

Conduct Matters in Contracts: What You Need to Know About the Duty of Honest Performance in Construction Contracts

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By ,

On December 18, 2020, the Supreme Court of Canada (“SCC”) released its decision in *C.M. Callow Inc v Tammy Zollinger*^[1] (“**Callow**”); this decision will impact contractors, subcontractors, suppliers and various other components of the construction industry. The SCC clarified the duty of honest performance in contractual obligations and what may be considered a breach of this duty.

What You Need to Know

- Parties to a contract have a duty of honest performance;
- The duty of honest performance means that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract;
- Following *Callow*, a breach of the duty of honest performance goes beyond just lying and may include silence and omissions;
- Failing to correct a party’s misunderstandings by staying silent and not correcting them may be considered knowingly misleading the party; and
- There is no positive duty to disclose a decision to terminate the contract, but failing to correct the other party’s misapprehension that the contract will not be terminated may be a breach of the duty of honest performance.

What Happened in *Callow*

The SCC revisited and clarified the duty of honest performance and noted that dishonesty in contractual performance is not limited to outright falsehoods, and may include half-truths, omissions, and even silence.

In *Callow*, a condominium corporation (“**Baycrest**”) entered into two two-year contracts with C.M. Callow (“**Callow**”); one was a winter maintenance contract and the other was a summer maintenance contract. The terms of the winter contract stipulated that Baycrest could terminate the contract by providing Callow with 10 days’ written notice. Sometime later, Baycrest unilaterally decided to terminate the winter contract but did not inform Callow of its decision for several months. In fact, Baycrest’s board members falsely represented to Callow that the winter contract would be renewed during this period. In response, Callow performed free work, above what was required by the summer contract, in anticipation that Baycrest would renew the winter contract.

The SCC concluded that while Baycrest did not have an obligation to disclose its intention to terminate prior to the notice period, it was required to not knowingly mislead Callow regarding its exercise of the termination clause and to correct Callow’s misperception that the contract would be renewed. Since Baycrest accepted Callow’s free work knowing that Callow was providing this work in anticipation of renewing the contract, accepting this work in silence without correcting Callow’s misperception was a breach of the duty of honest performance.

Callow is significant as it establishes that both action, such as direct communications, as well as inaction, such as silence and omissions, may constitute a breach of the duty of honesty in contractual performance.

Practical Implications on the Construction Industry

Moving forward from *Callow*, owners, contractors, consultants, suppliers, and various other members of a construction project should be aware that if their silence misleads other parties to the contract regarding the performance of the contract, their silence may be a breach of the duty of honest performance.

The following examples pertaining to a construction project may be impacted by the duty of honest performance, following *Callow*:

1. If a contractor asks the owner or a consultant to conduct a review of certain aspects of the work completed to date to see if it is sufficient and the contract between the parties permits the contractor to make such a request, it may be possible for the contractor to rely on the owner's silence as a suggestion that the contractor will not be terminated and payment will not be withheld from them for defects in the work. Where the contractor makes this belief clear to the owner, and the owner later complains about the work and terminates the contractor or withholds payment for the same, it may be possible that the owner's failure to correct the contractor's stated belief is a breach of the contractual duty of honest performance.
2. It is best practice to formalize additional work to a contract through a change order or change directive. In any case, if a party to a contract has represented to you that you will be compensated for additional work, even without a formal change order in place, you may be able to rely on this representation. A party to the contract cannot accept the additional work to the contract, knowing that you intend to be compensated for it, and silently intend not to pay you for it. The other party may have to fix your misperception that you will be paid for the additional work, or else they may be breaching the duty of honest performance. Hence, it is crucial for a party to vocalize when they do not intend to compensate the other party for additional work under the contract.
3. If a construction contract includes an option to renew and complete the next phase of the project, and a contractor intends not to renew a contract with a subcontractor for the next phase but doesn't inform them of such and falsely represents to them that the contract will be renewed, to ensure that the quality of work on the current project doesn't decrease, this may be a breach of the duty of honesty. If a party believes that the contract will be renewed for the next phase, it may be an obligation under the duty of honest performance to fix this misapprehension.
4. If a subcontractor and contractor have agreed to multiple projects under a Master Service Agreement, and the subcontractor intends to break the master agreement and not assist with the later projects but waits for compensation for the current project before alerting the contractor of such, this may be a breach of the duty of honest performance. If the contractor has made clear to the subcontractor that they believe that the subcontractor will assist with the subsequent projects under the master agreement, it may be the subcontractor's duty to correct this misunderstanding.
5. If a contractor or subcontractor is behind schedule in its scope of work, the contractor or subcontractor may be required to provide notice to the owner or contractor above them in the project as to the status of the project schedule. Otherwise, the owner or contractor may be entitled to rely on the assumption that the contractor or subcontractor's work is in compliance with the project schedule.

Of course – situations such as the above are rarely so straightforward. Each allegation of a breach of the duty of honest contractual performance will require a review of the facts leading up to the allegation and the contract between the parties before an assessment can be made. In any event, owners, contractors, consultants, suppliers, and other members of a construction project would be wise to ensure that they comply with the core requirements of the duty of honesty in contractual performance as revisited by *Callow*. Importantly, this includes more than the previous passive responsibilities to avoid lying to other parties and may now incorporate the positive obligation to correct the misunderstandings of other parties to the contract in certain circumstances.

Stay tuned, as *Callow's* companion case, *Wastech Services Ltd. v Greater Vancouver Sewerage and Drainage District*, is projected to

be released this year and is expected to explore how much regard a commercial party should have for its other contracting party's interests in the context of the duty of good faith.

For any questions or concerns regarding how the expanded duty of honest contractual performance may impact your ongoing and new construction projects, and for a review of your construction contracts to determine where the duty may apply please contact [Faren Bogach](#) or [Paul Conrod](#).

[\[1\]](#) 2020 SCC 45 [*Callow*].

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.

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