ЦИВІЛЬНЕ ПРАВО І ЦИВІЛЬНИЙ ПРОЦЕС; СІМЕЙНЕ ПРАВО; МІЖНАРОДНЕ ПРИВАТНЕ ПРАВО

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THE PRINCIPLE OF GOOD FAITH CONTRACTUAL PERFORMANCE SET BY THE SUPREME COURT OF CANADA IN *BHASIN*

Introduction. Ukraine is a state with the civil law legal system where the Civil Code of Ukraine [2] is the primary source of contract law. By contrast, all Canadian provinces, except Quebec, have the common law of contracts [3, p. 52]. The Bhasin is the decision which is based on doctrines and principles of common law system and is a part of the Canadian common law.

In Bhasin the Supreme Court of Canada took "two incremental steps" in the common law of contract: The Court (1) acknowledged a "general organizing principle" of good faith in contractual performance; and (2) recognized a general duty to act honestly in the performance of contractual obligations [1, para 33].

The rule in Bhasin that the duty of honesty does not impose on the party an obligation of disclosure, was further applied and developed by the Ontario Court of Appeal in Eureka Farms [4] and 2260695 Ontario [5].

An introduction of rules in Bhasin into the Ukrainian contract law would be beneficial because of consistency of the rules with the parties' self-interest, the rules can make the contract law more systemic, and the ability of the rules to increase the contractual certainty.

The Supreme Court of Canada's decision in Bhasin is a positive shift from the understanding that contractual relations are motivated by purely self-interested parties to the conception of contracts as cooperative and mutually beneficial undertakings.

Despite its flexibility, the principle of good faith performance can serve as an efficient gap-filling mechanism in contractual relations, as well as accord with the reasonable expectations of the parties to the contract. These characteristics can contribute to the contractual certainty.

To outline a background for this work, I will provide an overview of differences between Ukrainian and Canadian legal systems. This will be followed by facts of the Bhasin case as well as the decisions of courts. In Part1 I will demonstrate the essence and limits of the "general organizing principle" of good faith in contractual performance as one of the two "incremental steps" in Bhasin. In the next part of the paper, I will examine the duty of honesty which was introduced by Cromwell J in the case analyzed. Finally, in Part 3, I will discuss whether the rules in Bhasin could be beneficial for the Ukrainian contract law.

Background information. Ukraine has the civil law system. Under this system, the Civil Code is the primary source of private law and is more important than judicial decisions. At the same time, the Supreme Court of Canada's decision in Bhasin is based on the common law tradition. In general, the distinguishing features of the common law system are the reliance on precedent, the principle of stare decisis, and the use of an adversarial process in court [3, p. 38].

The Canadian common law system's methods and techniques if analyzing legal issues are different from those of the civil law system. When dealing with private law matters, judges, in the Canadian common law system, often does not consult any legislation. Instead, judicial precedents have binding nature under the principle of stare decisis.

Despite this fundamental difference between Canadian common law and Ukrainian legal system, in practice, they have much in common. Judges in both systems consult prior decisions and legal scholarship when trying to resolve the issues before them. And in both systems, statutes are the source of law.

Facts of the *Bhasin* case. Canadian American Financial Corp. ("Can-Am") had a contract with Mr. Bhasin, an enrollment director for more than ten years. The arrangement between Can-Am and Bhasin was not one of franchisor-franchisee though it shared some of the same features. The latest version of their contract provided for automatic renewal at the end of a three-year period unless one of the parties gave six months' written notice to the contrary. Nothing in the contract limited the reasons for non-renewal. The contract also contained an "entire agreement" clause [1, paras 2–6].

In the year leading up to non-renewal, Can-Am "repeatedly misled" Bhasin. The dishonesty related to Bhasin's main competitor, an enrollment director Hrynew, who wanted to take over and merge with Bhasin's business. Can-Am not only wanted the merger; it hired Hrynew as an internal officer to audit Bhasin's business. Can-Am lied, telling Bhasin that Hrynew was bound by the obligation of confidentiality. And when Bhasin confronted Can-Am with rumours about a merger, Can-Am was evasive when Bhasin asked if the merger was a "done deal". When Bhasin refused the audit, Can-Am threatened to terminate and six months before the end of the contract term, Can-Am gave notice of non-renewal, fully com-

plying with the unambiguous provisions of the contract. When the term expired, Bhasin lost the value of his business and workforce labour force, while his sales agents were poached by Hrynew [1, paras 7–13].

Bhasin sued Can-Am, inter alia, for breach of contract among other causes of action and by way of the remedy sought damages including for loss of income and loss of the value of his business. Bhasin claimed that there was a breach of the implied term of good faith. Can-Am argued that the role of good faith was limited to only certain categories of contracts, and not to contracts between commercial parties. The trial judge sided with Bhasin; the appeal court with Can-Am [1, paras 14–16].

In the Supreme Court of Canada, the appeal against Can-Am was allowed, while the one against Hrynew was dismissed. The trial judge's assessment of damages in the amount of $381,000 was varied, being reduced to $87,000 [1, para 112].

Analysis

Part 1. Organizing Principle of Good Faith

The Supreme Court of Canada, in Bhasin, explains that the organizing principle of good faith orders parties to perform their contractual duties honestly and reasonably and not capriciously or arbitrarily. [1, para 63] "The principle states in general terms a requirement of justice from which more specific legal doctrines may be derived, and therefore it is not a free-standing rule, but rather a standard that forms the basis for more specific legal doctrines". The purpose of organizing principles is to help to understand and contribute to the law in a more directed and cohesive manner [1, para 64].

"The acceptance of good faith as an organizing principle of contract law demonstrates the idea that, in carrying out his or her own performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner". The degree of appropriate regard to the other party's interests will vary contextually with the nature of the contracting relationship. At the very least this will require that a contracting party avoids undermining those interests through bad faith conduct [1, paras 65, 69].

Andrea Bolieiro offers a helpful account of what the Supreme Court of Canada in Bhasin means by the good faith principle. Relying on Bhasin's analysis of Ronald Dworkin's distinction between rules and principles, Bolieiro observes that a principle (like the principle of good faith) does not dictate results. Rather, it justifies results. [6, paras 9–10] As she notes, principles "are weighed against other principles to help judges come to the right result: the result that does justice between the parties in each case. Principles not only help judges apply rules, they allow judges to create new rules where necessary in order to do justice in a particular case. Without principles, judges may not be able to do justice according to existing rules, or may only be able to do justice at the cost of stretching existing rules beyond recognition" [6, para 11]. As examples, Bolieiro offers the following: "competent parties should be free to contract; courts should encourage commercial certainty, and parties generally must perform their contractual duties in good faith" [6, paras 10–11].

Prior to Bhasin, Canadian good faith case law was piecemeal and disorganized. [1, para 32] Generally, the jurisprudence could be characterized by a categorical distinction between a duty of good faith implied-in-law and a duty of good faith implied by the intentions of the parties, a duty implied-in-fact [7, p. 201].

In Bhasin, the Supreme Court of Canada was unwilling to imply a term of good faith for several reasons. First of all, the relationships between Can-Am and Bhasin fell outside of existing relationships, such as franchise or employment [1, para 72], where good faith has a presence [1, paras 54–56]. Any ruling that the exercise of non-renewal power required good faith "would constitute a significant expansion of the decided cases under that type of situation". [1, para 72] In addition, and as noted by the Court of Appeal, implying a term of good faith would contravene the entire agreement clause [1, para 72]. So, instead, the Supreme Court of Canada, assessed the issue more generally and acknowledged a "general organizing principle" of good faith in contractual performance.

After the decision of the Supreme Court of Canada in Bhasin, the Canadian courts of appellate level divorced from the implication of good faith terms into contracts. For instance, in Moulton Contracting, [8] the trial court implied a term that the Crown had guaranteed it had satisfactorily completed consultation in the agreement between the parties. The trial court found the province liable on that basis. In his reasoning, Justice Saunders found that the term should be implied in order to give effect to the parties' intentions and redress a power imbalance between them. The Appeal Court commented on the impact of Bhasin on implied terms of good faith by noting that the trial judge conflated the tests for terms implied-in-law and terms implied-in-fact. The judgment stated that "Bhasin does not suggest that the two tests should be combined to reach a hybrid law-fact conclusion on whether to imply terms" [8, paras 2, 67]. In High Tower [9], the Ontario Court of Appeal notes that the decision in Bhasin clarifies that the duty of good faith should not be thought of as an implied term [9, para 36].

In Bhasin, Cromwell J was careful to limit the organizing principle of good faith only to contractual performance. However, the Court's finding that Can-Am acted dishonestly toward Mr. Bhasin in exercising the non-renewal clause was one of the grounds of the decision [1, para 94]. The renewal (or non-renewal) process has much in common with the pre-contractual negotiations as well as termination of contract because in the instances mentioned the parties decide whether they will be bound by contractual relationships with each other in future or not. So, Bhasin case can be a basis for the development of broader general organizing principle of good faith in contractual relations that will cover formation, performance, and termination of contract.

As to the Civil Code of Ukraine, it does not state that the parties must conduct themselves in good faith at the time when the contractual obligation is performed. So, Bhasin with its detailed instructions how to apply the organizing principle of good faith performance

could be a good theoretical basis to introduce the principle of good faith into the Ukrainian contract law.

Part 2. Duty of Honesty

The Ukrainian contract law does not also specify that the parties to the contract must act honestly concerning each other. Although under the section 526 of the Civil Code of Ukraine, parties to the contract, must perform obligation appropriately, in fact, section 526 of the Code does not prohibit the parties from lying to each other.

As to the Canadian common law of contracts, the Supreme Court of Canada in Bhasin officially says that there is a duty of honesty [1, para 33]. According to the Court, Can-Am breached the new duty of honesty. Some of the Can-Am's misconduct as found by the trial judge may well have been tortious (though no tort of fraud or negligence against Can-Am was referred to or found by the trial judge) but, at a minimum, the conduct violated the new duty of honesty [7, p. 16].

Shannon O'Byrne and Ronnie Cohen provide an example for the distinction between dishonesty and fraud: In the context of contract formation between private individuals pursuing an "as is" contract, the doctrine of caveat emptor puts the obligation on the buyer to ask, not on the seller to tell. The authors assert that as a general principle when a seller remains silent and does not disclose to the purchaser an issue or difficulty that may negatively impact the value of the contract's subject matter, that failure may be considered dishonest in this sense of lacking in integrity but typically not fraudulent or otherwise actionable [10, para 23].

I would agree that there is a distinction between the duty of honesty and fraud. However, I think that Shannon O'Byrne and Ronnie Cohen provided not a good example of the difference because under the rule in Bhasin, the new duty of honesty does not impose on the party an obligation of disclosure [10, para 73]. This rule was further applied and developed by the Ontario Court of Appeal in Eureka Farms [4] and 2260695 Ontario [5]. In Eureka Farms, the Court states that the seller of the swine farm did not breach its duty of good faith by failing to advise the purchaser in advance that there would be no pigs in the barn when the transaction closed [4, paras 7–8]. In 2260695 Ontario, the appellant submitted that applications judge erred in failing to find that the respondents had breached their good faith obligations described in Bhasin to respond to the appellant's draft amendment and extension agreement in time. The Court did not agree with the appellant and stated that the refusal to respond is not a breach of good faith [5, paras 17–18].

Hugh Collins points out that honesty is the minimum good faith's requirement which probably applies to all contracts, even in the most antagonistic trading. The scholar also notes that the standard of good faith and fair dealing should be understood as comprising a spectrum of norms. At its narrowest end, good faith merely requires honesty in fact. At the other end of the spectrum of good faith, it edges close to fiduciary duties by requiring performance of the contract that takes the interests of the other party into account [11, p. 314].

The jurisprudence knows many other good faith duties such as: avoiding "commercial impropriety", "unacceptability" and "unconscionability", "fidelity to the parties bargain", "co-operation", a duty not to frustrate "reasonable expectations", a duty not to act "arbitrarily, capriciously or unreasonably", a duty not "unreasonably" to withhold a contractually required consent, a duty to bring "an unusual or onerous" term "fairly" to the notice of the other party, and "fair dealing", a duty to mitigate as well as rules relating to: good faith in "snapping up" an offer which the offeree knows has been made in error etc [12, paras 132, 135–39, 144–45, 150; 13, 482; 10, para 32].

So, despite a great variety of good faith duties known to jurisprudence, the Supreme Court of Canada in Bhasin made a very careful step adopting the duty of honesty as a minimum requirement of good faith.

As Justice Cromwell in Bhasin notes, the new duty of honesty means simply that parties to every contract must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract [1, para 73].

However, not every lie about matters directly linked to the performance of the contract should be considered as a breach of the duty of honesty. In Mason [14], the vendor claimed that his wife would not provide a bar of dower. In fact, the vendor had made no effort to persuade his wife to do so. In this way the vendor wanted to evade a real estate deal [14, para 13]. In Bhasin, Can-Am lied because it wanted to help Hrynew to poach the Bhasin's clients and sales agents. In these cases, parties lied with malicious intent. Nevertheless, what about instances where a party to the contract tells the untruth in order to encourage their business partner, or not to disappoint the partner etc.?

In my opinion, the introduction of the duty of honesty into contract law requires considering the intent and motive of the party which lied. If the party misinformed the counterparty with good intentions the party cannot be liable for breach of the duty of honesty since, in such situation, there is not a violation of good faith as a general principle.

Part 3. Potential benefits from the introduction of rules in *Bhasin* into Ukrainian Contract law

There are different opinions about the effect of the Supreme Court of Canada's decision in Bhasin on the Canadian common law of contracts. For example, Andrea Bolieiro points out that, the principle of good faith organizes the common law of contract and makes the law "more just" [6, para 16]. Chris Hunt states that in theory the duty to perform the obligations honestly adopted in Bhasin reflects a serious restriction of freedom of contract. At the same time, the scholar notes that in practice it is arguably not terribly restrictive [15, p. 6].

I think that there are at least three reasons why the introduction of rules in Bhasin into the Ukrainian contract law would be advantageous. They are consistency of the rules with the parties' self-interest, the ability of the rules to make the Ukrainian contract law more systemic, and the ability of the rules to increase the contractual certainty.

Consistency with the parties' self-interest.

Contract law was traditionally premised on the idea of a contract as a discrete transaction: the contracting parties are adversaries, seeking above all to maximize their own interests. When the transaction is over, they go on their merry way [6, para 13]. The contract law exists to "facilitate the pursuit of individual projects by emphasizing the parties' free choice of aims and lifestyles and the essentially purposive nature of human social existence" [16, p. 93]. Classical contract theory and classical liberalism share the belief that maximum productivity can be achieved when the state does not impede the ability of the contracting parties to act autonomously but interferes only to prevent force or fraud [13, p. 482]. In this sense, the state provides the minimum regulatory framework to allow individuals to reach optimal relationships with each other in the exchange of goods and services [17, p. 136].

Good faith requires both parties to a contract to respect those reasonable expectations of the other if they are not excluded by express terms of the contract. A party may still look primarily to his or her own interests, but in the performance of the contract and in the exercise of rights and powers conferred by the contract, that party must not defeat or undermine the reasonable expectations of the other. It implies a duty on each party to do what, within his reasonable powers, is necessary to permit the other party to enjoy the benefit of the contract [18, p. 66; 11, p. 315].

Good faith as an "organizing principle" in Canadian common law and the new duty of honest contractual performance constitute a fundamental theoretical shift away from the primacy of self-interest in the classical model [19, p. 112]. Although good faith is criticized for not sufficiently respecting the autonomy of parties [13, p. 490–92], it provides a greater framework for parties to undertake mutually advantageous transactions because it does not regard self-interest as more important than the pursuit of those mutually beneficial relationships [16, p. 151].

Despite the fact that the self-interest is an important factor for the parties to enter into contractual relationships, nowadays many contracts require a high degree of communication and co-operation, a significant level of mutual trust and confidence.

So, Bhasin is a positive shift in the Canadian common law from the understanding of contractual relations being motivated by purely self-interested parties to the conception of contracts as cooperative and mutually beneficial undertakings.

This corresponds to the requirements of reasonableness and fairness of contractual terms and conditions specified in section 627 of the Civil Code of Ukraine. Moreover, parties to the contract, under the section 526 of the Civil Code of Ukraine, must perform obligation appropriately. If the Ukrainian Parliament introduced the principle of good faith performance and the duty of honesty, it would not contradict the Civil Code rules but would be in line with them.

Systematizing of contract law

Prior to the decision in Bhasin, good faith jurisprudence in Canada was similar to that in the United Kingdom and Australia. Duties of good faith had been implied on a case-by-case basis, and were incident to certain classes of contracts, but were not otherwise recognized as being of general application [15, p. 5].

In Bhasin, Justice Cromwell notes that common law judges have unsystematically applied the concept of good faith to specific types of contractual relationships or factual situations. The Court's intent in recognizing good faith as an organizing principle is to clarify and improve the law [1, para 59]. Justice Cromwell instructs that the good faith principle is a "standard" which recognizes and supports old and new common law rules and doctrines, and intended to help to understand and develop the law in a coherent and principled way [1, paras 64, 66].

Jacob Young, citing the Honourable Mr. Justice Steyn, states that by recognizing good faith as an organizing principle of contract law, the Supreme Court of Canada provided for a new conception of the Canadian contract law that is consistent with the civil law approach and with the relational theory's emphasis on contract law as a subset of a broader law of obligations [19, p. 108].

Because of its civil law legal system, Ukrainian contract law does not recognize piecemeal solutions in its regulation and is almost fully based on the Civil Code. The Code is organized and systematized. Consequently, good faith as organizing principle in contract law would not be so radical as it was in common law Canada after the decision in Bhasin. The introduction of the principle of good faith would be reasonable for further systematizing of contract law rules in Ukrainian law.

Good faith is also very flexible because the content of good faith depends on the context. In particular, courts have to weigh the principle of good faith against other principles to determine what is required from the parties in each factual context. [1, para 66]

Contractual Certainty.

The Supreme Court of Canada in Bhasin reasoned that tying the organizing principle to the existing law mitigates the concern that any general notion of good faith in contract law will undermine certainty in commercial contract and cautioned against the temptation to descend into ad hoc judicial moralism or "palm tree" justice [1, para 71].

Professor McCamus notes, that commercial actors, and others, expect that the people with whom they enter into transactions will act in good faith [20, p. 838]. Mariana Pargendler posits that good faith can be understood as one end of a continuum of gap-filling mechanisms aimed at ensuring the proper behaviours of contractual actors. At the other end of this continuum is the fiduciary obligation. The notion of the "hypothetical bargain" is the most appropriate framework for understanding how to deal with contractual uncertainties in cases of conflict. The hypothetical bargain can be understood as "what the parties would have wanted" if they could have reasonably foreseen and accounted for the future risks of non-performance. The guiding presumption for courts faced with determining the content of the hypothetical bargain is that the parties would have chosen

whatever arrangement guarantees the largest possible contractual "pie" [21, p. 1317–19].

The Supreme Court of Canada in Bhasin also established the new duty of honesty in the performance of contractual obligations because it "accords with the reasonable expectations of commercial parties" and "is sufficiently precise that it will enhance rather than detract from commercial certainty" [1, paras 33–34].

So, despite its flexibility, the principle of good faith performance established in Bhasin, could serve as an efficient gap-filling mechanism in contractual relations, as well as accord with the reasonable expectations of the parties to the contract. These features of good faith can contribute to the contractual certainty but not decrease it.

Conclusion. The Supreme Court of Canada, in Bhasin, explains that the organizing principle of good faith orders parties to perform their contractual duties honestly and reasonably and not capriciously or arbitrarily. The Supreme Court of Canada was careful to limit the organizing principle of good faith to contract performance. However, Bhasin case can be a basis for the development of broader general organizing principle of good faith in contractual relations that will cover formation, performance, and termination of the contract.

The Civil Code of Ukraine does not specify that the parties must conduct themselves in good faith at the time when the contractual obligation is performed. So, Bhasin, with its detailed instructions on how to apply the organizing principle of good faith performance, could be a good theoretical basis to introduce this principle into the Ukrainian contract law.

In Bhasin, the Supreme Court of Canada states that the new duty of honesty does not impose on the party an obligation of disclosure. This rule was further applied and developed by the Ontario Court of Appeal in Eureka Farms and 2260695 Ontario.

Despite a great variety of good faith duties known to jurisprudence, the Supreme Court of Canada in Bhasin made a very careful step adopting the duty of honesty as a minimum requirement of good faith.

Not every lie about matters directly linked to the performance of the contract should be considered as a breach of the duty of honesty. Introduction of the duty of honesty into contract law requires considering the intent and motive of the party which lied. If the party misinformed the counterparty with good intentions the party cannot be liable for the breach of the duty of honesty since, in such situation, there is not a violation of good faith as a general principle.

Introduction of rules in Bhasin into the Ukrainian contract law would be advantageous for at least three reasons. They are consistency of the rules with the parties' self-interest, the ability of the rules to make the Ukrainian contract law more systemic, and the ability of the rules to increase the contractual certainty.

Good faith requires both parties to a contract to respect those reasonable expectations of the other if they are not excluded by express terms of the contract. A party may still look primarily to his or her own interests, but in the performance of the contract and in the exercise of rights and powers conferred by the contract, that party must not defeat or undermine the reasonable expectations of the other.

It implies a duty on each party to do what, within his reasonable powers, is necessary to permit the other party to enjoy the benefit of the contract. This corresponds to the requirements of reasonableness and fairness of contractual terms and conditions specified in section 627 of the Civil Code of Ukraine. Moreover, parties to the contract, under the section 526 of the Civil Code of Ukraine, must perform obligation appropriately. If the Ukrainian Parliament introduced the principle of good faith performance and the duty of honesty, it would not contradict the Civil Code rules but would be in line with the Civil Code.

Being a part of the Ukrainian civil law legal system, Ukrainian contract law does not recognize piecemeal solutions in its regulation and is almost fully based on the Civil Code. The Code is well organized and systematized. Therefore, the introduction of good faith contractual performance as organizing principle into contract law of Ukraine would not be so radical as it was in common law Canada after the decision in Bhasin.

Despite its flexibility, the principle of good faith performance established in Bhasin could serve as an efficient gap-filling mechanism in contractual relations, as well as accord with the reasonable expectations of the parties to the contract. These features of good faith can contribute to the contractual certainty but not decrease it.

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Богославець В.М. ПРИНЦИП ДОБРОСОВІСНОСТІ ПРИ ВИКОНАННІ ДОГОВОРУ, УСТАНОВЛЕНИЙ ВЕРХОВНИМ СУДОМ КАНАДИ У СПРАВІ БХАСІНА

Стаття присвячена аналізу принципу добросовісності при виконанні договору та загального обов'язку діяти чесно при виконанні договірних зобов'язань, що визначені у рішенні Верховного Суду Канади у справі Бхасіна. У статті також досліджується потенційна користь від запровадження таких правил в українському законодавстві.

Ключові слова: договір, добросовісне виконання договору, обов'язок діяти чесно, договірна ясність.

Богославец В.М. ПРИНЦИП ДОБРОСОВЕСТНОСТИ ПРИ ИСПОЛНЕНИИ ДОГОВОРА, УСТАНОВЛЕННЫЙ ВЕРХОВНЫМ СУДОМ КАНАДЫ В ДЕЛЕ БХАСИНА

Статья посвящена анализу принципа добросовестности при исполнении договора и общей обязанности действовать честно при выполнении договорных обязательств, что определенны в решении Верховного Суда Канады в деле Бхасина. В статье также исследуется потенциальная польза от введения подобных правил в украинском законодательстве.

Ключевые слова: договор, добросовестное выполнение договора, обязанность действовать честно, договорная ясность.

Bohoslavets V.M. THE PRINCIPLE OF GOOD FAITH CONTRACTUAL PERFORMANCE SET BY THE SUPREME COURT OF CANADA IN BHASIN

The article is devoted to the analysis of a principle of good faith in contractual performance, and a general duty to act honestly in the performance of contractual obligations established in the Supreme Court of Canada's decision in Bhasin. In the article, I also investigate whether the introduction of similar rules could be potentially advantageous for the Ukrainian contract law.

Key words: contract, good faith in contractual performance, duty to act honestly, contractual clarity.