Honest Performance and "Absolutely Everything" Else

Recent Developments in the Canadian Law of Contract

By Ryan P. Krushelnitzky and Sandra L. Corbett QC

Bhasin **and *Sattva* represent important changes and a broadened scope of what Canadian courts expect of parties in terms of contractual performance and interpretation.**

In 2014, the Supreme Court of Canada rendered two decisions relating to the law of contract. Parties doing business in Canada should be aware of these decisions because they have significantly changed how contracts are to be performed and how contracts are to be interpreted in Canada.

In terms of performance, the unanimous *Bhasin v. Hrynew*, 2014 SCC 71, decision identified good faith as an "organizing principle" of the law of contract and created a new duty of honest contractual performance into Canadian contract law.

The law before *Bhasin*, for most Canadian contracts, was that there was no general duty to perform contracts in good faith (except in narrow cases, for example, in contracts of insurance). As such, *Bhasin* represents an important change in how parties are expected by Canadian courts to perform their contractual duties.

In terms of contractual interpretation, the unanimous *Sattva v. Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, decision both clarified and fundamentally changed how Canadian courts interpret contracts. As we will see, *Sattva* has broadened both the scope and the availability of the use of the surrounding circumstances in contract interpretation.

This article explores these changes and the potential that they might have to increase uncertainty and complexity in commercial contractual disputes in Canada and the limitations that could be argued to apply to contain that complexity and uncertainty.

Good Faith and Honest Performance

The *Bhasin* decision involved a dispute related to a "commercial dealership arrangement" governing an education savings plan business. During the course of their dealings, one of the parties lied to the other when it came time to exercise a contractual renewal clause. In doing so, one party effectively expropriated the other party's business, and turned it over to his competitor at the time of contract renewal.

■ Ryan P. Krushelnitzky is an associate and Sandra L. Corbett QC is a partner at Field LLP's Edmonton, Alberta office. Mr. Krushelnitzky's civil litigation practice focuses primarily in construction, product liability, and insurance defense litigation. Ms. Corbett's practice focuses on resolution of complex tort and liability matters in the civil litigation area. She is a past DRI board member (2008-2011) and is both a past board member and past president of Canadian Defence Lawyers.

Bhasin was heard by the Supreme Court of Canada as an appeal from an earlier decision of the Court of Appeal of Alberta. *Bhasin v. Hrynew,* 2013 ABCA 98. There, the Court of Appeal of Alberta disposed of the matter on the basis of what it identified as "fundamental propositions of law" with "much authority" for each. *Id*. at para. 27. In particular, the Court of Appeal of Alberta explained that "there is no duty to perform most contracts in good faith." *Id*. at para. 27.

On appeal, the Supreme Court of Canada used *Bhasin* as an opportunity to make two fairly broad statements about good faith in commercial contractual dealings. First, the Court identified that there was, in general, an "organizing principle of good faith" underlying contractual performance. *Bhasin*, 2014 SCC 71, at para. 63. Second, the Court identified a "general duty of honest contractual performance" as being a specific example of a manifestation of that general duty of good faith. *Id*. at para. 72.

Good Faith as an "Organizing Principle"

Writing for the Court, Justice Cromwell explained that an "organizing principle states in general terms a requirement of justice from which more specific legal doctrines may be derived," rather than a "free-standing rule." *Bhasin,* 2014 SCC 71, at para. 64. As such, there is still no general duty of good faith in Canadian contracts, but rather a principle which

> …manifests itself through the existing doctrines about the types of situations… in which the law requires, in certain respects, honest, candid, forthright or reasonable contractual performance.

Id. at para. 66.

The Court identified those "existing doctrines" where a duty of good faith "manifest[s] itself" as including:

- Contracts expressly requiring cooperation of the parties to achieve their objects;
- Contracts involving the exercise of contractual discretion;
- Situations where a contractual power is used to evade a contractual duty;
- Contracts in the employment context in the narrow sense that the manner of termination must be done in good faith;
- Contracts in the insurance context; and
- Contracts in the tendering/procurement context.

Bhasin, 2014 SCC 71, at paras. 49 to 56.

While "this list is not closed," Justice Cromwell explained that "generally, claims of good faith will not succeed if they do not fall within these existing doctrines." *Id*. at para. 66.

Justice Cromwell did, however, leave the door open to the development of other areas in which the principle of good faith might manifest itself. He held that "the application of the organizing principle of good faith to particular situations should be developed where the existing law is found to be wanting." *Bhasin,* 2014 SCC 71, at para. 66.

The duty of honest performance, created by the Supreme Court of Canada in *Bhasin*, was one of these particular situations in which the law was "found to be wanting."

The Duty of Honest Performance

The Supreme Court of Canada created the duty of honest performance as one of the manifestations of the organizing principle of good faith. This duty of honest performance represents a significant change to the law of contract in Canada.

The duty of honest performance is not an implied term, but rather "a general doctrine of contract law that imposes as a contractual duty a minimum standard of honest contractual performance." *Bhasin,* 2014 SCC 71, at para. 74. As such, it applies to all contracts, and parties are not free to exclude it from their contracts, though they can modify it to some extent depending on the context. *Id*. at paras. 75, 78.

The Court very broadly explained the duty of honest performance, as follows:

1. It "means simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract";
2. It does "not impose a duty of loyalty or of disclosure" or "require a party to forego advantages flowing from the contract"; and
3. It is a "simple requirement not to lie or mislead the other party about one's contractual performance."

Bhasin, 2014 SCC 71, at para. 73.

The "precise content of honest performance will vary with context. *Id*. at para. 77. This leaves open the question of how such a duty will apply to any given situation. However, the Court's general observations about the duty suggest that it is limited to not "actively misleading or deceiving the other contracting party in relation to performance of the contract." *Id*. at para. 87.

Accordingly, this new contractual duty of good faith has essentially imported the tort of deceit into the law of contract, with only a few subtle differences. The Supreme Court of Canada recognized the "similarities with the existing law in relation to civil fraud" but observed that there were some slight differences so that the contractual duty of honest performance is "not subsumed" by the existing law of tort. *Bhasin,* 2014 SCC 71, at para. 88.

On appeal, the Supreme Court of Canada used *Bhasin* as an opportunity to make two fairly broad statements about good faith in commercial contractual dealings.

In particular, breach of the duty of honest performance does not require a party to establish the intent to have the other party rely on the fraudulent statements as is required by the tort. Further, the measure of damages in contract differs from the measures of damages in tort. *Id*. at para. 88.

In any event, the creation of a duty of honest performance represents a significant change to the manner in which contracts are to be performed in Canada. It has created a new duty, which can be breached, even though such a duty is not a term of the contract itself. Parties must be aware of this new duty of honest performance, which imposes obligations relating to performance beyond the terms of a contract itself.

Contractual Interpretation

Bhasin is not the only significant change to the law of contract in 2014; the Supreme Court of Canada also dealt with contractual interpretation in *Sattva*.

Contractual Interpretation Before *Sattva*

Contractual interpretation even before *Sattva* was an exercise in determining intent. What differs after *Sattva* is the enhanced role in which the extrinsic factual matrix—the surrounding circumstances—has to play in the interpretive process.

The leading Canadian case on contractual interpretation before *Sattva* was *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 SCR 129. Writing for the Court, Justice Iacobucci explained that contractual interpretation involved determining the true intent of the parties at the time of entry into the contract. Intent "is to be determined by reference to the words [that the parties] used in drafting the document, *possibly* read in light of the surrounding circumstances which were prevalent at the time." *Id.* at para. 54 (emphasis added).

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As to what made up those surrounding circumstances, Justice Iacobucci was careful to hold that "one party's subjective intention has no independent place in this determination." *Id.* at para. 54. And about when the surrounding circumstances could be referenced, Justice Iacobucci explained that if the language in an agreement was "clear and unambiguous on its face" it would be "unnecessary to consider any extrinsic evidence." *Id.* at para. 55.

Simply put, " to interpret a plainly worded document in accordance with the true contractual intent of the parties is not difficult, if it is presumed that the parties intended the legal consequences of their words." *Id.* at para. 56.

In Canada, by 1998, *Eli Lilly* supported the conclusion that absent ambiguity, "no further interpretive aids are necessary" besides reference to the words used by the parties upon reading the contract as a whole. This conclusion was supported as recently as 2010 in the Supreme Court of Canada's *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, [2010] 2 SCR 245 decision.

Writing for the Court in *Progressive Homes,* Justice Rothstein dealt with the interpretation of a number of commercial liability insurance policies. Despite being a decision about insurance contracts, Justice Rothstein's observations about how to interpret contracts were consistent with the Court's earlier direction in *Eli Lilly,* which dealt with the interpretation of contracts in general. Justice Rothstein identified a two-step process for the interpretation of insurance contracts. As to the first step, he held "The primary interpretive principle is that when the language of the policy is unambiguous, the court should give effect to clear language, reading the contract as a whole." *Id.* at para. 22.

As to the second step, Justice Rothstein went on to explain that in the face of ambiguity, courts will move on to "rely on general rules of contract construction." *Id.* at para. 23. These rules include interpretations that are consistent with the reasonable expectations of the parties, that avoid unrealistic results, and that ensure that similar policies are construed consistently. *Id.* at para. 23. The rules of construction are "applied to resolve ambiguity," and "do not operate to create ambiguity where there is none in the first place." *Id.*

As of 2010, Supreme Court of Canada jurisprudence continued to support an interpretive process by which courts first focused on the clear language of a contract, read as a whole, to arrive at the intention of the parties. In some circumstances, when faced with ambiguity, the courts could reference the "surrounding circumstances which were prevalent at the time." *Eli Lilly,* [1998] 2 SCR 129 at para. 54. However, reference to that factual matrix appeared limited to cases of ambiguity, rather than as a matter of course.

This is the same interpretive process described by one of the leading Canadian authorities on building contracts: "Evidence of surrounding circumstances *may only be used to clarify any ambiguities or uncertainties.*" Thomas G. Heintzman and Immanuel Goldsmith, *Heintzman and Goldsmith on Canadian Building Contracts*, 5th ed., at 2-15 (Toronto, Carswell, 2014 loose leaf)) (emphasis added).

Nevertheless, there remained uncertainty and inconsistency in how appellate courts across Canada dealt with the factual matrix, and when the factual matrix could be considered—only if there was ambiguity, or at all times.

For example, in Alberta, there was indication that consideration of the factual matrix did not require ambiguity. In *Western Irrigation District v. Alberta*, 2002 ABCA 200, the Alberta Court of Appeal held that "precedents are of limited value when interpreting contracts" as "the plain and ordinary meaning of each contract must be assessed in its own context with a focus on the intention of the parties." *Id.* at para. 29.

Similarly, the British Columbia Court of Appeal explained that the interpretation of agreements required the consideration of the "factual matrix in which they were intended to operate… in every case." *Jacobson v. Bergman*, 2002 BCCA 102 at para. 4.

Conversely, the Ontario Court of Appeal held with respect to the interpretation of a policy of insurance that "where an insurance policy is ambiguous, the court should adopt the interpretation that gives effect to the reasonable expectations or intentions of the parties.…" *Dunn v. Chubb Insurance Company of Canada*, 2009 ONCA 538 at para. 35.

However, two years previously, that same court of appeal held: "A consideration of the context in which the written agreement was made is an integral part of the interpretative process and is not something that is resorted to only where the words viewed in isolation suggest some ambiguity." *Dumbrell v. The Regional Group of Companies Inc.*, 2007 ONCA 59 at para. 54.

It is fair to say that in the years before *Sattva*, there was some uncertainty about exactly when the surrounding circumstances ought to be considered in the interpretive process. The Supreme Court's jurisprudence suggested that if an agreement was "clear and unambiguous on its face," it would be "unnecessary to consider any extrinsic evidence." *Eli Lilly,* [1998] 2 SCR 129 at para. 55. But certain appellate

decisions suggested that the surrounding circumstances ought to be considered on all occasions.

Contractual Interpretation According to *Sattva*

In *Sattva*, Justice Rothstein, once again writing for the Court, took the opportunity to clarify how Canadian courts ought to interpret contracts—this time in the context of a commercial rather than insurance agreement (as was the case in *Progressive Homes*).

To some extent, *Sattva* is consistent with the Court's earlier jurisprudence in that the Court reaffirmed "the goal of the exercise is to ascertain the objective intent of the parties—a fact specific-goal—through the application of legal principles of interpretation." *Sattva,* 2014 SCC 53 at para. 49. Justice Rothstein explained that the interpretation of contracts ought to be a "practical, common-sense approach not dominated by technical rules of construction." *Id*. at para. 47.

However, *Sattva* also expanded the role of the surrounding circumstances beyond the role earlier provided for them in *Eli Lilly* and *Progressive Homes*.

The Court also changed how questions of contractual interpretation are to be dealt with on appeal. Contractual interpretation is now a question of mixed fact and law, rather than a question of pure law, with different standards of review. That aspect of the *Sattva* decision is not dealt with in this article.

Justice Rothstein explained that the "consideration of the surrounding circumstances recognizes that ascertaining contractual intention can be difficult when looking at words on their own, because words alone do not have an immutable or absolute meaning." *Sattva,* 2014 SCC 53 para. 47. Rather than being used only in cases of ambiguity, the factual matrix could be used as a matter of course to "deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract." *Id*. at para. 57).

The interpretive process was described as follows by Justice Rothstein:

> The overriding concern is to determine "the intent of the parties and the scope of their understanding"… To do so, a decision-maker must read the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract.

Id. at para. 47.

Importantly, Justice Rothstein did not place any qualifications or limitations on when the surrounding circumstances ought to be referenced. The Court appears to have rejected its earlier requirement for ambiguity. The surrounding circumstances can now be referred to, even in the absence of ambiguity.

Therefore, in a post-*Sattva* world, the interpretive process is different from that set out by *Eli Lilly*, where if an agreement was "clear and unambiguous on its face" it would be "unnecessary to consider any extrinsic evidence." *Eli Lilly,* [1998] 2 SCR 129 at para. 55. The post-*Sattva* interpretive process as explained by Justice Rothstein is also different from the process that he described in *Progressive Homes*, which directed that ambiguity was necessary prior to considering the reasonable expectations of the parties. Now, even in the absence of ambiguity, the surrounding circumstances, which demonstrate those expectations, are to be considered.

Post-*Sattva*, the factual matrix now takes on a much more significant role in the interpretation of agreements. But what exactly are the surrounding circumstances that make up this factual matrix?

The Definition of the Factual Matrix

Justice Rothstein held that the factual matrix will "vary from case to case." *Sattva,* 2014 SCC 53 at para. 58. He also explained that the factual matrix was limited to only "objective evidence of the background facts at the time of the execution of the contract." *Id*. at 58. That is, the factual matrix consists of "knowledge that was or reasonably ought to have been within the knowledge of both parties at or before the date of contracting." *Id*. at 58.

However, and of great importance, Justice Rothstein's decision references the seminal English House of Lords decision *Investors Compensation Scheme Ltd. v. West Bromwich Building Society*, [1998] 1 All E.R. 98 (H.L.). Justice Rothstein adopted Lord Hoffman's holding in *Investors Compensation Scheme,* which defined the surrounding circumstances as "*absolutely anything* which would have affected the way in which the language of the document would have been understood by a reasonable man." *Id*. at p. 114. (emphasis added).

Sattva is the first time the Supreme Court of Canada has referenced this important English decision. Notably, the Court did not rely, or even refer to *Investors Compensation Scheme*, in *Eli Lilly*, when it clarified the then-approach to contractual interpretation. The Court's reference and adoption of Lord Hoffman's holding in *Sattva*, therefore, signals a significant development in the law of contract in Canada.

Post-*Sattva*, the factual matrix now takes on a much more significant role in the interpretation of agreements. But what exactly are the surrounding circumstances that make up this factual matrix?

Before *Sattva*, *Investors Compensation Scheme* was not part of the law of contract in Canada. Its potential to affect commercial disputes negatively had been the subject of earlier scholarly opinion. One Canadian commentator called *Investors Compensation Scheme* a "revolutionary expansion of the factual matrix rule" with the potential to increase "uncertainty and cost associated with litigation." Ronald Podolny, *A Pragmatic Approach to Contractual Interpretation*, 55 C.B.L.J. 428 (2014).

Another warned that the expansive approach to the factual matrix set out in *Investors Compensation Scheme* would "add to the length and complexity of proceedings" and was "not desirable." Geoff Hall, *A Curious Incident in the Law of Con-*

tract: The Impact of 22 Words from the House of Lords,, 40 C.B.L.J. 20 (2004).

Limitations on the Scope of the Factual Matrix

Despite the potentially expansive scope of the factual matrix created by *Investors Compensation Scheme*, Justice Rothstein did expressly draw some boundaries around the "absolutely anything" box. These boundaries will likely operate to contain the potentially expansive nature of the *Investors Compensation Scheme* definition of the surrounding circumstances.

The newly enhanced emphasis on the surrounding circumstances has the potential to add to the scope of the type of relevant and material evidence that could come into play in the interpretive process.

First, Justice Rothstein stressed the importance of the text of the agreement in comparison to the factual matrix. The surrounding circumstances "must never be allowed to overwhelm the words" of the agreement. *Sattva,* 2014 SCC 53 at para. 57. Further, the factual matrix cannot be used to "deviate from the text such that the court effectively creates a new agreement." *Id*. at para. 57).

For very plainly worded, unambiguous agreements, the *Eli Lilly* direction that the parties are presumed to have "intended the legal consequences of their words" arguably still applies. *Eli Lilly*, [1998] 2 SCR 129 at para. 56. That is, for plainly worded, unambiguous agreements, while the factual matrix may still capable of providing deeper understanding, *Sattva,* 2014 SCC 53 at para. 57, such a deeper understanding may not be necessary to clarify the meaning of a plain and unambiguous contract.

Second, Justice Rothstein further limited the scope of the factual matrix by expressly stating that any such evidence must be limited to evidence of the objective, and not subjective, intentions of the parties. The parol evidence rule would function to preclude, "among other things, evidence of the subjective intentions of the parties." *Id*. at para. 59.

Justice Rothstein emphasized the objective nature of the surrounding circumstances in the part of his reasons discussing the parol evidence rule. The parol evidence rule "precludes admission of evidence outside the words of the written contract that would add to, subtract from, vary, or contradict a contract that has been wholly reduced to writing." *Id*. at para. 59.

Interestingly, before *Sattva*, a strong argument could be made that the objective surrounding circumstances, as "evidence outside the words of the written contract," ought to have been inadmissible absent ambiguity under the parol evidence rule. This argument would have been consistent with the interpretive process described by *Eli Lilly,* [1998] 2 SCR 129 at para. 54. *Sattva*, therefore, can also be seen to be creating a new exception to the parol evidence rule itself, in that the objective factual matrix is no longer precluded by the parol evidence rule.

However, the Court did not appear to recognize this change. Rather, Justice Rothstein explained that evidence of the objective surrounding circumstances accords with the purposes of the parol evidence rule. That is, it is "consistent with the objectives of finality and certainty because it is used as an interpretive aid for determining the meaning of the written words… not to change or overrule the meaning of those words." *Sattva,* 2014 SCC 53 at para. 60.

As such, the scope of the factual matrix is limited to evidence showing the objective intentions of the parties, rather than the subjective intentions of the parties.

The above limitations should create the potential to impose boundaries on an extremely expansive *Investors Compensation Scheme* factual matrix. But only time will tell as *Sattva* is applied and interpreted by arbitrators, trial, and appellate courts across the country.

The Factual Matrix in a Commercial Dispute

Commercial disputes are often complex and document heavy. The newly enhanced emphasis on the surrounding circumstances has the potential to add to the scope of the type of relevant and material evidence that could come into play in the interpretive process. *Sattva*, and other Canadian courts decisions before *Sattva*, have provided some direction in terms of the types of information that could make up the factual matrix.

As will now be explored, based on this direction, the type of information that could make up the factual matrix in a commercial contract dispute might include following.

The Purpose of the Agreement

Sattva identifies the purpose of the agreement as one of the surrounding circumstances. 2014 SCC 53 at para. 48. This will entail an examination of the background, context, and market in which the parties are operating, and the reason for the contract in the first place. *E.g.*, *Kentucky Fried Chicken Canada v. Scott's Food Services Inc.* (1998), 41 BLR (2d) 42 (Ont C.A.) at para. 25, approving *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen*, [1976] 1 W.L.R. 989 at 995-96 (H.L.).

For example, with a building contract, this could include information about the reasons behind a particular project. What is being built? Why is it being built? Who is it being ultimately built for? What is the end use for the project? Does the project contemplate field construction or offsite fabrication?

Another example is a subcontract. There, the surrounding circumstances related to the purpose could include information about the contractual relationship between the parties to the prime contract. The relationship between the prime contractor and other subcontractors could also be argued to shed light on the purpose of the particular activity contemplated under a subcontract by comparison.

The Genesis of the Transaction

Another surrounding circumstance is knowledge about the genesis of the transaction. *Kentucky Fried Chicken,* (1998), 41 BLR (2d) 42 (Ont C.A.) at para. 25, *approv-*

ing Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen, [1976] 1 W.L.R. 989 at 995-96 (H.L.)).

Parties to a commercial dispute might argue that previous drafts of a contract in dispute are part of the factual matrix. Whether or not a previous draft is part of the factual matrix will likely turn on the purpose to which the draft will be used in the interpretive process.

For example, if a previous draft was being used as evidence of the subjective intentions of the parties, it would likely not be part of the factual matrix. Such evidence would run afoul of the parol evidence rule and would not accord with *Sattva*'s direction that the interpretive process is based on ascertaining the "objective intent" on the parties. 2014 SCC 53 at para. 49. An example of previous drafts not being admitted is found In *Kentucky Fried Chicken*. There, the Ontario Court of Appeal agreed with trial judge's approach, which held that various draft documents were evidence of subjective intentions and not part of the factual matrix. *Kentucky Fried Chicken,* (1998), 41 BLR (2d) 42 (Ont C.A.), at para. 24.

However, before *Sattva,* appellate courts were not always consistent on this point. For example, in *A.G. Clark Holdings v. HOOPP Realty Inc*., 2013 ABCA 101, the Court of Appeal of Alberta made use of "drafting history" as "the best evidence available… concerning the parties' reasonable expectation" concerning a dispute resolution clause in a written construction contract. *Id*. at para. 27. The court of appeal's reference to drafting history, however, was made after it expressly referred to an assumption that the language was ambiguous. As a result, someone could argue that the court of appeal's reliance on drafting history in the face of an ambiguity was consistent with the parol evidence rule's requirement for ambiguity.

On the other hand, an argument could be made that previous drafts could be admissible not for illustrating the subjective intent of the parties, but rather to show the commercial objectives of the parties. John D. McCamus, *The Law of Contracts*, 2nd ed., at 755 (Toronto, Irwin Law Inc. 2012). In such a case, the argument would be that the previous drafts are objective evidence of how the commercial goals that the parties had in mind were going to be achieved, and would permit an inference to be drawn about what those objectives might have been.

The same type of reasoning would likely apply to the admission of pre-contractual correspondence between parties dealing with their contractual negotiations. Such correspondence would not be part of the factual matrix if it was to be used to show the subjective intentions of the parties, but it would be part of the factual matrix if it was used to illustrate the genesis of the transaction.

Nature of the Relationship

The nature of the relationship created by the agreement is another surrounding circumstance identified by *Sattva,* 2014 SCC 53 at para. 48.

In *Bhasin*, the Supreme Court of Canada explained that "considerations of good faith" can also inform the interpretative process. Good faith, therefore, is an aspect of the nature of the relationship between the parties. That is, parties can "generally be assumed to intend certain minimum standards of conduct" governing their relationship. *Bhasin,* 2014 SCC 71 at para. 45.

The level of sophistication and experience of the parties to the agreement, including their business history, has also been identified as one of the surrounding circumstances related to the relationship between the parties. *Dumbrell,* 2007 ONCA 59 at paras. 57, 59. This could allow one party to argue that evidence relating to the other's prior experiences with similar types of projects is relevant and material to the interpretive process. The manner in which parties dealt with similar subject matter in past dealings with one another could also be argued to be relevant and material to the interpretive process.

Other Similar Subject Contracts

Another surrounding circumstance could be information related to contractual relationships between one of the parties and others which dealt with similar subject matter. For example, in *Kentucky Fried Chicken,* the Ontario Court of Appeal upheld a trial judge's use of "license agreements between the respondent and other franchisees in Canada" to interpret a license agreement between two litigants. (1998), 41 BLR (2d) 42 (Ont C.A.) at para. 24.

In a commercial dispute, this has the potential for parties to argue that related contracts—such as those dealing with previous, but similar, projects, between one or both of the parties—can be used in the interpretive process.

Other Objective Evidence

As the surrounding circumstances will by necessity be fact and context specific, they could include any other objective evidence of the background facts at the time of contract execution. *Sattva,* 2014 SCC 53 at para. 58. In the context of a commercial dispute, these could include industry standards, codes, custom, and the meaning of certain terms commonly as understood by a particular industry. For example, in *Kentucky Fried Chicken*, the Ontario Court of Appeal upheld a trial judge's use of custom of the industry in the interpretive process.

A factual matrix will "vary from case to case" and can include "absolutely anything" that has the potential to add greatly to the scope of discoverable information, and add complexity and cost to what is already a costly and complex process. The above are illustrations of how broad the factual matrix could be in a dispute relating to the interpretation of a commercial contract.

Nevertheless, *Sattva* placed limits on the factual mix: the surrounding circumstances must "never be allowed to overwhelm the words" of an agreement, 2014 SCC 53 at para. 57; and (2) the focus is on objective rather than subjective intentions, *id*. at para. 59.

As such, the more clearly worded and unambiguous a document is, the less likely it will be that a very broadly defined surrounding circumstance will be necessary or material to the interpretative process.

Conclusions

The Supreme Court of Canada's *Bhasin* and *Sattva* decisions have resulted in significant changes to the manner in which contracts are to be performed, and the manner in which contracts are to be interpreted in Canada. Parties doing business in Canada are well advised to familiarize themselves with these changes to the law of Canadian contract.

Honest Performance and Good Faith

"Good faith" has now been identified as an organizing principle, which will manifest itself in various preexisting contractual doctrines, as well as some that still may develop.

In addition, the Supreme Court has identified the new duty of honest performance as a manifestation of that organizing principle of good faith. Active dishonesty is now actionable as a breach of contract if damages can be proved to have been caused by that dishonesty. In that regard, *Bhasin's* duty of honest performance is a significant change in that it imposes a minimum standard on parties that they do not actively deceive each other—a standard, which, unusually, before *Bhasin,* did not exist in Canadian contract law.

Parties to Canadian contracts can now benefit from this new duty of honest performance in that they can expect certain minimum standards of conduct from their contractual partners. *Bhasin* has also created the opportunity for parties to argue that a more comprehensive duty of good faith such as that found in the American Uniform Commercial Code should develop in Canadian law.

However, the Court's broad statements about good faith as an "organizing principle," apart from leaving the door open for creative arguments in future disputes, gives little practical direction in terms of how the law in this area will develop. *Bhasin's* focus on context, and its generality, also give rise to significant uncertainty as to exactly how good-faith and honest performance apply to any given contractual dispute. And with that uncertainty comes added litigation cost and added litigation risk.

Contractual Interpretation

Contractual interpretation in Canada has traditionally involved determining the objective intentions of the parties at the time of contract formation. Before *Sattva*, the Supreme Court of Canada's jurisprudence suggested that the interpretive process was focused on the clear language of a contract, read as a whole. While context was important, the "surrounding circumstances [were] only [to] be used to clarify any ambiguities or uncertainties." Thomas G. Heintzman and Immanuel Goldsmith, *Heintzman and Goldsmith on Canadian Building Contracts*, 5th ed., at 2-15 (Toronto, Carswell, 2014 loose leaf).

Sattva has expanded the role in which the surrounding circumstances are to be used in the interpretive process. They are now to be used in all cases to "deepen a decision-maker's understanding of the mutual and objective intentions of the parties." *Sattva,* 2014 SCC 53 at para. 57. While the surrounding circumstances will necessarily "vary from case to case," the Court has explained that they can include "absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable [person]." *Id*. at para. 58.

Parties can benefit from *Sattva* in that it expands the scope of discovery and can provide them with more information in which to establish intent. A party that would have previously suffered from harsh contractual language, standing on its own, may now have the opportunity to rely on other surrounding circumstances to show that the parties intended a different outcome.

On the other hand, the "absolutely anything" definition is based on the "revolutionary expansion of the factual matrix rule" from *Investors Compensation Scheme*, Ronald Podolny, *A Pragmatic Approach to Contractual Interpretation*, 55 C.B.L.J. 428 (2014). In adopting that definition, *Sattva* has the potential to greatly increase the scope, uncertainty and complexity of all Canadian contract disputes. And with increased scope, uncertainty, and complexity comes added litigation cost and added litigation risk.

Nevertheless, the potentially expansive scope of the surrounding circumstances does have its limits. Justice Rothstein was careful to hold that the surrounding circumstances cannot ever "overwhelm the words" of an agreement, and that the surrounding circumstances are limited to showing objective intentions, not subjective intentions.