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## **Thou Shalt Not Deceive: The New Commandment for Canadian Business**



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In 2014, the Supreme Court of Canada rendered two decisions relating to the law of contract. Parties doing business in Canada should be aware of these decisions because they have significantly changed how contracts are to be performed and how contracts are interpreted in Canada. This article is condensed from a paper published in *For The Defense*, a DRI International magazine which can be read in its entirety [here](#).

### **Good Faith and Honest Performance**

The *Bhasin* decision involved a dispute related to a “commercial dealership arrangement” governing an education savings plan business. One of the parties lied to the other when it came time to exercise a contractual renewal clause. In doing so, one party effectively expropriated the other party’s business, and turned it over to a competitor at the time of contract renewal.

On appeal, the Supreme Court of Canada used *Bhasin* as an opportunity to make two fairly broad statements about good faith in commercial contractual dealings. There is still no general duty of good faith in Canadian contracts, but rather a principle which “requires, in certain respects, honest, candid, forthright or reasonable contractual performance.” The Supreme Court of Canada created the duty of honest performance as one of the manifestations of the organizing principle of good faith. This duty of honest performance represents a significant change to the law of contract in Canada.

The duty of honest performance is not an implied term, but rather “a general doctrine of contract law that imposes as a contractual duty a minimum standard of honest contractual performance.” As such, the duty of honest performance applies to all contracts, and parties are not free to exclude it from their contracts, though they can modify the duty to some extent depending on the context.

Active dishonesty is now actionable as a breach of contract if damages can be proved to have been caused by that dishonesty. In that regard, *Bhasin*’s duty of honest performance is a significant change in that it imposes a minimum standard on parties that

they do not actively deceive each other—a standard that did not previously exist in Canadian contract law.

The Supreme Court very broadly explained the duty of honest performance as follows:

1. It “means simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract”;
2. It does “not impose a duty of loyalty or of disclosure” or “require a party to forego advantages flowing from the contract”; and
3. It is a “simple requirement not to lie or mislead the other party about one’s contractual performance.”

Parties to Canadian contracts can now benefit from this new duty of honest performance, in that they can expect certain minimum standards of conduct from their contractual partners. The duty of honest performance created a new duty, which can be breached, even though such a duty is not a term of the contract itself. Parties must be aware of this new duty of honest performance, which imposes obligations relating to performance beyond the express terms of the contract.

### **Contractual Interpretation**

The Supreme Court of Canada also dealt with contractual interpretation in *Sattva*. Now, even in the absence of ambiguity, the surrounding circumstances may be considered, although such admissible circumstances are limited to only “knowledge that was or reasonably ought to have been within the knowledge of both parties at or before the date of contracting.”

*Sattva* has expanded the role in which the surrounding circumstances are to be used in the interpretive process. They are now to be used in all cases to “deepen a decision-maker’s understanding of the mutual and objective intentions of the parties.” While the surrounding circumstances will necessarily “vary from case to case,” they can include “absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable [person].”

The scope of the relevant surrounding circumstances is limited to evidence showing the objective intentions of the parties, rather than the subjective intentions of the parties. The type of information that could potentially be relevant in a commercial contract dispute might include:

- The purpose of the agreement
- The genesis of the transaction
- Nature of the relationship
- Other similar-subject contracts between the contracting parties, or between a party to the dispute and a third party

*Sattva* expands the scope of discovery, and will provide parties with more information in which to establish intent. A party that would have previously suffered from harsh contractual language, standing on its own, may now have the opportunity to rely on other surrounding circumstances to show that the parties intended a different outcome.

On the other hand, this decision of the Supreme Court may greatly increase the scope, uncertainty and complexity of all Canadian contract disputes - and with increased scope, uncertainty, and complexity comes

added litigation cost and added litigation risk. However, this may be mitigated by the principle that consideration of the surrounding circumstances cannot ever “overwhelm the words” of an agreement.

The Supreme Court of Canada’s *Bhasin* and *Sattva* decisions have resulted in significant changes to the manner in which contracts are to be performed, and the manner in which contracts are to be interpreted in Canada. Parties doing business in Canada are well advised to familiarize themselves with these changes to the law of Canadian contract, and to seek legal advice throughout the negotiation and contracting process to reduce the risk of creating records and agreements that could be used by others to evade their business obligations or expose your business to a claim.

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