relating to conflict of laws,

criminal law, constitutional law and employment law. But contract law is very different from those areas of law because, in their contract, the parties can make their own law and contract out of other legal principles, unless precluded by some principle of law from doing so.

In those other areas of law, there has been a tension between "organizing principles" and the substantive law. In the ***Provincial Judges' Reference*** (1997), Chief Justice Lamer noted that the preamble to the ***Constitution Act, 1867*** "recognizes and affirms the basic principles which are the very source of the substantive provisions of the ***Constitution Act, 1867.***" He continued:

> "although the preamble is clearly part of the Constitution, it is equally clear that it has no enacting force…In other words, strictly speaking, it is not a source of positive law, in contrast to the provisions which follow it. …But the preamble does have important legal effects. Under normal circumstances, preambles can be used to identify the purpose of a statute, and also as an aid to construing ambiguous statutory language…. The preamble to the ***Constitution Act, 1867***, certainly operates in this fashion. However, in my view, it goes even further……It recognizes and affirms the basic principles which are the very source of the substantive provisions of the ***Constitution Act, 1867***. As I have said above, those provisions merely elaborate those organizing principles in the institutional apparatus they create or contemplate. As such, the preamble is not only a key to construing the express provisions of the ***Constitution Act, 1867*****,** but also invites the use of those organizing principles to fill out gaps in the express terms of the constitutional scheme. It is the means by which the underlying logic of the Act can be given the force of law." (underlining added)

If the "organizing principles" of contract law are of this nature, can a breach of them amount to a breach of contract?

A further question arises. Does the decision in ***Bhasin v. Hrynew*** re-introduce, in one form or another, the doctrine of fundamental term or fundamental breach that the Supreme Court of Canada discarded in the ***Tercon v. British Columbia*** **decision (2010)**? Is the Supreme Court saying in ***Bhasin v. Hrynew*** that there are some core elements of contractual conduct –now defined more by morality than by the terms of the contract – which the parties cannot contract out of?

Bhasin v. Hrynew**, 2014 SCC 71**

Building Contract - Performance - Good Faith - Honest Performance

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