

New legal duty of *honest performance*: What it could mean for employers

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The Supreme Court of Canada recently identified a new legal doctrine – a duty of honest performance - requiring parties to be honest with each other in relation to the performance of their contractual obligations (*Bhasin v. Hrynew*, 2014 SCC 71 (CanLII)). Applicable to all contractual relations, the new legal doctrine will impact employment law. Senior management, managers and supervisors should therefore learn how to recognize when the duty of honest performance may be triggered and respond appropriately.

What happened?

Canadian American Financial (“Can-Am”) administers education savings plans which it markets through dealers. Harish Bhasin (“Bhasin”) had been one of Can-Am’s Alberta-based dealers since 1989. Through sales agents working under Bhasin, he had developed a flourishing niche business within his ethnic community. As of 1998, the relationship between Can-Am and Bhasin was governed by a dealership agreement with a three-year term expiring in November 2001, which would automatically renew for a further term unless either party gave six-months’ written notice.

In 1999, Can-Am embarked on a plan toward consolidating its marketing in Alberta through a single dealer, a competitor of Bhasin. This led Can-Am to reach a settled intention not to renew Bhasin’s contract in favour of forcing him to “merge” by assuming a role under the competing dealer. Bhasin resisted these attempts to subordinate his business, and developed suspicions a decision to complete the merger had already been made. When Bhasin asked Can-Am if the merger was a “done deal”, Can-Am on various other occasions made misleading misrepresentations which led Bhasin to believe a decision was still pending.

For almost a year, Can-Am misled Bhasin in this manner. Finally, in May 2001, Can-Am gave Bhasin six-months’ notice of non-renewal, effective in November of that year. This led to the destruction of Bhasin’s business as his agents all deserted him. He ended up working in a less remunerative position for a Can-Am competitor.

Lawsuit and trial

Bhasin sued Can-Am based on a number of theories of legal liability. After a lengthy trial before a judge of the Alberta Queen’s Bench, Can-Am was found to have committed various tortious and contractual breaches including a breach of its obligations of good faith in failing to renew Bhasin’s contract. The judge found that, but for its breach, Can-Am would likely have retained Bhasin through to his retirement, and he was awarded \$381,000 in damages.

Alberta Court of Appeal

The Alberta Court of Appeal overturned the trial judge's decision on the basis Bhasin had no right to have his contract renewed. According to the appeal court, the contractual wording was very clear in that the relationship would expire upon a party serving notice of non-renewal; and no court had authority to rewrite the parties' agreement.

As for the allegations of bad faith, the appeal court made two observations: First, there is no *general* obligation of good faith owed to an opposite contracting party; and second, the obligation of good faith and fair dealing (*per* the well-known case of *Wallace v United Grain Growers*), applies only to the *manner of termination* of an *employment* relationship; not to the expiry of a *commercial* relationship which has run its contractual course.

Supreme Court of Canada

On further appeal, the Supreme Court of Canada took a broader view of the duty of good faith owed between contracting parties. The Supreme Court was unwilling to sanction a legal system under which it was permissible to deliberately lie to and detrimentally mislead another contracting party. The court stated:

... [P]arties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of [a] 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 Supreme Court recognized the new common law duty as follows:

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.

Significantly, the court also made it clear that, unlike many other contractual duties, there were limits on the parties' right to 'contract out' of the duty of honest performance:

The obligations of good faith, diligence, reasonableness and care ... may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable.

As for Bhasin and Cam-Am, the Supreme Court disagreed with the trial judge that Bhasin had a right to have his contract renewed or to work with Cam-Am until retirement, as this would have interfered with Can Am's general entitlement to pursue its own interests. However, the court found that Bhasin did have a right not to be misled by false statements that there was a prospect for renewal. The court therefore awarded Bhasin damages of \$87,000, reflecting the value of his business calculated on the basis that Can-Am's misleading conduct caused Bhasin to lose the opportunity to sell his business when it still had value as a going concern.

Tips for employers

The full impact of this new contractual duty is difficult to predict. As with any new doctrine of law, it will take time for courts and arbitrators to provide additional clarity. Until then, remember that any employment relationship is a contract (even if verbal), so the duty of honest performance applies in a way that is more expansive than the duty of good faith and fair dealing which only applies to the *manner of termination* of the relationship.

Senior management, managers and supervisors should learn how to recognize when the duty of honest performance may be triggered and respond appropriately. For example:

- There may be times when an employee will request information on which the employee may rely or act to its detriment, such as a question related to job security. Although an employer is usually entitled to decline to answer, care must be taken to not provide an answer that is misleading.
- When providing information to an employee on which the employee is liable to rely or act to its detriment, it may be advisable to put the information in writing. That way, a subsequent claim involving disputed allegations of what was said verbally can be avoided.
- While the Supreme Court has made it clear parties cannot 'contract out' of the duty of honest performance, parties may - through properly drafted contractual language - regulate the standard by which performance of a contract is measured.
- The duty of honest performance is not solely applicable to employers. Employees also owe a duty not to mislead in the course of employment. As such, where an employer may rely or act to its detriment, on an employee's representation, an employer should be sure to have the representation adequately documented.
- It may not always be clear what to do in a given situation. Before unnecessarily exposing your workplace to potential liability with no defined limits, it is prudent to consult with expert employment counsel.

For assistance, contact a member of the Sherrard Kuzz LLP team.

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