

The Supreme Court of Canada Clarifies the Application of the Duty of Honest Performance in the Context of the Exercise of Unilateral Termination Clauses

December 23, 2020

On December 18, 2020, the Supreme Court of Canada released its decision in *C.M. Callow Inc. v Zollinger*,^[1] in which it took the “opportunity to clarify what constitutes a breach of the duty of honest performance where it manifests itself in connection with the exercise of a seemingly unfettered, unilateral termination clause.”^[2] What appeared to be, on its face, a straightforward case for the application of the duty of honest performance set out in *Bhasin v Hrynew*^[3] (“*Bhasin*”) ended up not being so straightforward after all, with a unanimous Court of Appeal reversing the trial judge’s decision, and a divided Supreme Court reinstating the decision of the trial judge, with one dissenting judge (Côté J.) and three concurring judges (Brown, Moldaver and Rowe JJ.) disagreeing with the majority on both methodological and substantive grounds.

Factual Background

The appellant, C.M. Callow Inc. (“**Callow**”), had entered into a two-year winter maintenance agreement with a group of condominium corporations (“**Baycrest**”). The agreement included a clause pursuant to which Baycrest was entitled to terminate the agreement for any reason upon giving ten days’ notice to Callow.

Towards the end of the first winter, Baycrest made the decision to terminate the agreement, but did not inform Callow of its decision at that time. During the following spring and summer, Callow began discussions with Baycrest regarding a renewal of the winter maintenance agreement after the second winter. As a result of Callow’s discussions with board members of Baycrest, he was under the impression that he was likely to get a two-year renewal of his winter maintenance agreement and that Baycrest was satisfied with his services. Baycrest knew that Callow was under such impression.

Callow had a separate summer maintenance agreement with Baycrest. During the summer, he performed some “freebie” work in the hope that it would act as an incentive for Baycrest to renew the winter maintenance agreement at the end of the upcoming winter. In mid-September, Baycrest finally informed Callow about its decision to terminate the winter maintenance agreement.

Callow subsequently sued Baycrest for breach of contract, alleging bad faith conduct. Callow also alleged that, as a result of Baycrest’s conduct, it did not bid on other tenders for winter maintenance contracts during the summer and claimed damages for loss of opportunity.

Decisions of the Lower Courts

At trial, the judge found that Baycrest had actively deceived Callow about termination, in breach of the duty of honest performance formulated in *Bhasin*. She awarded damages to Callow in the amount of the value of the winter maintenance agreement for one year, minus expenses that Callow would typically incur.

The Court of Appeal set aside the judgment. It held that there was no unilateral duty to disclose information relevant to termination, and that Baycrest was free to terminate the agreement provided that it gave Callow the required notice. The Court of Appeal also found that Baycrest's conduct did not rise to the high level required to establish a breach of the duty of honest performance and that, in any event, any deception in the communications that took place during the summer related to a new contract not yet in existence (i.e., the renewal) and was not directly linked to the performance of the winter maintenance agreement.

Decision of the Majority of the Supreme Court

Writing for the majority, Kasirer J. (Wagner C.J., Abella, Karakatsanis and Martin JJ. concurring) reversed the decision of the Court of Appeal. After reviewing the principles set out in *Bhasin*, he noted that the scope of the duty of honest performance was limited by the requirement that any breach of the duty be directly linked to the performance of obligations or the exercise of rights under the contract. While the duty of honest performance does not bar the exercise of a contractual prerogative, a party who exercises such prerogative dishonestly will be liable to pay damages as a consequence of its behaviour. Kasirer J. stated as follows:

Good faith is thus not relied upon here to provide, by implication, a new contractual term or a guide to interpretation of language that was somehow an unclear statement of parties' intent. Instead, the duty of honesty as contractual doctrine has a limiting function on the exercise of an otherwise complete and clear right because the duty, irrespective of the intention of the parties, applies to the performance of all contracts and, by extension, to all contractual obligations and rights. This means, simply, that instead of constraining the decision to terminate in and of itself, the duty of honest performance attracts damages where the manner in which the right was exercised was dishonest.^[4]

After drawing on the framework of abuse of rights under Quebec civil law, Kasirer J. held that "[d]ishonesty is directly linked to the performance of a given contract where it can be said that the exercise of a right or the performance of an obligation under that contract has been dishonest." He concluded that Baycrest's alleged dishonesty in this case was not only about a future contract, but that it was directly linked to the performance of the winter maintenance contract, i.e., Baycrest's exercise of its termination right under the contract. According to the majority, if someone is led to believe that their counterparty is content with their work and their contract is likely to be renewed, it is reasonable for that person to infer that the ongoing contract will not be terminated early.

As to the issue of whether Baycrest's conduct amounted to dishonesty within the meaning of the duty of honest performance, the appellant and respondents agreed that parties to a contract could not outright lie or knowingly mislead a counterparty, but they disagreed about what might constitute knowingly misleading conduct. In the majority's opinion, the concept of misleading another party will in some circumstances capture forms of silence or omission, like the failure to correct a misapprehension caused by one's own misleading conduct. Imposing a duty to correct such a misapprehension does not amount to imposing an unbargained-for duty of disclosure on contractual parties. As Kasirer J. explained:

While the duty of honest performance is not to be equated with a positive obligation of disclosure, this too does not exhaust the question as to whether Baycrest's conduct constituted, as a breach of the duty of honesty, a wrongful exercise of the termination clause. Baycrest may not have had a free-standing obligation to disclose its intention to terminate the contract before the mandated 10 days' notice, but it nonetheless had an obligation to refrain from misleading Callow in the exercise of that clause. In circumstances where a party lies to or knowingly misleads another, a lack of a positive obligation of disclosure does not preclude an obligation to correct the false impression created through its own actions.^[5]

The majority stressed that whether or not a party knowingly misled its counterparty was a highly fact-specific determination, and that deference should be shown to the trial judge on such an issue. It found that no reviewable error had been shown in the trial judge's finding of dishonesty that took place in anticipation of Baycrest's exercise of its right to terminate the contract. Kasirer J. stated that when Baycrest deliberately remained silent despite knowing that Callow had drawn the mistaken inference that the contract was in

good standing because it was likely to be renewed, Baycrest breached its contractual duty of honest performance by failing to correct Callow's misapprehension.

The majority held that a breach of the duty of honest performance should, in general, be compensated by way of the ordinary contractual measure of expectation damages, i.e., damages that put the party in the position that it would have been had the contractual duty been performed. They concluded that the trial judge made no palpable and overriding error in her assessment of damages. Addressing the appellant's argument based on the proposition set out in *Hamilton v Open Window Bakery Ltd.*^[6] that damages should be assessed by the mode of performance which is least burdensome to the defendant, Kasirer J. stated the following:

While damages are to be measured against a defendant's least onerous means of performance, the least onerous means of performance in this case would have been to correct the misapprehension once Baycrest knew Callow had drawn a false inference. Had it done so, Callow would have had the opportunity to secure another contract for the upcoming winter.^[7]

The majority was satisfied that if Baycrest's dishonesty had not deprived Callow of the opportunity to bid on other contracts, Callow would have made an amount that was at least equal to the profit that it lost under the winter maintenance agreement with Baycrest.

Concurring Reasons

Brown J. (Moldaver and Rowe JJ. concurring) agreed with the majority that Baycrest did not identify any palpable and overriding errors in the trial judge's findings and that, as a result, the trial judge's award should be restored. However, he expressed a "fundamentally methodological" objection^[8] with respect to the majority's use of the civilian abuse of right framework to clarify when dishonesty is directly linked to the performance of a given contract. This objection is surprising given the multiple references to Quebec civil law in *Bhasin*. It is also reminiscent of a similar objection that Brown J. and others raised with respect to the use of international law and comparative law sources in another decision earlier this year.^[9]

In addition, Brown J. expressed the view that the proper measure of damages for the breach of the duty of honest performance was not the expectation measure of damages, but, instead, reliance damages. In his view, a contracting party that breaches the duty of honest performance should be liable to compensate its counterparty for any foreseeable losses suffered in reliance on the misleading representations.

Conclusion

In light of the disagreement between the lower courts in this case, additional clarification and guidance regarding the application of the duty of honest performance are welcomed. Since the duty of honest performance is a relatively new doctrine in Canadian common law, it will likely take many more years and decisions to "flesh it out". In doing so, references to the mature body of law in Quebec civil law regarding the application of the duty of good faith will no doubt be helpful.

The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

^[1] *C.M. Callow Inc. v Zollinger*, 2020 SCC 45 ("**Callow**").

^[2] *Ibid.* at para. 30.

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

[4] *Callow*, *supra* note 1, at para. 53.

[5] *Ibid.* at para. 38.

[6] *Hamilton v Open Window Bakery Ltd.*, 2004 SCC 9.

[7] *Callow*, *supra* note 1, at para. 114.

[8] *Ibid.* at para. 124.

[9] *Quebec (Attorney General) v 9147-0732 Québec inc.*, 2020 SCC 32.

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