CIRCUlawR
A regular publication for legal news and reviews

Civic Legal LLP

The Operating Principle of "Good Faith" in Construction Contracts – Part II

SCC Judgment: C.M. Callow Inc. v Zollinger - The Exercise of Termination Clauses

The Supreme Court of Canada (SCC) rendered its judgment in the case of *C.M. Callow Inc. v Zollinger*[1] on December 18, 2020. In this judgment, the SCC addressed the question of what it means to breach the duty of honest performance in relation to a "seemingly unfettered" contractual clause that gives a party the right to terminate the contract for convenience. The court concluded that, even though the parties to a contract can provide for such unfettered rights to terminate the contract, the party having this contractual right has to exercise it in keeping with the duty to act honestly, which requires the contracting party to refrain from lying or otherwise knowingly misleading the counterparty about matters directly linked to the performance of the contract.

This article is a continuation of the article we wrote in November 2020 about the operating principle of good faith in construction contracts, which included a discussion about the judgments rendered by the lower courts in the *C.M. Callow* case, which can be found at the following link: http://civiclegal.ca/wp-content/uploads/2020/11/CircuLAWr-Nov-2020-Good-Faith.pdf.

The SCC Judgment in *C.M. Callow*

The Facts

C.M. Callow Inc. (Callow) entered into a two-year winter maintenance contract with a group of condominium corporations (Baycrest). At the end of the two-year term, the parties renewed the winter maintenance agreement and entered into a separate summer maintenance services contract. The new winter maintenance agreement had a two-winter term, and it contained a clause that allowed Baycrest to terminate the agreement for any reason upon giving 10-days written notice.

In early spring of 2013, during the first year of the winter maintenance agreement, Baycrest decided to terminate the agreement with Callow, and chose to not inform Callow of its decision, to avoid jeopardizing the performance of the summer services contract. Throughout the spring and summer of 2013, Callow had discussions with two of the board members of Baycrest about the renewal of the winter maintenance agreement. Following these discussions, Callow was under the impression that it was likely to get a renewal of this agreement. In addition, Callow performed work beyond its summer maintenance services contract free of charge, hoping to incentivise Baycrest to renew the winter maintenance agreement. Baycrest was aware of Callow's mistaken belief that a renewal was likely, but it did nothing to correct this belief.

In early fall of 2013, Baycrest informed Callow about its decision to terminate the winter maintenance contract by giving Callow 10-days notice as provided by the contract. Callow brought an action against Baycrest for breach of contract alleging that Baycrest had acted in bad faith, and that as a result of Baycrest's bad faith conduct Callow did not bid on other tenders for winter maintenance contracts.

The SCC's Holding

The SCC's decision represents an application of the principles espoused by the SCC in *Bhasin v Hrynew*[2] (the leading contract law case recognising the duty to perform contracts honestly) as opposed to an expansion of the law set forth in *Bhasin*. The case presented to the SCC an opportunity to clarify when the duty of honest performance would be breached in the context of the exercise of a termination clause that grants a right to terminate the contract for any reason.

The starting point for the SCC's analysis was the proposition put forward by the SCC in *Bhasin* that the duty of honest performance means "simply that parties must not lie or otherwise knowingly mislead each other about matters linked to the performance of the contract".[3] The application of this proposition in the circumstances of the case required clarification of two points: (1) when the dishonesty is directly linked to the performance of the contract, and (2) what con-

(Continued on page 2)

CIRCUlawR
A regular publication for legal news and reviews

Civic Legal LLP

The Operating Principle of "Good Faith" in Construction Contracts – Part 2

stitutes knowingly misleading conduct.

The trigger for the first question was the Ontario Court of Appeal finding that any dishonesty on Baycrest's part was about a potential renewal of the winter contract, which meant that the dishonesty was concerning the pre-contractual negotiations of the contract to which the duty of honest performance does not apply. The SCC disagreed with the Court of Appeal, finding that the dishonesty was linked to the performance of the existing winter contract rather than to a potential renewal contract. In arriving at this conclusion, the SCC advised that the question to ask when determining whether there is a connection between the dishonesty and the contract is "whether a right under the contract was exercised, or an obligation under the contract was performed, dishonestly".[4] The link between Baycrest's dishonesty and the existing winter contract was provided by the inference that could reasonably be drawn from Baycrest's representations. Namely, the court thought that it was reasonable for Callow to infer that the existing winter contract will not be terminated early based on Baycrest's suggestion that it was satisfied with Callow's work and that the existing contract was likely to be renewed.

The SCC noted that the requirement that a link be established between the dishonesty and the performance of the contract controls the scope of the duty of honest performance. The duty rests on a "requirement of justice"[5] that the parties "have appropriate regard to the legitimate contractual interests of their counterparty"[6], and as such, it applies to all legitimate contractual rights and obligations, including an apparently unfettered termination right, irrespective of the parties' intentions.[7] Therefore, the parties are not free to contract out of this duty.[8] In light of this potentially wide reach of the duty, the SCC reasoned that the direct link between the breach of the duty and the performance of the contract is necessary to appropriately limit the duty. Thus, a dishonesty occurring at the same time as the performance of the contract, but not directly linked to the performance, is not enough to find a breach of the duty of honest performance.

In answering the second question, the SCC began its analysis by making it clear that the duty of honest performance does not entail a positive obligation of disclosure, but rather a "negative" obligation asking the contracting parties to refrain from acting dishonestly. That is, without more, Baycrest was not required to disclose its intention to terminate the contract before the 10 days' notice. However, in circumstances where the party lies or knowingly misleads its counterparty, the party should be mindful to correct the false impressions which were created through its actions. When considering what constitutes conduct that knowingly misleads, the SCC stated that one can mislead through action, by saying something directly to its counterparty, or through inaction, by failing to correct a false impression caused by its misleading conduct.[9] The SCC further noted that the question of whether a conduct is knowingly misleading is "a highly fact-specific determination".[10] Such conduct can include, but is not limited to, lies, half-truths, omissions, and even silence in the right circumstances.[11] As regards Baycrest's conduct, the court found that Baycrest deceived Callow through "active communications" in anticipation of the termination, including the communications that suggested that a renewal of the winter agreement was likely and the acceptance of the free work provided by Callow as an incentive for Baycrest to renew. By failing to correct Callow's misapprehension, the court stated, Baycrest breached the duty of honest performance. The SCC restored the trial judge's award of damages in the amount of $64,306.96 for the loss of profits incurred due to Callow losing an opportunity to secure other work for that winter, in addition to an award for certain expenses incurred and an unpaid invoice.

Key Takeaways

- The duty of honest performance operates in relation to both the performance of contractual obligations and the exercise of contractual rights;
- The contracting parties cannot contract out of this the duty, even when the contract grants an "apparently unfettered" right to terminate the contract for any reason. The duty applies to contracts irrespective of the parties' intentions;

(Continued on page 3)

CIRCUlawR
A regular publication for legal news and reviews

Civic Legal LLP

The Operating Principle of "Good Faith" in Construction Contracts – Part 2

- The duty of honest performance does not preclude parties from including in a contract or exercising a termination for convenience clause; rather it is focused on the manner in which the right is exercised;
- The duty of honest performance does not impose a positive obligation to disclose the intention to terminate the contract before the prescribed notice period or to put the counterparty's interests ahead of your own; but it does require a party to refrain from misleading the counterparty about the exercise of the termination right;
- Once a party lies or knowingly misleads its counterparty about its performance of a contractual obligation or the exercise of a contractual right, it should correct the counterparty's misapprehension to avoid breaching this duty;
- The dishonesty must be directly linked to the performance of the contract. A temporal connection between the dishonesty and the performance is not enough for a finding of breach of the duty. A direct link is likely to be found when a party exercises a right under the contract, or performs an obligation under that contract, dishonestly;
- A party may be found to have acted dishonestly if it makes a decision to terminate, and thereafter represents or misleads the counterparty that the decision has not been made or has been made to the contrary;
- The determination of whether a party knowingly misled its counterparty it is highly fact specific. A party can knowingly mislead through lies, half-truths, omissions, and silence, depending on the circumstances (this list of examples of knowingly misleading conduct is not exhaustive).

January, 2021
Adrienne Atherton & Marcela Ouatu

RECENT COVID-19 CASE OF INTEREST

Can you register a builders lien for pre-construction services on a project cancelled due to COVID-19?

This was the question the British Columbia Supreme Court had to address in the recent case of *Shelly Morris Business Services Ltd. v Syncor Solutions Limited*.[12] The short version of the answer provided by the court is "no".

In the case, Shelley Morris Business Services Ltd. (SMBS) entered into an agreement with Syncor Solutions Limited (Syncor) for the provision of interior design and construction management services for the renovation of two office premises. In March 2020, as a result of the COVID-19 pandemic, Syncor advised SMBS that the project had to be suspended. Before the suspension, SMBS provided some services for the project, such as site visits, design work, issuing tender documents to sub-trades, and ordering materials, but it made no physical alterations to the property. SMBS had paid only for a portion of the services. Unable to resolve its differences with SMBS, Syncor decided to file claims of lien for the unpaid amounts against the title of the lands where the offices were located. SMBS brought an application seeking cancellation of the lien on the basis that the lien was invalid.

Pursuant to section 2 of the *Builders Liens Act*[13], a contractor, subcontractor or worker has a lien for the price of work or materials supplied only when the work performed and the supply of materials are in relation to an "improvement". Accordingly, the question before the court was whether the definition of "improvement" in the *BLA* includes "an intended renovation that has not yet started".[14] Based on a review of the case law, the court concluded that there was no improvement within the meaning of section 2 of the *BLA*. The reason behind this conclusion, the court explained, is that

the primary objective of the *BLA* is to prevent an owner from getting the benefit of an improvement without a corresponding payment. In the case, SMBS did not receive any benefit of an improvement because there was no improvement made, and thus, there could not be a lien on the lands in relation to the project.

The take-away of the case is that to have a lien on the lands of an owner of the project, an improvement to the site in the nature of a physical alteration must have been made.

[1] *C.M. Callow Inc. v Zollinger,* 2020 SCC 45 [*C.M. Callow*]

[2] *Bhasin v Hrynew*, 2014 SCC 71 [*Bhasin*]

[3] *Ibid* at para 73

[4] *Supra* note 1 at para 37

[5] *Ibid* at para 47

[6] *Ibid*

[7] *Ibid* at paras 47 and 48

[8] *Ibid* at paras 48 and 84

[9] *Ibid* at para 90

[10] *Ibid* at para 91

[11] *Ibid*

[12] *Shelly Morris Business Services Ltd. v Syncor Solutions Limited,* 2020 BCSC 2038

[13] *Builders Liens Act,* SBC 1997 c 45 [*BLA*]

[14] *Supra* note 12 at para 24

Our lawyers combine legal experience in local government, commercial real estate development, and construction law to provide legal services to local governments,

---

710 - 900 West Hastings Street, Vancouver, BC, V6C 1E5
604.639.3639 | **www.civiclegal.ca** | CivicLegal

Adrienne Atherton
604.358.6648
adrienne@civiclegal.ca

Adrienne brings over 25 years of legal experience in litigation and dispute resolution representing local governments and other public entities, insurers and corporations, including in-house as Senior Staff Lawyer at Municipal Insurance Association of BC. Adrienne has represented and provided strategic and practical advice in relation to a variety of complex matters, including procurement, construction (including builders' lien, delay and defect claims), environmental, regulatory, expropriation, bylaw and FOIPPA disputes and processes, municipal jurisdiction, procedure, constitutional challenges, judicial reviews, remedial action orders, administrative hearing processes, contract claims, and privacy, insurance and risk management issues. Adrienne has extensive experience at all levels of Court in British Columbia, administrative tribunals, mediations and arbitrations. Adrienne regularly writes and presents on a variety of matters of interest to public entities and the construction industry.

Marcela Ouatu
604.358.7590
marcela@civiclegal.ca

Marcela is an associate lawyer of the firm. Her practice is focused primarily in the areas of tendering, procurement, construction matters and local government law. Marcela's experience includes assisting with construction contracts, procurement, and liability issues for public organizations as well as insurance disputes and construction litigation. She writes on legal topics of interest to members of the local government and construction communities, including builders' liens and construction contracts. Prior to joining Civic Legal LLP, Marcela completed a Juris Doctor and a Master of Laws at the Peter A. Allard School of Law at the University of British Columbia. Marcela articled at a civil litigation law firm, where she gained extensive legal experience in advocacy by frequently representing clients in the Supreme Court of British Columbia.