

A Relief for Lenders: Duty of Good Faith Performance of Contractual Obligations does not Require Lenders to Advance Additional Funds to Borrowers

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Since the Supreme Court's landmark decision in *Bhasin v Hrynew*¹ confirmed the existence of a general duty to perform contracts in good faith, the Canadian legal and business communities have looked to understand the scope of this duty and its application to various types of contracts. In *Willowbrook Nurseries*², the Ontario Court of Appeal set out certain guidelines regarding the duty of good faith performance of contracts in the commercial lending context.

Willowbrook Nurseries involved a dispute between Royal Bank of Canada [RBC] and Willowbrook Nurseries Inc. [Willowbrook] over RBC's duties under its contractual arrangements with Willowbrook. Beginning in 2005, RBC advanced funds to Willowbrook, a plant nursery business, under a line of credit, demand loan, various mortgages and a corporate credit card. Given the seasonal nature of Willowbrook's business and its need for extra working capital during planting season, RBC advanced amounts in excess of the line of credit limit to Willowbrook every winter. These amounts were always repaid by Willowbrook the following spring or summer.³ In 2008, Willowbrook failed to repay the \$1.29 million in additional funds advanced by RBC in 2007. Nevertheless, it submitted a further request for \$1.7 million of additional funds in October 2008.⁴ RBC turned down the credit request and transferred Willowbrook's accounts to its special loans department. The lender's unwillingness to lend these additional funds resulted in Willowbrook being unable to pay its suppliers on time and having to lay off some employees.

Willowbrook brought a claim, which alleged that RBC performed its contract in bad faith by (i) by refusing to advance additional funds to Willowbrook in 2008, in line with its previous practice; and (ii) transferring Willowbrook's accounts to its special loans department.⁵

The Ontario Court of Appeal confirmed the trial court's decision, stating that the duty of good faith performance of contracts did not require RBC to advance new money to Willowbrook. The Court affirmed earlier case law that had held that a bank has a duty to give a customer notice of a change in the prevailing course of conduct with respect to overdraft lending. However, the Court determined that the prevailing course of conduct in this situation consisted of RBC advancing additional funds to Willowbrook each winter and Willowbrook repaying those funds the following year, prior to receiving a subsequent request.⁶ In 2008, Willowbrook had requested additional funds prior to paying the previous year's advance. As such, in the Court's view it was Willowbrook who had changed the course of conduct, not RBC.

The Court of Appeal also rejected Willowbrook's argument that RBC acted in bad faith in placing Willowbrook into special loans. The Court stated that the special loans conditions, including a change of account manager, the requests for additional financial information and appraisals, and strict enforcement of previously agreed upon overdraft limits, were reasonable and could not support a claim of bad faith.⁷ Justice Pardu also held that the principle of good faith performance of contractual obligations did not extend so far as to require RBC to subjugate its own financial interests by extending additional credit that it did not wish to advance.⁸

The Court also noted that, contrary to Willowbrook's argument, RBC's decision to refrain from advancing additional funds to

Willowbrook as a condition of its special loans conditions, was not reviewable on an objective standard. It confirmed that the choice to lend new money is a “subjective business decision to be made by a bank”⁹ and that such decisions “should not be assessed by a court, after the fact, for objective fiscal prudence.”¹⁰

Willowbrook confirms that the courts will not use the principle of good faith performance of contractual obligations to interfere with a lender’s power to decide whether or not to advance additional funds to a borrower, especially where the advancing of such new funds is not in line with the lender’s previous course of conduct with that particular borrower. This decision should provide some comfort to lenders who are concerned with the possibility that the new duty to perform contracts in good faith, as set out in *Bhasin*, might interfere with their ordinary lending decisions.

¹*Bhasin v. Hrynew*, 2014 SCC 71 [*Bhasin*].

²*Willowbrook Nurseries Inc. v. Royal Bank of Canada*, 2017 ONCA 974 [*Willowbrook Nurseries*].

³*Willowbrook Nurseries* at para 5.

⁴*Willowbrook Nurseries* at paras 6-7. Willowbrook requested \$1.2 million in the form of a temporary accommodation request and an additional \$500,000 in the form of a demand loan.

⁵*Willowbrook Nurseries* at para 18.

⁶*Willowbrook Nurseries* at para 31.

⁷*Willowbrook Nurseries* at para 37.

⁸*Willowbrook Nurseries* at para 38.

⁹*Willowbrook Nurseries* at para 44.

¹⁰*Willowbrook Nurseries* at para 44.

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