

You gotta have (good) faith: How to perform a unique contract duty

SPEAKERS



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09:58

In business relationships, contracts set out terms and responsibilities, in part, to help prevent disputes. In the era of good faith, Canadian businesses must increasingly think beyond those explicit terms and responsibilities.

In this video, Torys litigators [Andrew Bernstein](#), [Jeremy Opolsky](#) and [Rachael Saab](#) discuss how the drafting and execution of contracts should be considered with good faith in mind.

We discuss:

- How the duty of good faith differs from other contractual terms
- Why good faith injects commercial uncertainty into contract relationships
- The power of careful drafting in the era of good faith
- Three court rulings that have determined the legal landscape

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Video transcript



Andrew Bernstein (00:08): Hi everyone, and welcome to our video series on commercial disputes. I'm Andrew Bernstein, the moderator and host of this series. And we're very fortunate to have with us today two of my colleagues from the Torys litigation department, Jeremy Opolsky and Rachael Saab. And today we're going to talk about good faith in contracting and commercial performance. It's a hotly discussed topic and there's lots of nuance, but Jeremy and Rachael are going to get through it all in 10 minutes with a little nudging for me. So let's get right to it. Jeremy, let's start with you.

Jeremy Opolsky (00:37): 10 minutes you say, Andrew, so here we go. The modern interpretation of good faith and contracting really started in the case from the Supreme Court, called Bhasin. Well Bhasin said is that there is an organizing principle of good faith in contract parties must generally perform their contractual duties honestly and reasonably, which means that they can't perform them capriciously or arbitrarily. Importantly, this is a principle of law. It's not an implied term in a contract, so it exists as a foundational bedrock throughout the common law. Secondly, what Bhasin talks about is a duty generally of honest performance or honesty in contractual performance. Parties can't lie to each other or knowingly mislead each other when they're performing their contractual duties. And that too is a principle of law and not a principle of implied terms.

Andrew Bernstein (01:33): So Bhasin was a thing, and in our own lawyerly way us commercial litigators thought that the sky might be falling. So did it?

Jeremy Opolsky (01:42): I don't think the sky fell, Andrew. But the Court continued to evolve the doctrine, most recently in two cases called Callow and Wastech. And Callow—I love this case it's the most Canadian case ever, it's about snow plowing. Callow was an independent contractor. He worked for two condominium corporations, and he had a two-year contract, which was terminable on 10 days' notice. And he thought his contract was going to be renewed. And the condo board had led him to believe that his contract was going to be renewed, and as a result he performed all sorts of freebies for them in the expectation of renewal. Most importantly, the condo board knew that he thought his contract was going to be renewed, despite having decided that they were going to terminate the contract. Callow sued after they terminated his contract for breach of good faith, and the Supreme Court upheld the trial judge's decision that because the condominium board had engaged in active deception and knowing that Callow thought he was getting a renewed contract when they knew they were not renewing it, he got damages for the term of an entire contract that he lost, because he thought he was getting the renewal.

Andrew Bernstein (02:49): And Rachael, is Callow the end of the good faith story?

Rachael Saab (02:52): This was not the end of the good faith story for the Supreme Court of Canada. They then decided the case in Wastech against the City of Vancouver, and this one was all about garbage in my fair hometown of Vancouver. And the facts are fairly complex, but basically the parties had a target profit ratio and one party, Vancouver, could make discretionary decisions that would affect its contractor waste tax profit ratio. And when those decisions significantly lowered the profit ratio, the contractor Wastech sued for a breach of duty of good faith, and the contractor wanted to be made whole, arguing that Vancouver had breached its contractual duty of good faith by exercising its discretion to shift waste allocation to another site and refusing to compensate Wastech for that decision. And the arbitrator, in the first instance, awarded damages to bring it back to the profit ratio. But the Supreme Court of Canada overturned, and it said in the course of overturning that decision that there was a duty of good faith in contractual discretion, and that's essentially a general duty to exercise contractual discretion in good faith. And it's one that you can't contract out of. It's not an implied term. And what does that mean? It means essentially that you need to exercise the discretion reasonably. So in a manner consistent with the purpose for which the discretion was granted in the contract. And in this case, Vancouver's exercise of discretion was not unreasonable because the contract gave Vancouver absolute discretion to determine how waste could be allocated. So when read as a whole, the purpose of the contract was clear. That was to allow Vancouver to maximize its efficiency and how it allocated this waste and therefore its determination to allocate waste to a new location was not a breach of the duty of good faith.

Andrew Bernstein (04:59): Okay, so we have Bhasin, Callow and Wastech, but what does that mean for contract disputes, Jeremy?

Jeremy Opolsky (05:09): Why should we care effectively? Why are people listening to this presentation? We should care because—

Andrew Bernstein (05:13): I'm sure they're wondering that themselves right now.

Jeremy Opolsky (05:16): Me too. We should care because the duty of good faith is different than other contractual terms. The duty of good faith prevents a party, or you could say creates liability from acting in ways that would otherwise not be a breach of contract. Basically, you can point to the contract and say, "But I followed the contract, how do I have any liability?" And the answer is because a party didn't do it in good faith. There's no question, for example in *Callow*, that there was a 10-day termination provision, 10-day notice for termination. And yet there was still liability because even though they followed the notice provision, they did not act in good faith. Just like a *Wastech*, there was no question that Vancouver can make these discretionary decisions, but nonetheless there was a good faith claim. Looking at the contract, in effect, isn't enough. You need to look at the behaviour about how the contract was performed to understand good faith. I think it Andrew, it all goes back to what you what I learned in kindergarten, which is "But he or she said!" And is it fair. And those are the core principles underlining the duty of good faith.

Andrew Bernstein (06:21): Rachael, in kindergarten we learned that we should be doing what's fair. But in law school we learned that what you write in the contract is what the court's going to uphold. And it looks like the Supreme Court has gone some distance away from that, which from my perspective, injects a pretty significant amount of commercial uncertainty into contract relationships. So what can we do about that?

Rachael Saab (06:44): Yeah. So we're somewhere in middle school territory between kindergarten and law school. And what you can do when you're in middle school territory is think about the duty of good faith when negotiating your contracts and when drafting your contracts. How will it impact rights and obligations of the parties? And careful drafting is really key in the era of good faith. So that's especially the case for discretionary powers. And for those discretionary powers, you need to include the purpose of the power in the relevant section of the contract. So purpose is really important, as we saw in *Wastech* in determining the scope of good faith. And it's something you should really turn your mind to and make sure you are including your contracts, including considering a preamble at the outset of the contract, which sets out the purpose of the contract. And if this ever ends up in court, that will help the court determine the scope of the discretionary power.

Jeremy Opolsky (07:40): And I would add on the other part of it, which is the *Bhasin* duty of honest performance, that you should consider when you make decisions. I mean, that's the issue in *Callow*, right? When the decision was made. You don't have to disclose once the decision has been made, but you have to be honest if asked. So consider—when your board makes a decision, when the executive makes a decision and when the decision is final—your communication strategy to make sure that you have some honesty if you have to communicate about the decision.

Andrew Bernstein (08:11): Okay. Well, my recollection of middle school was we knew some things, but there was still a heck of a lot to learn. So what would you say that we don't know about the evolving duty of good faith in Canada?

Rachael Saab (08:22): Yeah, so there's lots of questions about where the duty of good faith is going to go next. Is it going to extend into other areas like the duty of cooperation? So that's the principle that the parties have to cooperate in order to achieve the objects of the contract. And that was mentioned in *Bhasin* as one of the three broad types of situations in which a duty of good faith of performance has previously been found to exist. But there's not a lot of treatment in the case law of it, yet to see whether there's potential for growth in that area.

Andrew Bernstein (08:54): Jeremy, last word to you. What can us middle schoolers look forward to?

Jeremy Opolsky (09:00): Study hard in AP classes, but otherwise, I mean, I think that there's a lot that we don't know about the discretionary powers' decision from *Wastech*. For example, what is a discretionary decision? *Wastech* doesn't define that. What is the scope of reasonableness? Does it apply to contract termination with *Bhasin* expressly doesn't decide, and the overarching question through *Callow* and *Wastech*, of what is the continuing role of the civil law? The Québec civil law? In a understanding of good faith. And I guess you'd say, I don't know, TBD? Tune in? Next case?

Andrew Bernstein (09:37): Stay tuned? Yeah, exactly.

Rachael Saab (09:39): Have a good summer? See you next year.

Andrew Bernstein (09:40): Exactly. What I did on my summer holiday. Okay. Thank you so much, Rachael and Jeremy, for sharing your expertise with us. I'm Andrew Bernstein from Torys and on behalf of my colleagues, thank you very much! We will see you next time.

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