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Good Faith in Commercial Dealings

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Agenda

- **Introduction**
- **Good Faith in Negotiations**
- **Duty of Honest Performance**
 - Recent expansion of the duty by the Supreme Court of Canada
- **What Can We Do?**
- **Q&A**
- **Closing Remarks**

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Principle of Good Faith

- *Bhasin v. Hrynew*, 2014 SCC 71
 - The Supreme Court recognized an organizing principle of good faith in contracts, which means that “*parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily*”
- Content of the duty:
 - Have appropriate regard to the interests of other contracting parties
 - Do not lie or mislead the other party about one’s contractual performance
 - Discretion must be exercised reasonably (i.e. not dishonestly) and not for an “improper” or “extraneous” purpose
 - What is reasonable is fact specific and may depend on whether the discretionary powers are susceptible to objective measurement

Good Faith in Negotiations

- There remains no *general* or independent duty to negotiate *new* commercial agreements in good faith (see *Martel (SCC)*)
- Parties to a negotiation are *generally* expected to act entirely in their own interests
- A duty to negotiate in good faith may be recognized where there is a “special relationship between parties to a negotiation”, including where there is an element of trust, confidence or reliance
- **Exercise caution when negotiating the renewal of an existing agreement. Parties likely subject to good faith obligations arising from existing contractual relationship**

Letters of Intent

- Letters of intent occupy the middle ground - neither negotiations between strangers nor a definitive agreement
- Traditionally viewed as and intended to be non-binding to create space to reach definitive agreement
- Often contain explicit obligation to negotiate definitive agreement in good faith

Good Faith Performance

- Before *Callow*, it was undecided whether there was a freestanding duty to negotiate in good faith under an LOI in Ontario (see *Molson Canada 2005* and others)
- Now, is there likely is an obligation given the decision in *Callow*?
- A claim of failure to negotiate in good faith can either be a claim for damages, or a claim for specific performance
- **An allegation of failure to negotiate in good faith can impair your asset for the duration of the litigation**

Case Study #1

- Astromart, a national Canadian retailer, has decided to offer consumer financing to its customers as a way to further expand its business and develop greater customer loyalty
- Rather than develop this offering from the ground up, Astromart approaches Snears, a struggling global retailer, that is looking to divest portions of its Canadian operations, including its valuable financial services division
- Snears has some concerns about Astromart's ability to complete a transaction of this nature, but sees strong indications that Astromart is a highly motivated buyer

Case Study #1, Cont'd

- The parties sign a non-binding letter of intent together with a confidentiality agreement and agree to a short period of exclusivity for due diligence
- After weeks of negotiations and various delays on the part of Astromart, Snears becomes increasingly worried that Astromart will be unable to secure financing for the transaction
- Snears decides that it may be better off marketing its financial services division to a financial institution and notifies Astromart of its intention to terminate negotiations

Duty of Honest Performance

- The “duty of honest performance” was established by the Supreme Court of Canada a number of years ago
 - *Bhasin v. Hrynew*, 2014 SCC 71
 - means “simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract”
- The Supreme Court of Canada recently revisited the duty in *C.M. Callow Inc. v Zollinger*, 2020 SCC 45.
 - Greatly expanded the duty of honest performance

C.M. Callow Inc. v Zollinger, 2020 SCC 45

- Facts of the case:
 - Callow provided maintenance services to Baycrest (condominiums), split between a winter contract and a summer contract
 - Winter contract ran from November 1, 2012 to April 30, 2014
 - Contract contained a favourable termination clause: Baycrest can terminate the contract for any reason by providing ten days' written notice
 - On September 12, 2013, condominium group provided Callow with formal 10-days notice

C.M. Callow Inc. v Zollinger, 2020 SCC 45

- Where things went wrong:
 - Made the decision to terminate the winter maintenance contract at a March 2013 meeting
 - Held negotiations for extension of both summer and winter maintenance contracts; Callow thought he was likely to get renewed. Callow performed extra work to incentivize Baycrest to extend
 - Internal email:
 - “It’s nice he’s doing it but I am sure it’s an attempt at us keeping him. Btw, I was talking to him last week and he is under the impression we’re keeping him for winter again. I didn’t say a word cuz I don’t wanna get involved but I did tell Tammy that Callow thinks we’re keeping him for winter.”

C.M. Callow Inc. v Zollinger, 2020 SCC 45

- Findings (majority decision of SCC):
 - Baycrest breached its duty by knowingly misleading Callow into believing the winter maintenance agreement would not be terminated
 - Duty applies even where the parties have expressly provided for the mode of termination
 - Quebec civil law helps interpret the duty of honest performance
- **Breach of the duty can be satisfied by half-truths, omissions and even silence**

C.M. Callow Inc. v Zollinger, 2020 SCC 45

- What the duty does not entail:
 - No positive duty to disclose
 - Need not subvert ones own interests to those of the counterparty.
 - Extra-contractual duties: the dishonesty must be directly linked to the performance of the contract
- Damages
 - Balance of the winter contract value

Case Study #2

- Jane's Jeans, a small clothing manufacturer, supplies jeans for sale to Astromart pursuant to a supply contract with a 2-year term.
- Contract provides that it is renewable at Astromart's sole discretion, and Astromart must give 60 days' notice in writing of renewal or non-renewal.
- Contract contains limitation on Astromart's liability for all indirect and consequential damages, including those Jane's Jeans specifically advised Astromart about.

Case Study #2, Cont'd

- 8 months before the contract is set to expire, Jane's Jeans writes to Astromart, advising that they are setting their budget for the upcoming year and asking for confirmation that the contract will be renewed since they will be basing their business plan and staff allocation on the renewal.

What Can Be Done?

- Back to Basics:
 - Personal relationships and trust with internal clients, screen for bad behaviour, create written records when your gut says to, be mindful of “special relationships”, renewals and terminations.
- M&A sell-side: spend a few minutes here to avoid impairing your business.
- New commercial relationship: consider how you use strategic vagueness in you LOI/MOU.
- Existing commercial relationship: can you really say when a contract is not in renewal discussions?
- Termination: newly expanded duty – don’t lie and don’t mislead.
- Other potential protections regarding termination:
 - Control flow of communication;
 - Document reasons for termination (internally and to the other party);
 - Avoid a decision until comfortable communicating it (omission to inform could be misleading);
 - While not strictly required, advance notice/a transition period may be salutary and protect against a claim.
- Bonus: limited time opportunity to exploit information asymmetry and this development in the law?

Questions and Answers

We will endeavour to answer as many questions as possible.

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Thank You

Thank you for joining us.

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Your feedback is greatly appreciated.

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