

Supreme Court of Canada revisits good faith in contracts

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In its recent decision in [*C.M. Callow Inc. v. Zollinger*](#), the Supreme Court of Canada recognized that [the duty of good faith](#) in contractual performance requires one party to a contract to correct a reasonable misapprehension its deceptive representations induced in the other party.

What you need to know

- The Court held that the duty of honest performance it recognized in [*Bhasin v. Hrynew*](#) (Bhasin) not only precludes a party to a contract from directly lying to the other party, but also **precludes a party from remaining silent while the other party operates under a misapprehension that the first party created by making deceptive representations.**
- In this case, a group of condominium corporations breached this duty by making deceptive representations that led a snow removal contractor to believe that “all was fine” with the contract when, in fact, the corporation had already decided to exercise its right to terminate for convenience.
- The Court held that expectation damages are the appropriate measure of damages for such a breach which, in this case, amounted to putting the contractor in the position he would occupied, had the corporations corrected his misapprehension at the time.
- Going forward, **parties will need to consider not just the content of their communications with their co-contracting parties, but also the context of their communications**, to ensure that they cannot be accused of deception.

Background

This case concerns a contract for snow removal at a group of condominiums. The condominium corporations (Baycrest) contracted with C.M. Callow Inc. (Callow) for snow removal.

In 2012, Baycrest entered into a two-year contract with Callow for snow removal in the 2012/13 and 2013/14 winters. The contract provided that Baycrest could terminate for any reason, giving 10 days’ notice to Callow.

In the spring of 2013, after the first of the two winters covered by the contract, Callow began negotiations with Baycrest with a view to extending the term of the contract. Unbeknownst to Callow, around the same time, Baycrest decided it was going to terminate the contract, relying on the termination for convenience provision.

Throughout the summer of 2013, Callow had conversations with Baycrest that led Callow to believe all was well with the snow removal contract and that renewal discussions were progressing. During the summer of 2013, Callow performed “freebie” landscaping services for Baycrest, as a goodwill gesture.

In September 2013, Baycrest gave Callow 10 days’ notice that it was terminating the contract.

Callow filed a claim for breach of contract. The trial judge held in Callow’s favour, holding that Baycrest had actively deceived Callow. The judge awarded damages including lost profits under the contract (less the overhead) for snow removal during the 2013-2014 winter, the cost of the work done in the summer and the cost of leasing the equipment the Court found Callow would not have leased but for the prospect of the Baycrest contract.

The Court of Appeal overturned the trial judge’s decision, holding that the discussions related to a future contract, not performance of the existing contract, and that the duty of good faith in contractual performance in *Bhasin* did not apply to these circumstances.

It is notable that the Supreme Court’s decision on appeal took more than a year to release, which is longer than average. The appeal was heard at the same time as the appeal in *Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage District*, which remains under reserve.

Duty of good faith and honest performance

The majority decision in the Supreme Court, written by Justice Kasirer, rested on two major points.

First, the Court held that while the contract provided Baycrest what was, on its face, an unfettered right to terminate the contract with 10 days’ notice, Baycrest could only exercise that right honestly – it could not “lie or otherwise knowingly mislead” Callow “about matters directly linked to the performance of the contract” (para. 37).

Justice Kasirer wrote that the Court had recognized the duty of good faith in its previous decision in *Bhasin*, and that this duty imposed not only an obligation to perform a contract honestly, but also to exercise contractual rights honestly.

The Court based its analysis on an analogy to the civil law concept of “abuse of right,” which allows the Court to consider the way in which a party exercises its rights under a contract. The Court was clear that this is not an implied term of a contract, which parties could contract out of, but rather based on the organizing principle of good faith.

In this case, the Court held that Baycrest’s dishonesty related directly to the exercise of the termination clause, since Baycrest’s false representations and conduct led Callow to

believe, mistakenly, that Baycrest was not going to exercise its contractual right to terminate for convenience. When this misapprehension was repeated by Callow to a representative of Baycrest, it was not corrected.

Second, the Court held that Baycrest's conduct amounted to a breach of the duty of honest performance, framed in *Bhasin* as 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." (para. 73).

While the Court recognized that Baycrest did not have a freestanding obligation to disclose its intention to terminate the contract prior to the mandated 10 days' notice, it had an obligation not to mislead Callow in its exercise of that right.

The trial judge found that Baycrest made false representations to Callow, which Callow reasonably took to mean that Baycrest would not exercise its right to terminate for convenience. In the circumstances, the Court held that Baycrest had an obligation to correct the misconception its statements had created once Baycrest realized that Callow was under this misapprehension. However, the Court stressed that the duty did not require Baycrest to act in Callow's best interest, nor did it imply any fiduciary-type duty.

Justice Brown wrote concurring reasons (for himself and Justices Moldaver and Rowe) and Justice Côté dissented. The concurring reasons differed from the majority on the issue of damages. The dissent would have held that Baycrest's conduct did not fall within the category of active dishonesty that the duty of honest performance in *Bhasin* prohibits.

Proper measure of damages

The Court awarded Callow damages based on what the Court held that Callow could have expected had Baycrest exercised its contractual rights consistently with the duty of honest performance. That meant awarding Callow damages that would place it in the position it would have occupied, what it could have expected had Baycrest corrected the misapprehension that it created. Had Baycrest done that, the trial judge found that Callow would have been able to obtain another contract for the 2013/14 winter, it would not have performed the "freebie" work in the summer and it would not have leased the equipment.

The Court rejected any measure of damages based on Callow's reliance, though in this case the result was effectively the same. The Court emphasized that the duty of good faith performance was not a duty in tort, so the standard tort measure of damages – reliance damages – was inappropriate. Moreover, the Court refused to limit the damages available to reliance damages, since a claim for breach of contract does not require the plaintiff to prove any loss.

Justice Brown's concurring reasons would not have awarded expectation damages, but rather found that reliance damages were the appropriate measure of damages for a breach of the duty of honest performance. As discussed above, in this case applying either measure of damages arrived at the same result.

Takeaways

While the Supreme Court indicates in its decision that it was applying its previous holding in *Bhasin*, in practice this decision arguably expands the duty of honest performance, or at minimum gives a warning that parties must carefully consider their correspondence with their co-contracting parties.

It is clear that it is not enough to refrain from direct lies. Rather, a party must not be actively deceptive and must correct misapprehensions created by its active deceptions if and when they become known. The Supreme Court held that the scope of this rule is not fixed:

“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. I stress that this list is not closed; it merely exemplifies that dishonesty or misleading conduct is not confined to direct lies.”

Parties must therefore consider not just the content, but also the context of their communications with their co-contracting parties.

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