“Play Nice” and “Think Context”: The Supreme Court Changes the Law of Contract

Authors: John Stefaniuk, K.C.

published 01/12/2015

In the course of two of its recent decisions, the Supreme Court of Canada (SCC) has fundamentally altered the legal landscape as to how parties must behave in their contractual relationships and how contracts are to be interpreted.

In the natural resource development business contracts are everywhere: joint venture agreements, supply agreements, impact benefit agreements, options - the list is endless. There are “handshake” deals and there are written agreements hundreds of pages long. For so long as there have been agreements, parties have had to deal with each other under their agreements and have had to interpret and seek the meaning of the agreements that define their relationships. And for just as long as they have been doing that, disputes have arisen. The legal ground rules in how contracting parties must behave toward each other and how their agreements are to be understood have now changed.

First is the case of *Bhasin v. Hrynew*, released November 13. Bhasin marketed education savings plans on behalf of a company that we will call “C”. Hrynew, a competitor, wanted Bhasin’s business. Bhasin resisted Hrynew’s entreaties to merge. Hrynew tried to get C to pressure Bhasin into a merger. Hrynew had C appoint him as a compliance auditor of Bhasin’s business, despite Bhasin’s objections that the move would give Hrynew access to Bhasin’s confidential business information.

Bhasin refused to give Hrynew access to his records. C then gave notice that it would not renew its contract with Bhasin. When the contract expired Bhasin lost his business and his sales force, most of whom were then recruited by Hrynew. The Court found that C acted dishonestly with Bhasin and found C liable for damages resulting from the loss of his business.

In making its decision, the Court stated, first, that good faith contractual performance is a general organizing principle of the common law of contracts in Canada. Second, as part of this principle of good faith, there is a duty that applies to all contracts; one that requires parties to act honestly in the performance of their contractual obligations.

What does this mean vis-à-vis your relationship with another contracting party? Well, according to the SCC:

•You must perform the contract with “appropriate regard” to the “legitimate contractual interests of the contracting partner”.

•What is meant by “appropriate regard” will depend on the context of the relationship, but, in general, it requires that you do not act in bad faith to seek to undermine the other party’s interests in the contract.

•You have no general duty of loyalty to the other contracting party (unless you are contracting to be, or otherwise are a fiduciary, which is an entirely different discussion). You may act in your self-interest but the other party is entitled to expect honest, candid, forthright or reasonable performance of the contract from you.

•There is a new general duty of honesty in performing a contract. As a minimum standard, you must not lie or otherwise knowingly mislead another party about matters directly linked to the performance of the contract.

The next case that I want to mention is *Sattva Capital Corp. v. Creston Moly Corp.,* released August 1. Creston had appealed an arbitrator’s decision regarding the calculation of a finder’s fee on the acquisition of a molybdenum mining property by Creston. Sattva had scored a big win before the arbitrator, based on his interpretation of the relevant agreement.

Most of the SCC’s decision was focused on when an arbitrator’s decision on how a contract should be interpreted could be appealed to the courts. Appeals are based on a “question of law” - the SCC said that interpreting a contract is a matter of both fact and law and therefore not subject to appeal in the circumstances.

In its pronouncement that there are limited circumstances under which an arbitrator’s decision can be appealed to a court, the SCC turned the common law surrounding the interpretation of contracts on its head. The traditional approach to contractual interpretation was rejected by the Court.

Rather than relying strictly upon the written agreement, it will now be the “overriding concern” of the Courts to determine “the intent of the parties and the scope of their understanding”. In doing that, the contract must be read as a whole, in its ordinary and grammatical meaning, but consistent with the surrounding circumstances known to the parties at the time the contract was formed.

What forms the context for interpreting an agreement? According to the SCC, context includes the purpose of the agreement and the nature of the relationship created by the agreement. In other words, contracts are to be interpreted in the context of the factual matrix under which they arise.

What does this all mean to your contracts and business relationships? It will be years until all the nuances are worked out by the Courts. In the meantime, the new “golden rule” might be

summarized as, “treat your contractual partners fairly and squarely”. And, when it comes to understanding an agreement, look at the purpose and factual context behind an agreement to divine the meaning of the written words.

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