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AN IMPORTANT CLARIFICATION OF THE DUTY OF HONEST CONTRACTUAL PERFORMANCE

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Background

Six years ago, in *Bhasin v. Hrynew* (“**Bhasin**”), the Supreme Court of Canada (“**SCC**”) recognized a contractual duty of honest performance.¹ On December 18, 2020, the SCC released its decision in *CM Callow Inc. v. Zollinger* (“**Callow**”), clarifying that duty.

In *Callow*, the SCC found that a party’s duty to honestly perform contracts applies to contractual rights, including the right to terminate an agreement, as it does to a party’s contractual obligations. Moreover, in addition to prohibiting parties from knowingly misleading their counterparties, the duty of honest performance also prohibits parties from “half-truths, omissions, and even silence, depending on the circumstances.”²

Facts of the Case

Callow involved the performance of maintenance contracts between a group of condominium corporations (“**Baycrest**”) and CM Callow Inc. (“**CMCI**”), a maintenance services provider.

In 2012, Baycrest entered into two separate maintenance contracts with CMCI: a two-year winter maintenance contract and a one-year summer maintenance contract. The winter maintenance contract permitted Baycrest to terminate the agreement on ten days’ written notice.

In early 2013, Baycrest decided to terminate the winter maintenance contract, but chose not to inform CMCI of its decision. Over the course of the spring and summer of 2013, Baycrest led CMCI to believe that Baycrest was satisfied with CMCI’s services and that the winter maintenance contract would not be terminated. Additionally, Baycrest accepted CMCI’s offers of free and additional summer maintenance services. Baycrest knew CMCI was offering these additional summer maintenance services to convince Baycrest to continue the winter maintenance contract.

In September 2013, Baycrest provided CMCI with ten days’ notice to terminate the winter maintenance contract, in strict compliance with Baycrest’s rights under the contract. CMCI alleged that Baycrest had breached its duty of honest contractual performance by misleading CMCI about whether the winter maintenance contract would be continued.

CMCI brought a claim against Baycrest for breach of contract.

The Decision

At trial, the judge found that Baycrest had breached its duty of honest contractual performance. Baycrest had acted in bad faith when it:

(1) withheld from CMCI that it did not intend to continue the winter maintenance contract; and (2) continued to represent to CMCI that the winter maintenance contract was not in danger of being terminated, despite knowing that CMCI was taking on extra tasks to increase the likelihood of it being continued.³

On appeal, the Ontario Court of Appeal (“**ONCA**”) overturned the trial judge’s decision. The ONCA held that Baycrest did not breach its duty of honest performance because its alleged deceptions were not directly linked to the winter maintenance contract’s performance.⁴

The majority of the SCC restored the trial judge’s decision, holding that Baycrest had breached its duty of honest contractual performance.

The majority held that the duty of honest performance, as identified in *Bhasin*:

1. Applies to both the performance of one’s contractual obligations and the performance of one’s rights under the contract.⁵ Furthermore, parties may not exclude this duty from their agreements, including by “agree[ing] to a term that provides for an apparently unfettered right to terminate the contract for convenience”⁶.
2. Prohibits parties’ from lying or knowingly misleading their contractual counterparties.⁷ Additionally, parties’ are also prohibited from “lies, half-truths, omissions, and even silence, depending on the circumstances.”⁸

Although Baycrest was exercising its contractual termination right, it knowingly misled CMCI to believe that the contract would not be terminated early. Moreover, Baycrest knew that CMCI was operating under the mistaken belief that the contract would not be terminated, and deliberately failed to correct CMCI’s mistaken belief.⁹

The majority also discussed how damages should be measured in cases for a breach of the duty of honest performance.¹⁰ Plaintiffs in such cases should receive expectation damages, the ordinary measures for breach of contract damages, as opposed to reliance damages, the ordinary measure for tort damages. In other words, plaintiffs should be put in the position in which they would have been had the duty not been breached. In this case, expectation damages would result in CMCI being awarded the value of the winter maintenance contract with Baycrest.¹¹

³ *Callow* at para 21.

⁴ *Callow* at para 26.

⁵ *Callow* at para 53.

⁶ *Callow* at para 84.

⁷ *Callow* at para 86.

⁸ *Callow* at para 91.

⁹ *Callow* at para 104.

¹⁰ *Callow* at para 105.

¹¹ *Callow* at para 113.

¹ *Bhasin v Hrynew*, 2014 SCC 71 [Bhasin]; *CM Callow Inc v Zollinger*, 2020 SCC 45 at para 30 [Callow].

² *Callow* at para 91.

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Finally, the majority affirmed that the duty of honest performance is a contract law doctrine distinct from the doctrines of civil fraud and estoppel.

Conclusion

The key takeaways from *Callow* are: (1) strictly complying with one's rights in a contract may not be sufficient to avoid liability for breach of contract; and (2) the duty of honest performance is broader than a prohibition against lying and misleading and may include a prohibition against half-truths, omissions, and silence. Determining whether the duty was breached will depend on the circumstances, and will necessarily involve a fact-based inquiry.

It is important for businesses operating in Canada to consider their good faith obligations under the duty of honest performance when performing contractual obligations or exercising their contractual rights. Given the SCC's ruling in *Callow*, businesses may not escape liability when strictly complying with rights under contracts if there has been dishonesty or the other party has been misled. Though it does not appear that a party's duty to honestly perform contracts goes so far as to require notifying counterparties of unsatisfactory performance, businesses should be aware of the risk of misleading counterparties regarding their future intentions to exercise contractual rights.

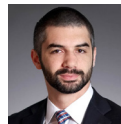
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