

TOWARD A FRAMEWORK TO DEFINE THE OUTER BOUNDARIES OF GOOD FAITH IN CONTRACTUAL PERFORMANCE

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Since Bhasin v. Hynnew, the application of good faith in contract law has varied and its outer boundaries have been unclear. To understand the variance in judicial applications of good faith, this article offers a framework that both explains judicial tendencies and prescribes a template for judges to justify differing approaches. The proposed framework distils the application of good faith to the interaction between institutional variables (the factors that determine judicial reasoning) and transactional variables (factors that arise from the context in which the contract arises). The article develops a taxonomy of the various alternative ways of approaching the doctrine of good faith resulting from the overlap of two institutional variables, the possible functions that good faith may serve and the criteria that inform the prescriptive content of good faith. The article then demonstrates how transactional variables inform the types of institutional variables a judge employs. Two cases that were recently decided by the Supreme Court of Canada demonstrate that by explicitly adhering to the proposed framework, judges can be more transparent about how and why they employ good faith in differing contexts.

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I. INTRODUCTION

In *Bhasin v. Hrynew*, the Supreme Court of Canada acknowledged good faith as a “general organizing principle” of contractual performance at common law.¹ The Supreme Court’s purported intent was “to make the common law less unsettled and piecemeal, more coherent and more just.”² However, *Bhasin* did not provide a comprehensive definition of good faith, nor did it outline the precise ambit of operation of the newly recognized organizing principle.³ According to the Supreme Court, the good faith principle states, “parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily.”⁴ The Supreme Court adds, “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,”⁵ which often “merely requires that a party not seek to undermine those interests in bad faith.”⁶ These definitions hinge on largely undetermined terms, such as “appropriate regard,” and “legitimate contractual interests,” thereby generating uncertainty regarding the outer boundaries of good faith.

Bhasin recognized four distinct duties that manifest a general organizing principle of good faith: a duty of co-operation between the parties to achieve the objects of the contract;⁷ a duty to exercise contractual discretion in good faith;⁸ a duty not to evade contractual obligations in bad faith;⁹ and a duty of honest performance.¹⁰ In addition, the Supreme Court emphasized that “[c]onsiderations of good faith are apparent” in the process of contractual interpretation, in the law of implied terms, and in the doctrine of unconscionability.¹¹ Although the Supreme Court stresses that all instances in which a duty of good faith has arisen constitute specific manifestations of the same overarching concept, it makes no attempt to explain *what* the unifying elements underpinning the instances in which good faith arises *are*. Moreover, it does not clarify *how* these factors help define the substantive content of various contract rules and doctrines informed by good faith.¹² As a number of contract doctrines, with the central organizing concept being that of good faith, have been unified, the task now is to provide coherence to the general organizing principle of good faith, if it is to be organizing in any meaningful sense. Without this further theoretical step, a group of formally discrete but functionally similar rules might be exchanged for largely subjective and highly idiosyncratic ad hoc elements.

¹ 2014 SCC 71 at para 33 [*Bhasin*].

² *Ibid.*

³ See Geoff R Hall, “*Bhasin v Hrynew*: Towards an Organizing Principle of Good Faith in Contract Law” (2015) 30:2 BFLR 335 (“*Bhasin* deliberately made no effort to define the outer limits of the organizing principle” at 335); Peter Roy Cotton-O’Brien, “Unpacking the Meaning of Good Faith in *Bhasin v. Hrynew*” (2018) 48:4 Adv Q 473 (“the Supreme Court’s understanding of good faith is opaque and lacks intelligible boundaries” at 473).

⁴ *Bhasin*, *supra* note 1 at para 63.

⁵ *Ibid* at para 65.

⁶ *Ibid.*

⁷ *Ibid* at para 49.

⁸ *Ibid* at para 50.

⁹ *Ibid* at para 51.

¹⁰ *Ibid* at para 73.

¹¹ *Ibid* at paras 43–45.

¹² See Hall, *supra* note 3 (“the new organizing principle incorporates existing law, but as already noted that law ... has not become any less chaotic just because a new label has been attached to it” at 341).

In addition to justifying existing contract rules, the general organizing principle of good faith provides the basis for the judicial promulgation of new contract rules or elements.¹³ In recognizing this expansive role, the Supreme Court aims to provide lower courts with a structured, logically consistent process for evaluating good faith claims arising *outside* the scope of existing doctrines. Justice Cromwell defines a three-step process.¹⁴ Courts should first determine whether the issue falls within existing doctrines. If the situation lies outside the recognized rules, courts must decide whether a new doctrine should be derived as a manifestation of the general organizing principle. If a new doctrine is created, the court should define its substantive content. However, despite its attempt to articulate a clear analytic process for creating new contract rules, *Bhasin*'s conceptualization adds uncertainty to the outer boundaries of good faith. The extent to which judges can extend the implications of the principle is ultimately unclear. It is therefore not surprising that after *Bhasin*, it is standard practice among litigants to attempt to expand the principle of good faith to a diverse range of circumstances of perceived unfairness between contracting parties.¹⁵

In two recent decisions, the Supreme Court of Canada has revisited and clarified two important and most frequently applied good faith doctrines: (1) the duty of honesty in contract performance, and (2) the duty to exercise contractual discretion in good faith. In *C.M. Callow Inc. v. Zollinger*, the Supreme Court expanded the duty of honesty by holding that this duty “applies to the performance of all contracts and, by extension, to all contractual obligations and rights.”¹⁶ A divided majority found that “no contractual right can be exercised in a dishonest manner because, pursuant to *Bhasin*, that would be contrary to an imperative requirement of good faith.”¹⁷ The *Callow* majority held that the duty of honest performance requires that parties not mislead one another in the performance of their contractual obligations — that is, when a party to a contract is aware that its conduct has created a misapprehension in the counterparty’s mind in relation to the performance of an obligation or the exercise of a right under a contract, the duty of honesty requires that party to correct it. The majority addressed the concern that an overly expansive approach to honest contractual performance may lead to commercial uncertainty by insisting throughout the decision that the scope of the duty of honesty is controlled by its direct *link* to the performance of the terms of a contract;¹⁸ however, as is discussed in greater detail, the *Callow* Court’s incomplete conceptualization of the scope of the duty of honesty is likely to inject further uncertainty into the common law of good faith in contractual performance.

In *Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage District*, the Supreme Court of Canada explored a different manifestation of the general organizing principle of good faith, namely, the extent to which good faith constrains the exercise of

¹³ See *Bhasin*, *supra* note 1 at para 66.

¹⁴ *Ibid.* See also Manasvin Goswami, “Coherence and Consistency in a System of Good Faith: Assessing and Explaining the Impact of *Bhasin v. Hrynew* on Canadian Contract Law” (2017) 77 SCLR (2d) 309 at 334.

¹⁵ See David Percy & Douglas Stollery, “Justice Jean E.L. Côté, the Court of Appeal, and the Changing Nature of Contract Law” (2019) 56:4 Alta L Rev 1263 (“as any contract litigator will attest, the breach of the duty of good faith performance is alleged daily in contract cases, sometimes by both sides” at 1271).

¹⁶ 2020 SCC 45 at para 53 [*Callow* SCC].

¹⁷ *Ibid.* at para 54.

¹⁸ *Ibid.* at paras 44, 49, 51, 63–67, 73–74.

discretionary powers under the contract.¹⁹ The *Wastech* Court formally recognized “the duty to exercise discretion in good faith as a general doctrine of contract law” that flows directly from the general organizing principle stated in *Bhasin*.²⁰ This duty requires contracting parties to exercise discretion “reasonably”²¹ — that is, “in a manner consistent with the purposes for which [discretion] was granted in the contract.”²² Thus, contractual discretion is exercised unreasonably when the parties’ discretionary choices are “capricious or arbitrary,”²³ as they fall outside the range of behaviour contemplated by the parties in the contract.²⁴ However, as is discussed throughout this article, the way *Wastech* conceptualizes the content and the source of the general duty of good faith in the exercise of discretionary power raises questions concerning the outer boundaries of the courts’ power to scrutinize the parties’ exercise of discretionary power beyond mere breaches of express terms.

Taken together, the Supreme Court’s decisions in *Wastech* and *Callow* confirm that the general organizing principle of good faith stated in *Bhasin*, along with the good faith doctrines that derive from it, is central to contract law. At the same time, however, these decisions highlight the legal uncertainties following from *Bhasin* and emphasize the pressing need to clarify the extent to which the doctrines stated by the Supreme Court to be grounded on the general principle of good faith can be applied to qualify, supplement, or correct the formal terms of the contract. The uncertainty surrounding the outer boundaries of good faith has been further highlighted by contrasting decisions by post-*Bhasin* lower courts over the issue of whether, and to what extent, good faith can modify, supplement or qualify a bargained-for contractual right.²⁵

The uncertainty in the case law is paralleled by diverging interpretations within scholarly debate. Scholars’ attitudes can be grouped into two broad categories: restrained and expansionist approaches.²⁶ *Restrained* approaches attempt to read and contain *Bhasin* within the narrow scope traditionally attributed to good faith in the Anglo-Canadian common law tradition. For example, *Bhasin* “articulates a light version of a good faith principle” and as such “poses no danger” to the common law tradition.²⁷ Krish Maharaj suggests, “some classification other than ‘contract’” must be found for the duty of honest performance (which stems from good faith), “if we are to avoid having the doctrine inflict a calamity on our understanding of the law of obligations.”²⁸ One commentator went as far as to argue, “the

¹⁹ 2021 SCC 7 [*Wastech* SCC].

²⁰ *Ibid* at para 91.

²¹ *Ibid* at para 63.

²² *Ibid*.

²³ *Ibid* at para 88.

²⁴ *Ibid*.

²⁵ *Styles v Alberta Investment Management Corporation*, 2017 ABCA 1 [*Styles*] (declining to utilize the organizing principle of good faith to impose constraints on the parties’ discretionary power to terminate the contract); *Mohamed v Information Systems Architects Inc*, 2018 ONCA 428 [*Mohamed* ONCA] (applying the good faith principle to impose the duty on the exercise of the facially unfettered right to terminate the contract).

²⁶ Enman-Beech identifies three strategies used in the scholarly and jurisprudential debate surrounding the emerging principle of good faith within common law jurisdictions: avoidance, containment, and embrace. John Enman-Beech, “The Good Faith Challenge” (2019) 1:1 J Commonwealth L 35 at 36. What I call the restrained approach largely corresponds to what Enman-Beech refers to as “containment” strategies; what I call expansionist approaches overlaps with what he calls “embracing” strategies.

²⁷ Hector MacQueen & Shannon O’Byrne, “The Principle of Good Faith in Contractual Performance: A Scottish-Canadian Comparison” (2019) 23:3 Ed L Rev 301 at 327.

²⁸ Krish Maharaj, “An Action on the Equities: Re-Characterizing *Bhasin* as Equitable Estoppel” (2017) 55:1 Alta L Rev 199 at 205.

Bhasin decision in fact does *not*, or at any rate does not *yet*,” import a general duty of good faith into Canadian contract law.²⁹ On the other hand, *expansionist* strategies embrace the idea of good faith as a general principle of the common law of contract.³⁰ From this perspective, *Bhasin* shifts the Canadian common law of contract away from adversarial or individualistic ethics toward co-operation and a greater focus on the relational dimensions of contract.³¹ Along these lines, a few commentators emphasize the structural similarity between *Bhasin*’s conceptualization and the civilian approach to good faith.³²

Restrained and expansionist approaches capture, respectively, the challenges and opportunities associated with the recognition of a general organizing principle of good faith. Restrained approaches express legitimate concerns about its negative implications in terms of undermined contractual freedom and reduced legal certainty, while expansionist approaches highlight potential gains in terms of enhanced fairness and normative accuracy of adjudicative outcomes. The values that underpin both strategies are viable, and any attempt to precisely delimit the good faith principle must ultimately strike a fine balance between them. What is often missing in both approaches is a *unified* and comprehensive explanation of how the general principle of good faith is organized in different situational contexts. The marked divergence between restrained and expansionist approaches often traces back to the incomplete nature of their analytical assumptions, rather than their mutually exclusive axiological priorities. In short, both approaches are single-institutional:³³ they focus on defining *one* conceptualization of good faith, while overlooking the fact that the good faith principle is conceptualized in *Bhasin* as a *variable* whose meaning is contextual and tied to the relationship or situation within which it is to be applied. The Supreme Court of Canada states:

Good faith may be invoked in widely varying contexts and this calls for a highly context-specific understanding of what honesty and reasonableness in performance require so as to give appropriate consideration to the legitimate interests of both contracting parties. For example, the general organizing principle of good faith would likely have different implications in the context of a long-term contract of mutual cooperation than it would in a more transactional exchange.³⁴

²⁹ Catherine Valcke, “*Bhasin v Hrynew*: Why a General Duty of Good Faith Would Be Out of Place in English Canadian Contract Law” (2019) 1:1 J Commonwealth L 65 at 67.

³⁰ See Jacob Young, “Justice Beneath the Palms: *Bhasin v. Hrynew* and the Role of Good Faith in Canadian Contract Law” (2016) 79:1 Sask L Rev 79; Daniele Bertolini, “Decomposing *Bhasin v Hrynew*: Towards an Institutional Understanding of the General Organizing Principle of Good Faith in Contractual Performance” (2017) 67:3 UTLJ 348 [Bertolini, “Decomposing *Bhasin*”]; John Enman-Beech, “Good Faith between Public and Private” (2018) 84 SCLR (2d) 353; Cotton-O’Brien, *supra* note 3.

³¹ On the distinction between the ethics underlying different good faith regimes, see Roger Brownsword, “Two Concepts of Good Faith” (1994) 7 J Contract L 197 at 208–18 [Brownsword, “Concepts”]; Roger Brownsword, “Good Faith in Contracts’ Revisited” (1996) 49:1 Current Leg Probs 111 at 132–51 [Brownsword, “Good Faith”]; Roger Brownsword, “After *Investors*: Interpretation, Expectation and the Implicit Dimension of the ‘New Contextualism’” in David Campbell, Hugh Collins & John Wightman, eds, *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (Oxford: Hart, 2003) 103 at 124–33 [Brownsword, “After *Investors*”].

³² See e.g., Young, *supra* note 30 at 79–80; Bertolini, “Decomposing *Bhasin*,” *supra* note 30 at 366; Nicholas Reynolds, “Two Views of the Cathedral: Civilian Approaches, Reasonable Expectations, and the Puzzle of Good Faith’s Past and Future” (2019) 44:2 Queen’s LJ 388 at 390–97.

³³ For a methodological discussion of single-institutional and comparative institutional analysis, see Neil K. Komesar, *Imperfect Alternatives: Choosing Institutions in Law, Economics, and Public Policy* (Chicago: University of Chicago Press, 1994).

³⁴ *Bhasin*, *supra* note 1 at para 69 [citations omitted].

The Supreme Court's decisions in *Wastech* and *Callow* confirm the highly contextual nature of both the duty of good faith in the exercise of contractual discretion³⁵ and the duty of honesty in contractual performance,³⁶ respectively.

Despite this emphasis on the contextual nature of good faith by the Supreme Court, courts and legal scholars have not yet developed a framework offering a rationalization of the various possible ways of structuring the role and the content of good faith. Restrained and expansionist approaches fail to incorporate the institutional pluralism necessary to implement the general principle of good faith. Due to their single-institutional methodology, both tend to overgeneralize their conclusions by not connecting their prescriptive propositions to the specific features of the varying transactional settings within which good faith applies. I argue the legitimate concerns underlying both restrained and expansionist strategies can be reconciled, to a significant extent, by systematically inserting into the legal reasoning an inquiry into the relationship between different versions of good faith and changing transactional settings. Much of what is written about the general organizing principle of good faith stated in *Bhasin*, as well as the jurisprudential debate, proceeds from the assumption that only one of two approaches is a viable alternative. Given the complexity of contractual relationships, however, this binary divide is inevitably too crude to capture the full range of contractual settings. Common law must construct a richer apparatus of classification, so that alternative versions of good faith can be applied in different transactional contexts. It then becomes possible to formulate more nuanced propositions concerning the outer boundaries of good faith, thereby overcoming the rigid contraposition between restrained and expansionist approaches. Rather than resisting or opposing the recognition of a general principle of good faith, or embracing it without articulating its mode of operation across varying contexts, the aim of this article is to provide methodological guidelines for *operationalizing* the organizing principle of good faith stated in *Bhasin*; by clarifying how this principle may serve as a powerful tool for understanding and rationalizing the law of contract, this article will thereby increase transparency in judicial decision-making and improve legal certainty.

The idea that the scope and mode of operation of good faith changes across transactional settings is hardly a novel insight. Several commentators note that the incidence of good faith duties may vary as a function of the characteristics of the transactional settings in which good faith is applied.³⁷ Other scholars have convincingly demonstrated that judges use different versions of good faith to reflect the pluralism underlying contract law, and that this value-pluralism is a function of the changing features of transactional settings.³⁸ However, saying good faith changes across transactional settings does not provide an explanation of how good

³⁵ *Wastech SCC*, *supra* note 19 at para 76.

³⁶ *Callow SCC*, *supra* note 16 at para 91.

³⁷ See e.g. Todd D Rakoff, "The Implied Terms of Contracts: Of 'Default Rules' and 'Situation-Sense'" in Jack Beatson & Daniel Friedmann, eds, *Good Faith and Fault in Contract Law* (Oxford: Clarendon Press, 1995) 191; Jane Stapleton, "Good Faith in Private Law" (1999) 52:1 *Current Leg Probs* 1; Hugh Collins, "Implied Terms: The Foundation in Good Faith and Fair Dealing" (2014) 67:1 *Current Leg Probs* 297 [Collins, "Implied Terms"].

³⁸ See John Wightman, *Contract: A Critical Commentary* (London, UK: Pluto Press, 1996) at 96–121 [Wightman, *Contract*]; John Wightman, "Good Faith and Pluralism in the Law of Contract" in Roger Brownsword, Norma J Hird & Geraint Howells, eds, *Good Faith in Contract: Concept and Context* (Aldershot, UK: Ashgate, 1999) 41 [Wightman, "Good Faith"]; Brownsword, "Concepts," *supra* note 31; Brownsword, "Good Faith," *supra* note 31; Brownsword, "After *Investors*," *supra* note 31.

faith organizes various contract doctrines. Most importantly, it does not help define the nature and scope of good faith duties arising in different contexts. To define the general organizing principle of good faith, further analytical efforts are required.

In this article, I provide a coherent rationalization of the general organizing principle of good faith by developing a framework that can serve as a basis for a systematic understanding of how the good faith principle operates in varying transactional settings. This framework has both an explanatory and a prescriptive dimension. It is explanatory as it identifies core tendencies in the judicial application of the good faith principle and its manifestations. In taking this explanatory step, I rely on insights provided by the growing case law and scholarly literature on good faith in common law jurisdictions. It is prescriptive as it aims to provide guidance on how judges could more rationally and transparently justify their use of alternative versions of good faith, depending on the relevant features of transactional settings. The proposed framework improves clarity on the outer limits of the various doctrines grounded on the general organizing principle of good faith stated in *Bhasin*. The ultimate goal of the analysis is not necessarily to change adjudicative outcomes. Rather, its purpose is to enhance the coherence and transparency of judicial decision-making. *Bhasin* was meant to make the common law of good faith more coherent and less piecemeal.³⁹ These goals can be achieved by outlining the reasons that underlie changes in the scope of good faith duties across transactional settings.

I hypothesize a relationship exists between the characteristics of the transactional settings in which the principle of good faith is applied and the version of good faith judges use to adjudicate a contractual dispute. Based on this assumption, I conceptualize the operation of the good faith principle as a function of the interaction between institutional and transactional variables. *Institutional variables* encompass the legal reasoning employed by judges in applying the notion of good faith. *Transactional variables* are the contractual settings within which good faith is applied. I do not claim the proposed framework captures all the relevant variables affecting the scope and functioning of the good faith principle, nor that it explains all instances in which such duties arise. The goal is to provide a preliminary framework for improving the transparency of judicial decision-making and the judicial use of good faith by rendering explicit the factors that most affect the incidence of good faith duties.

This article is organized as follows. Part II examines the lower courts' and the Supreme Court of Canada's decisions in *Wastech* and *Callow*. This analysis provides a useful illustration of the most critical implications involved in defining the outer boundaries of the duty of honesty and the duty to exercise contractual discretion in good faith.⁴⁰ Part III identifies the relevant institutional variables of good faith and briefly notes alternative versions judges employ in contract adjudication. Part IV examines the relationship between these alternative versions of good faith and the varying features of transactional settings, showing the relationship between transactional variables and the changing scope of good faith duties. Finally, Part V examines the issues identified in Part II and revisits the decisions

³⁹ *Bhasin*, *supra* note 1 at para 33.

⁴⁰ For a comprehensive discussion of post-*Bhasin* case law, see Goswami, *supra* note 14 at 319–37; MacQueen & O'Byrne, *supra* note 27 at 309–16; Brandon Pasternak, "A 'First Look': The Canadian Courts' Treatment of Good Faith Contractual Performance Post-*Bhasin*" (2016) 19 *Trinity College L Rev* 124 at 132–49.

in *Wastech* and *Callow* in light of the proposed framework. This work illustrates the usefulness of the proposed framework as a way toward a unified explanation of the various manifestations of good faith.

II. CASE LAW

In this part, I examine the lower courts' and Supreme Court's decisions in *Wastech* and *Callow* by focusing on scope and nature of the duty to exercise contractual discretion in good faith and the duty of honesty. This analysis highlights the practical and theoretical implications of the lack of properly defined outer boundaries of good faith and identifies the major sources of legal uncertainty related to the extension of the good faith principle and doctrines.

A. *WASTECH SERVICES LTD. v. GREATER VANCOUVER SEWERAGE AND DRAINAGE DISTRICT*

1. THE DISPUTE

Wastech involved a contract dispute between Wastech Services Ltd. (Wastech) and the Greater Vancouver Sewerage and Drainage District (Metro) for the operation of the Greater Vancouver Regional District's waste disposal system. The two negotiated for 18 months and produced a complex long-term contract. According to the agreement, Wastech was bound to accept municipal solid waste provided by Metro and transport it to alternative waste disposal locations. Wastech's compensation was structured around a target operating ratio (Target OR). At the time of contract formation, both parties knew that Wastech attaining the Target OR would depend on a balanced volume of waste allocated by Metro across disposal sites. Four features of the contract are crucial. First, the preamble to the contract stated the parties' goal to maximize the efficiency and reduce the cost of waste disposal. Second, an express term of the contract gave Metro full discretion to annually allocate waste between three disposal sites. Third, the agreement did not provide a guarantee that the sites would meet their Target OR in any given year. Fourth, no provision provided for compensation for Wastech's lost profits resulting from a radical reallocation of waste volumes between disposal sites. During the negotiation both parties thought it highly unlikely this would occur; therefore, the contract only included adjustment provisions for marginal variations.

In 2010, in accordance with the express terms of the contract, Metro undertook a radical reallocation of waste across disposal sites generating a severe and unexpected decline in the volume of waste. This negatively affected Wastech's ability to achieve its Target OR and, in turn, to realize its contractual profit margin for that year. Wastech initiated an arbitration claim, arguing that although the contract gave Metro discretion on how to allocate waste between disposal sites, Metro's waste reallocation made it impossible for Wastech to achieve its target, which should have resulted in contractual consequences. Wastech's claim is grounded on two legal bases. First, Metro breached an *implied term* of the agreement requiring a retroactive rate adjustment and compensatory payment. Second, Metro breached a duty to perform the agreement in *good faith* when it allocated waste volumes that deprived Wastech of the opportunity to meet their Target OR. Therefore, Wastech sought to recover expectation damages.

2. THE ARBITRATOR'S DECISION

In adjudicating the dispute, the arbitrator turned first to the question of whether, if Metro allocated waste in a manner that made it impossible for Wastech to achieve the Target OR, an implied term in the contract established a retroactive adjustment to compensate Wastech for the lost opportunity. The arbitrator held that to imply such a term would mean rewriting the agreement contrary to the express intentions of the parties.⁴¹ The arbitrator then considered the duty of good faith and found that Metro's conduct was both honest and reasonable, in furtherance of their own business objectives. Metro did not exercise their contractual discretion capriciously or arbitrarily. However, the arbitrator found that Metro nevertheless acted in bad faith as their behaviour lacked appropriate regard for Wastech's legitimate expectation to not be deprived of the opportunity to achieve the Target OR. On this basis Wastech was awarded compensation for this lost opportunity.

A significant part of the arbitrator's reasoning focused on the impact of good faith, as stated in *Bhasin*, on the exercise of express, bargained for contractual rights. He stated:

Inherent in the concept of an obligation to perform contracts in good faith is the proposition that *the mere fact that the impugned act is expressly authorized by, or not prohibited by, the contract is not determinative...* It seems to me that the good faith doctrine, characterizes the exercise of even an acknowledged, bargained-for contractual right as "dishonest" where it is *wholly at odds with the legitimate contractual expectations of the other party*. No additional form of dishonesty is required to be shown.⁴²

The arbitrator's reading of *Bhasin* enlarges the scope of good faith by allowing the adjudicating body to protect a contractual party's expectation not included in the express or implied terms of the contract. The exercise of an express contractual right may be precluded or limited by considerations concerning its effect on the other contracting party's legitimate expectations.

3. THE SUPREME COURT OF BRITISH COLUMBIA DECISION

On appeal, the Supreme Court of British Columbia rejected the arbitrator's finding that Metro's behaviour lacked appropriate regard for Wastech's legitimate expectations and that their conduct was dishonest or in bad faith.⁴³ The Court conducted an extensive analysis of post-*Bhasin* case law examining whether the general organizing principle enlarged the circumstances in which good faith duties may arise. The Court found, "*Bhasin* did not extend the duty of good faith beyond the existing authorities" and determined there was no free-standing obligation to exercise contractual discretionary power in good faith.⁴⁴ Justice McEwan wrote, "[t]he imposition of a duty to have 'appropriate regard' for the interests of the other contracting party *must be based on the terms of the contract itself*."⁴⁵ The

⁴¹ Arbitrator Decision at para 31 [Arbitrator], cited in *Greater Vancouver Sewerage and Drainage District v Wastech Services Ltd*, 2018 BCSC 605 at para 35 [*Wastech BCSC*].

⁴² Arbitrator, *ibid* at para 90, cited in *Wastech BCSC*, *ibid* at para 23 [emphasis added].

⁴³ *Wastech BCSC*, *ibid*.

⁴⁴ *Ibid* at para 53.

⁴⁵ *Ibid* at para 56 [emphasis added].

determination of a breach of good faith “requires an exercise in looking at the contract and deciding what it addresses.”⁴⁶

The Court noted the case was not a situation in which the parties overlooked a provision on which they could have readily agreed. Instead, these sophisticated parties deliberately left “aside a term that might have addressed the problem.”⁴⁷ During the negotiation, Wastech and Metro considered several possible mechanisms to correct an imbalance in the allocation of waste across sites and agreed that inserting a solution to such matters would add undue complexity to the negotiation.⁴⁸ Thus, there was a *common intention* between the parties not to include such a provision in their agreement. In light of these circumstances, there was no legal basis to impose limitations on Metro’s discretionary power, as the parties had considered and rejected this approach. A finding that Metro’s conduct was dishonest due to being at odds with Wastech’s legitimate contractual expectations could “only be achieved by ignoring the contract.”⁴⁹ On this basis, the Court concluded that the arbitrator expanded the doctrine of good faith beyond what is allowed by *Bhasin*. The Court wrote, “*Bhasin* is not authority for the proposition that contracts may be adjusted to accommodate situations where one party regrets the contract in hindsight.”⁵⁰ The Court then set aside the arbitrator’s award of damages to Wastech.

4. THE BRITISH COLUMBIA COURT OF APPEAL DECISION

In rejecting Wastech’s appeal from the trial judge’s decision, the British Columbia Court of Appeal narrowly defined the scope of good faith.⁵¹ First, an expectation can be qualified as “contractual,” and therefore protected by the duty of good faith, only if it is embodied in the parties’ agreement. The Court noted that pre-*Bhasin* authorities — such as *Arton Holdings Ltd. v. Gateway Realty Ltd.*,⁵² *Mesa Operating Limited Partnership v. Amoco Canada Resources Ltd.*,⁵³ and *Schluessel v. Maier*⁵⁴ — “refer in one way or another to the legitimate *contractual* expectations or interests of the other party,” a central element of the general organizing principle of good faith.⁵⁵ In both contexts, however, the legitimate contractual expectations must be grounded in the contractual terms rather than in a consideration of the negative financial impact of a party’s exercise of his or her contractual rights on the counterparty. The arbitrator erred in law in failing to assess whether Wastech’s expectation (that Metro would not exercise its discretion to provide subsidiary payments) was actually grounded in the terms of the contract.

The Court observed that *Bhasin* “did not intend to change the principle of good faith substantially, nor to establish a new ‘free-standing’ duty”;⁵⁶ therefore, it is unlikely *Bhasin*

⁴⁶ *Ibid* at para 53.

⁴⁷ *Ibid* at para 57.

⁴⁸ Arbitrator, *supra* note 41 at para 75, cited in *Wastech BCSC*, *ibid* at para 56.

⁴⁹ *Wastech BCSC*, *ibid* at para 61.

⁵⁰ *Ibid* at para 63.

⁵¹ *Greater Vancouver Sewerage and Drainage District v Wastech Services Ltd*, 2019 BCCA 66 [Wastech BCCA].

⁵² 1992 NSCA 70.

⁵³ 1994 ABCA 94.

⁵⁴ 2001 BCSC 60.

⁵⁵ *Wastech BCCA*, *supra* note 51 at para 67 [emphasis in original].

⁵⁶ *Ibid* at para 70.

meant to suggest the duty of good faith would be breached “*whenever* a party exercising a contractual discretion fails to have ‘appropriate regard’ for the other party’s (contractual) interests.”⁵⁷ In line with pre-*Bhasin* case law, the duty of good faith is breached only when the impugned conduct deprives the other party of all or a substantial amount of the benefit for which it entered into the contract. Based on this interpretation of *Bhasin*, the Court found that the arbitrator erred in law in “concluding that the duty of good faith is breached *whenever* a contracting party fails to have ‘appropriate regard’ for the other, in circumstances where the agreement has not been found to have been ‘nullified’ or ‘eviscerated.’”⁵⁸

5. THE SUPREME COURT OF CANADA DECISION

The Supreme Court of Canada unanimously dismissed Wastech’s appeal from the Appellate Court’s decision by holding that Metro had not violated its duty to exercise contractual discretion in good faith. Writing for the majority, Justice Kasirer endeavoured to carefully articulate the content, scope, and source of this duty.

a. Content of the Duty

The duty to exercise discretion in good faith flows from the notion, stated in *Bhasin*, that parties must exercise their contractual rights, reasonably and not “capriciously” or “arbitrarily.”⁵⁹ This notion is rooted in the theory of corrective justice, which anchors the organizing principle of good faith and the specific duties derived therefrom.⁶⁰ Because capriciously and arbitrarily are broad standards that cover a variety of different levels of conduct depending on the circumstances, to determine what constraints the duty to exercise discretion in good faith imposes on the holder of that discretion, one must refer to the *purposes* for which discretion is granted in the contract.⁶¹ More specifically, one must ask whether the exercise of contractual discretion is *connected* to the purpose for which the contract granted discretion.⁶² Where discretion is exercised in a manner consonant with the purpose identified in the contract, the exercise can be characterized as *reasonable* according to the agreement for which the parties bargained and therefore “may be thought of as undertaken fairly and in good faith on the parties’ own terms.”⁶³ In contrast, where the exercise of discretion is unconnected with contractual purpose, “the exercise is unreasonable in light of the agreement for which the parties bargained and, as such, it may be thought of as unfair and contrary to the requirements of good faith.”⁶⁴

b. Scope of the Duty

Based on this definition, the Supreme Court endeavoured to fix the proper limits of the judicial scrutiny of the exercise of the power. Justice Kasirer emphasized that determining what constitutes a reasonable exercise of contractual discretion depends on the parties’

⁵⁷ *Ibid* [emphasis in original].

⁵⁸ *Ibid* at para 74 [emphasis added].

⁵⁹ *Wastech SCC*, *supra* note 19 at para 62 (referring to *Bhasin*, *supra* note 1 at paras 63–64).

⁶⁰ *Wastech SCC*, *ibid* at paras 4, 111.

⁶¹ *Ibid* at paras 62–63.

⁶² *Ibid* at para 69.

⁶³ *Ibid* at para 70.

⁶⁴ *Ibid* at para 71.

intention as disclosed by their contract.⁶⁵ Accordingly, what fixes the proper limits for judicial review of the exercise of the power is not “what a court sees as fair according to its view of what is the proper exercise of the discretion”⁶⁶ but rather “what is reasonable according to the parties’ own bargain.”⁶⁷ Stated differently, a finding of a breach of good faith hinges on an exercise of contractual *interpretation*, rather than on general notions of fairness or commercial reasonableness.⁶⁸

The Supreme Court clarified that “[w]herever a party is granted discretion, there may be differing yet legitimate ways in which that party can exercise its power that is itself part of the bargain”⁶⁹ and that “a range of outcomes flows from the choices that may be considered a reasonable exercise of discretion.”⁷⁰ Some of these choices may properly be characterized as connected to the purposes of the discretion, and, as such, they are “insulated from judicial review as a matter of fairness.”⁷¹ In contrast, other choices may be unconnected to the contractual purpose and accordingly be qualified as unreasonable and contrary to the requirements of good faith. The task of the court “is not to ask whether the discretion was exercised in a morally opportune or wise fashion from a business perspective,”⁷² but rather to assess whether the exercise of the discretionary power falls within the range of choices connected to the purpose for which the agreement the parties themselves crafted provides discretion. Therefore, good faith “does not eliminate the discretion-exercising party’s power of choice”;⁷³ rather, it “limits the range of legitimate ways in which a discretionary power may be exercised in light of the relevant purposes.”⁷⁴

Because the purpose of contractual discretion is determined by reference to the contract, the scope of judicial scrutiny is directly affected by the language of the contract and the characteristics of the performance. If the text of the clause that confers a discretionary power makes the parties’ contractual purpose clear, the scope of judicial scrutiny is narrowly limited by the clause itself. In contrast, if the discretionary clause is “entirely general,” a court must look to the broader business relationship the contract is intended to give effect to.⁷⁵ Furthermore, if a discretion relates to a matter “readily susceptible [to] objective measurement,” then “the range of reasonable outcomes will be relatively smaller.”⁷⁶ In contrast, if discretion relates to a matter that is not as susceptible to objective measurement, then “the range of reasonable outcomes will be relatively larger.”⁷⁷

⁶⁵ *Ibid* at para 76.

⁶⁶ *Ibid* at para 71.

⁶⁷ *Ibid*.

⁶⁸ *Ibid* at para 76.

⁶⁹ *Ibid* at para 75.

⁷⁰ *Ibid*.

⁷¹ *Ibid* at para 70.

⁷² *Ibid* at para 73.

⁷³ *Ibid* at para 75.

⁷⁴ *Ibid*.

⁷⁵ *Ibid* at para 72.

⁷⁶ *Ibid* at para 77. The Supreme Court offered examples of the kinds of matters to which such discretionary power could relate. These are: operative fitness, structural completion, mechanical utility, or marketability.

⁷⁷ *Ibid*. These include matters involving taste, sensibility, personal compatibility, or judgment of the party.

c. Source of the Duty

Having determined the content and scope of the duty to exercise contractual discretion in good faith, the Supreme Court considered its source. Justice Kasirer acknowledged that the duty to exercise contractual discretion in good faith is expressly recognized in the *Bhasin*'s account of the general organizing principle of good faith;⁷⁸ however, he took a step further by stating that — like the duty of honest performance — the duty to exercise contractual discretion in good faith is not an implied term, but a general doctrine of contract law, which operates in every contract irrespective of the parties' intentions.⁷⁹ Parties cannot exclude this duty by granting absolute discretion,⁸⁰ nor by drafting entire agreement clauses.⁸¹ The Supreme Court addressed the concern that recognizing the courts' general power to police the exercise of discretion under contracts may significantly interfere with the parties' freedom of contract. In this respect, Justice Kasirer stated that requiring a discretion-exercising party to act consistently with contractual purposes interferes little with parties bargaining choices, as parties to a contract will rarely expect discretion to be exercised in a manner unconnected to the purposes for which it was conferred.⁸² Furthermore, "the content of the duty is guided by the will of the parties as expressed in their contract";⁸³ therefore, the obligation to exercise discretion in good faith will not interfere with the parties' objectives or impose duties on them beyond their reasonable contemplation.

d. Application to Metro's Exercise of Discretion

In applying these principles to the facts, the Supreme Court found that Metro did not breach its duty to exercise discretion in good faith. The text of the discretionary clause in the contract between Metro and Wastech did not spell out, in explicit terms, why Metro was provided with "absolute discretion" to allocate waste on a yearly basis;⁸⁴ however, when read in the context of the contract as a whole, the purposes of granting Metro absolute discretion were clearly "to allow it the flexibility necessary to maximize efficiency and minimize costs of the operation."⁸⁵ Based on these purposes, Metro did not act unreasonably. Metro's exercise of discretion was guided by the objectives of maximizing efficiency and ensuring the cost-effectiveness. This cannot be said to be "unconnected to the contractual purposes for which discretion was granted."⁸⁶ Importantly, the Supreme Court clarified that "the duty did not require Metro to subordinate its interests to those of Wastech in exercising its discretionary power."⁸⁷ On this point, the Supreme Court of Canada departed from the Court of Appeal's suggestion that substantial nullification or evisceration of the benefit of a contract is a requirement to a finding of a breach of good faith.⁸⁸ The fact that Metro's

⁷⁸ *Ibid* at para 58 (referring to *Bhasin*, *supra* note 1 at paras 47–48, 50, 89).

⁷⁹ *Wastech SCC*, *ibid* at paras 91, 94.

⁸⁰ *Ibid* at para 72.

⁸¹ *Ibid* at para 95. On the relationship between entire agreement clauses and the principle of good faith, see Daniele Bertolini, "Unpacking Entire Agreement Clauses: On the (Elusive) Search for Contractually Induced Formalism in Contractual Adjudication," (2021) 66 *MGill LJ* [forthcoming], online: <papers.ssrn.com/sol3/papers.cfm?abstract_id=3730825>.

⁸² *Wastech SCC*, *ibid* at para 92.

⁸³ *Ibid* at para 93.

⁸⁴ *Ibid* at paras 97, 104.

⁸⁵ *Ibid* at para 99.

⁸⁶ *Ibid* at para 100.

⁸⁷ *Ibid* at para 101.

⁸⁸ *Ibid* at para 84.

decision caused Wastech to lose profit is not dispositive of whether Metro's decision breached the duty of good faith. The impact of Metro's choice on Wastech rather reflects the allocation of risk that is defined in the contract.⁸⁹ Justice Kasirer emphasized the detailed nature of the contract and that the parties carefully structured their relationship, and precisely allocated the risks of their bargain. This is not a case of an unforeseen or unregulated matter: "[t]he parties foresaw [the] risk — and chose to leave the discretion in place."⁹⁰ Because the exercise of discretion was within the range of conduct contemplated by the purpose of the clause, Metro's choice cannot be said to be in bad faith, despite the fact that Wastech's own interest suffered as a consequence.⁹¹

B. *C.M. CALLOW INC. V. ZOLLINGER*

1. THE DISPUTE

The central issue in *Callow* pertains to the relationship between the exercise of contractual discretion and the duty of honesty in contractual performance, as stated in *Bhasin*. C.M. Callow Inc. entered into two separate maintenance contracts with ten condominium corporations covering winter and summer maintenance. The winter contract, which ran until April 2014, contained a provision allowing the condominium corporations to terminate the contract early, with ten days' notice. In the spring of 2013, the condominium corporations decided to terminate the winter contract, but did not provide Callow with a notice of termination until September 2013. The corporations delayed informing Callow of their decision to terminate to avoid interfering with Callow's completion of maintenance work under the summer contract, which ran until October 2013. In the summer of 2013, unaware that the decision to terminate the winter contract had already been taken, Callow performed additional "freebie" landscaping work in the hope it would act as an incentive for the corporations to renew the contracts. In September 2013 the corporations gave notice they intended to terminate the winter contract. Callow sued for breach of contract.

2. THE ONTARIO SUPERIOR COURT OF JUSTICE DECISION

At trial, the corporations' right to unilaterally terminate the contract was not in dispute; the issue concerned the *timing* of their communication of the termination decision to Callow.

The Ontario Superior Court of Justice determined the corporations breached their contractual duty of honest contractual performance by acting in bad faith.⁹² Justice O'Bonsawin explicitly extended the duty to act in good faith as stated in *Bhasin* to the termination of contract. She held that, although the duty of honest performance does not involve any unilateral duty to disclose information *before* the notice period, contracting parties must be able to rely on "a minimum standard of honesty"⁹³ to ensure they "will have a fair opportunity to protect their interests if the contract does not work out."⁹⁴ The delay of

⁸⁹ *Ibid* at para 103.

⁹⁰ *Ibid* at para 102.

⁹¹ *Ibid* at para 106.

⁹² *CM Callow Inc v Tammy Zollinger*, 2017 ONSC 7095 [*Callow* ONSC].

⁹³ *Ibid* at para 60.

⁹⁴ *Ibid*, citing *Bhasin*, *supra* note 1 at para 86.

the corporations in providing notice of termination to Callow deprived the latter of a fair opportunity to protect their interests. The minimum standard of honesty would have required the corporations “to provide prompt notice, or to refrain from any representations in anticipation of the notice period.”⁹⁵ By withholding the fact that they intended to terminate the winter contract, the corporations led Callow to believe that the winter contract was not in danger of non-renewal, thereby acting in bad faith.⁹⁶ The Court set aside the express termination clause and granted Callow a one-year net-revenue damage award.

3. THE COURT OF APPEAL FOR ONTARIO DECISION

The Court of Appeal for Ontario showed deference to the trial judge’s findings that the corporations actively deceived Callow regarding their intention to terminate the contract.⁹⁷ However, the Court held that while these findings may suggest that the corporations failed “to act honourably ... they do not rise to the high level required to establish a breach of the duty of honest performance.”⁹⁸

The Appellate Court emphasized that the duty of honesty must be “directly linked to the performance of the contract”⁹⁹ and should not be extended in a way that limits the exercise of an expressly bargained for right. The trial judge’s decision that the minimum standard of honesty required the corporations to give prompt notice or to refrain from representations in anticipation of the notice period “had the effect of substantially modifying the appellant’s right to terminate the contract.”¹⁰⁰ The communications between the parties may have led Callow to believe their contract would be extended, but those “communications did not preclude the [corporations] from exercising their right to terminate the winter contract.”¹⁰¹ The Court overturned the trial judge’s ruling, finding it improperly expanded the duty of honest performance in a manner that went beyond the terms of the contract.

4. THE SUPREME COURT OF CANADA DECISION

The Supreme Court of Canada affirmed the trial judge’s conclusion that corporations breached their duty of honesty under *Bhasin*, as they knowingly misled Callow into believing that the agreement would not be terminated early.¹⁰² The majority took the opportunity to clarify the issues of the content of the duty of honest performance, its outer limits, and what may constitute a misleading conduct.

a. Content of the Duty

The majority’s reasoning begins by confirming that the *Bhasin* organizing principle of good faith in contractual performance is not a free-standing rule but rather manifests itself through a plurality of existing good faith doctrines. It emphasized that these doctrines are

⁹⁵ *Callow* ONSC, *ibid* at para 67.

⁹⁶ *Ibid* at para 65.

⁹⁷ *CM Callow v Zollinger*, 2018 ONCA 896 [*Callow* ONCA].

⁹⁸ *Ibid* at para 16.

⁹⁹ *Ibid* at para 18, quoting *Bhasin*, *supra* note 1 at para 73.

¹⁰⁰ *Callow* ONCA, *ibid* at para 19.

¹⁰¹ *Ibid* at para 18.

¹⁰² *Callow* SCC, *supra* note 16 at para 40.

“distinct but nonetheless connected,”¹⁰³ in that they share the same “requirement of justice”¹⁰⁴ that a contracting party must have appropriate regard to the legitimate contractual interests of their counterparty. On this point, the Supreme Court ventured further than *Bhasin*¹⁰⁵ by clarifying the *substantive* foundation of good faith. The Supreme Court clarified that the requirement of justice, which underpins and informs various good faith doctrines, is rooted in the “ideal of corrective justice”¹⁰⁶ — that is, it reflects the notion that the bargain is “the first source of fairness”¹⁰⁷ between the parties to a contract, and the rights and obligations arising from the contract “must be exercised and performed . . . honestly and reasonably and not capriciously or arbitrarily.”¹⁰⁸

The Supreme Court emphasized that the function of good faith in the context of deciding the issue at hand, is not to supply “a new contractual term or a guide to interpretation of [the] language of the contract.”¹⁰⁹ Instead, the doctrine of the duty of honest performance “has a *limiting* function on the exercise of an otherwise complete and clear right.”¹¹⁰ The duty operates irrespective of the parties’ intention. It cannot be disclaimed by the parties, and it “applies to the performance of all contracts and . . . to all contractual obligations and rights.”¹¹¹ In this sense, the duty of honest performance “shares a common methodology with the duty to exercise contractual discretionary powers in good faith”¹¹² — both doctrines focus on “the wrongful exercise of a contractual prerogative.”¹¹³ Simply put, the duty of honesty focuses “on the *manner* in which the termination right was exercised,”¹¹⁴ rather than “*whether* the right could be exercised.”¹¹⁵

b. Scope of the Duty

Based on these premises, the Supreme Court attempted to provide guidance for how the outer limits of the scope of the duty of honesty should be defined. Violation of the duty of honesty cannot be assessed in the abstract; rather, it must pertain to the defendant’s rights or obligations under the contract. The Supreme Court repeatedly emphasized that the scope of the duty of honest performance is defined by the *link* between the dishonest conduct and the performance of contractual obligations or the exercise of contractual rights.¹¹⁶ To illustrate this point the majority draws on the civilian doctrine of the abuse of rights in Quebec, which was referred to in *Bhasin*.¹¹⁷ Within the framework for abuse of rights, this link operates as a judicial scrutiny over the exercise of a contractual right (or performance of contractual obligation) according to “the ethical standard expressed in the common law duty to act

¹⁰³ *Ibid* at para 46.

¹⁰⁴ *Ibid* at para 47 (referring to *Bhasin*, *supra* note 1 at paras 63–64).

¹⁰⁵ On the procedural dimension of the definition of good faith provided in *Bhasin*, see Bertolini, “Decomposing *Bhasin*,” *supra* note 30 at 360.

¹⁰⁶ *Callow SCC*, *supra* note 16 at para 47.

¹⁰⁷ *Ibid* at paras 47, 83.

¹⁰⁸ *Ibid* at para 47.

¹⁰⁹ *Ibid* at paras 53, 84 (referring to *Bhasin*, *supra* note 1 at para 75).

¹¹⁰ *Callow SCC*, *ibid* at para 53 [emphasis added].

¹¹¹ *Ibid*.

¹¹² *Ibid* at para 51.

¹¹³ *Ibid*.

¹¹⁴ *Ibid* at para 55 [emphasis in original].

¹¹⁵ *Ibid* [emphasis in original].

¹¹⁶ *Ibid* at paras 51–57, 63–66.

¹¹⁷ *Ibid* at paras 56–57, 67.

honestly.”¹¹⁸ That is, it reflects the notion that contractual rights are not insulated from review as to the manner in which they are exercised and that in performing the contract parties must conform to standards of ethical conduct.¹¹⁹ In short, the duty of honesty provides a safeguard against the *abuse* of the exercise of an apparently unfettered contractual right by limiting the manner in which the right may be exercised.

c. Dishonest Performance

Having clarified that the duty of honesty is directly linked to the performance of the contract, the Supreme Court addressed the issue of what may constitute dishonest performance. On this point, the Supreme Court reaffirmed the law from *Bhasin* that the duty of honest performance does not entail a duty to disclose material information; however, the majority clarified that dishonesty or misleading conduct is not confined to direct lies: “whether or not a party has ‘knowingly misled’ its counterparty is a highly fact-specific determination, and can include lies, half-truths, omissions, and even silence, depending on the circumstances.”¹²⁰ Crucially, when a party to a contract remains silent despite being aware that its conduct caused a counterparty to misapprehend a matter directly connected to the performance of the contract or the exercise of a contractual right, that party may be liable for a breach of the duty of honest performance. While there may not be a duty of positive disclosure, there is always a duty not to actively mislead and to correct misapprehensions caused by one of the parties’ conduct. Applying these principles to the facts, the majority concluded that the corporations knowingly misled Callow in how they exercised the termination clause. They made a series of “active communications” that deceived Callow by suggesting that a renewal of the winter contract was likely and by knowingly accepting Callow’s free work as an incentive to renew the winter contract, despite already knowing that the contract was being terminated.¹²¹ Upon realizing that Callow was under this false impression, the corporations should have corrected Callow’s misapprehension; by failing to do so, they breached the *Bhasin* duty of honesty.

Both Justice Côté’s dissenting opinion and Justice Brown’s concurring opinion vigorously criticize the majority’s expansive approach to good faith. Justice Côté stated that extending the duty beyond a simple requirement not to lie would detract from certainty in commercial dealings.¹²² Silence “cannot be considered dishonest within the meaning of *Bhasin* unless there is a positive obligation to speak.”¹²³ In the absence of such an obligation, a party to a contract has no obligation to correct his counterparty’s mistaken belief.¹²⁴ Justice Brown’s concurring opinion emphasized that the majority’s reference to the civil law doctrine of an abuse of rights contributes to obscuring the distinction between the duty of honest performance and the duty to exercise discretionary powers in good faith, and this may only create uncertainty and confusion over the scope and operation of the duty of honest

¹¹⁸ *Ibid* at para 68.

¹¹⁹ *Ibid*.

¹²⁰ *Ibid* at para 91.

¹²¹ *Ibid* at paras 95–97.

¹²² *Ibid* at para 199.

¹²³ *Ibid* at para 200.

¹²⁴ *Ibid*.

performance.¹²⁵ The limitations of the Supreme Court's decision in *Callow* are discussed further in the subsequent section.

C. SETTLED COMMON LAW OF GOOD FAITH

Wastech and *Callow* confirm that the general organizing principle of good faith and the doctrines that derive from it are central to contract law and that they are likely to define the outer boundaries of the judicial scrutiny of a contract and its performance in the near future. More specifically, these decisions clarify the following aspects of the general organizing principle of good faith, the duty to act honestly in contractual performance, and the duty to exercise contractual discretionary power in good faith:

- (1) The theory of corrective justice anchors the organizing principle of good faith and the specific contract doctrines derived from it.¹²⁶
- (2) The duty to act honestly applies to the performance of all contractual obligations and to the exercise of all contractual rights;¹²⁷ it includes the obligation that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract.¹²⁸
- (3) Parties to a contract have a duty to exercise contractual discretion in good faith, meaning that they must act reasonably — that is, in ways connected to the purposes for which the contract granted discretionary power.¹²⁹
- (4) Both the duty of honest performance and the duty to exercise contractual discretionary power in good faith are not implied terms; rather, they are general doctrines of contract law grounded on the general organizing principle good faith and operate in every contract irrespective of the intentions of the parties.¹³⁰
- (5) Both the duty to act honestly and the duty to exercise discretion in good faith operate independently — that is, the latter can be breached even if the former is not.¹³¹
- (6) Both the duty to act honestly and the duty to exercise discretion in good faith involve a highly context-specific determination by courts.¹³²
- (7) Both the duty to act honestly and the duty to exercise discretion in good faith do not require a party to subordinate its interests to those of the other party; therefore, causing loss to another party in the legitimate pursuit of economic self-interest does not necessarily constitute breach of contract.¹³³

D. SOURCES OF LEGAL UNCERTAINTY

Despite the efforts to clarify the legal uncertainties flowing from *Bhasin*, the Supreme Court decisions in *Callow* and *Wastech* further highlight the unresolved tension between

¹²⁵ *Ibid* at para 124.

¹²⁶ *Ibid* at paras 47, 83; *Wastech* SCC, *supra* note 19 at paras 4, 111.

¹²⁷ *Callow* SCC, *ibid* at para 53.

¹²⁸ *Ibid* at para 86.

¹²⁹ *Wastech* SCC, *supra* note 19 at para 63.

¹³⁰ *Callow* SCC, *supra* note 16 at para 3 (referring to *Bhasin*, *supra* note 1 at para 73); *Wastech* SCC, *ibid* at para 94.

¹³¹ *Wastech* SCC, *ibid* at para 56.

¹³² *Callow* SCC, *supra* note 16 at para 91; *Wastech* SCC, *ibid* at para 52.

¹³³ *Callow* SCC, *ibid* at paras 81, 86 (*Bhasin*, *supra* note 1 at para 86); *Wastech* SCC, *ibid* at paras 112–13.

expansionist and restrained strategies. Two major sources of uncertainty remain: (1) the required nexus between the particular terms of the contract and a contracting party's alleged legitimate contractual expectations, and (2) the normative sources of good faith standards; these uncertainties are rooted in the ambiguity of the *Bhasin* conceptualization of the general organizing principle of good faith and reflect in the uncertain outer boundaries of the good faith doctrines that are grounded on the principle.

1. THE NEXUS BETWEEN CONTRACT TERMS AND LEGITIMATE EXPECTATIONS

The first undefined element is how to conceptualize the required nexus between the particular terms of the contract and a contracting party's belief that expectations will be recognized as legitimate and therefore will be protected by the duty of good faith. On this point, an unresolved tension between expansionist and restrained strategies remains within the case law, despite the efforts of the Supreme Court to coherently define the scope of good faith.

The expansionist approach rests on a broad understanding of the contractual relationship and the parties' reasonable expectations. Under this approach, judges can extend legal protection to the parties' expectations that are *not* reflected in the agreement's express or implied terms. The Supreme Court's decision in *Callow* adopts an expansionist approach as it extends the good faith doctrine of the duty of honest performance to the exercise of contractual discretion. In *Callow*, although the contract provides for an apparently unfettered right to terminate the contract, the Supreme Court held that "that right cannot be exercised in a manner that transgresses the *core expectations* of honesty required by good faith in the performance of contracts."¹³⁴ In this way, the Supreme Court uses the principle of good faith to provide legal recognition of expectations that are not reflected in the (express or implied) terms of the contract but that are rooted in the overarching normative principle of corrective justice. This principle justifies the imposition of constraints on the exercise of a facially unfettered right.

In an effort to fix the outer limits of the duty of honesty, Justice Kasirer insists that throughout the decision, the scope of the duty of honesty is defined by its direct *link* to the performance of the terms of a contract; however, the repeatedly emphasized proposition that the breach of the duty of honesty must be directly connected to the performance is woefully incomplete as a criterion for clearly defining the outer limits of the duty of honesty. Merely emphasizing the requirement of a direct link between the duty of honesty and contractual performance does not clarify in the least *how* judges should determine the existence of a sufficiently consistent nexus between the defendant's dishonesty and the rights or obligations under the contract. This is illustrated by the fact that the Appellate Court, in the same proceeding, stated the requirement of a direct link between good faith and contract terms to justify a reversed substantive outcome. The ill-defined requirement of a "direct link" between dishonesty and contractual performance raises more questions than it claims to answer, and as such, it may fail to prevent the risk of an over-expansive application of the duty of

¹³⁴ *Callow* SCC, *ibid* at para 84 [emphasis added].

honesty.¹³⁵ For example, after *Callow*, it is unclear whether a discussion of the terms of a potential contract renewal may lead a counterparty to incorrectly infer the contract's likely continuance. This would generate uncertainty over the existence of a duty to correct the counterparty's misapprehension. I argue that legal certainty could be promoted by clarifying which *variables* courts should consider to determine whether the defendant's dishonest conduct is sufficiently connected with the contractual rights and obligations. This point will be further discussed below.

In contrast, the restrained approach promotes the idea that an expectation is protected by good faith only if it is grounded in the contract's express or implied terms. The Appellate Courts' decisions in *Callow* and *Wastech* exemplify this approach, as both Courts decided the cases based on the agreements' plain meaning and the principle that the only legitimate contractual expectations are those that arise from the terms of the contract. The Supreme Court in *Wastech* also addressed the concern that an overly expansive approach to the duty of good faith in the exercise of contractual discretion may result in increased commercial uncertainty and undue interference with freedom of contract. Justice Kasirer insists throughout the decision that the duty of good faith should be regarded not as an imposition of unbargained-for terms but rather as a means of enforcing the parties' bargain. He emphasizes that the parties' intention remains pivotal in determining whether a particular exercise of contractual discretion is actually unreasonable and that courts may only intervene where the exercise of power is unconnected to the underlying purpose as disclosed in the contract.

At the same time, however, the Supreme Court affirmed a court's general power to police the parties' exercise of discretion under contracts. Justice Kasirer emphasized that the parties' intentions are *not* relevant to determine whether the duty applies and that parties cannot contract out the duty to exercise discretionary power in good faith. Furthermore, the power to scrutinize the exercise of contractual discretion is susceptible to expansion: where the clause conferring discretionary power is "entirely general," the court itself must construe the ambit of its own scrutinizing power.¹³⁶ While emphasis on the primary role of the contractual agreement in fixing the limits for judicial review fits with a restrained approach to good faith, the emphasis on the irrelevance of the parties' intentions in determining the operation of the duty and on the court's role in constructing the limits of their intervention reflects a more expansive approach to good faith.

These counterbalancing elements in *Wastech's* line of reasoning seem to reflect and perpetuate the fundamental ambiguity of *Bhasin's* original conceptual framework. As Shannon O'Byrne and Ronnie Cohen have correctly observed in the aftermath of *Bhasin*, the duty of honesty as articulated in *Bhasin* is a strange hybrid of a contractual term and a

¹³⁵ See however, *Brandt Tractor Ltd v BOMAG (Canada) Inc*, 2021 ABQB 71 (holding that the duty of honest performance as outlined in *Callow* did not require the defendant to immediately inform the plaintiff of its non-renewal decision).

¹³⁶ *Wastech SCC*, *supra* note 19 at para 72.

judicial doctrine.¹³⁷ In a similar fashion, the general duty of good faith in the exercise of the discretionary power as articulated in *Wastech* is ambiguously characterized by the Supreme Court. Like a doctrine, it operates irrespective of the intentions of the parties, but like a term its application “ultimately ‘depend[s] upon the intention of the parties as disclosed by their contract.’”¹³⁸ The hybrid nature of the duty of honesty is paralleled by *Wastech*’s ambiguous conceptualization of the duty to exercise discretionary power in good faith.

Overall, the *Wastech* Court fails to coherently delimit the outer boundaries of judicial review. When the discretionary clause is unfettered on its face, the court (not the parties) reconstruct the degree of “loyalty”¹³⁹ required of the parties, and the limits of judicial scrutiny are defined by the judicially constructed contractual purposes. In this way, as Justices Brown and Rowe observe in the concurring opinion, the majority opinion expands the ambit of judicial intervention far beyond the scope of contractual interpretation at the risk of “distorting the parties’ bargain by imposing constraints to which they did not agree.”¹⁴⁰ It is argued here that legal certainty could be promoted by stating which *variables* courts should consider in determining the limits of the judicial scrutiny of parties’ discretionary choices. This point will be further discussed below.

Finally, another unsettled aspect is whether the new manifestations of the general organizing principle of good faith should be qualified as implied terms or contractual doctrines.¹⁴¹ Divergent understandings of this issue are based on different understandings of the nature of good faith. According to the expansionist conception, good faith is a doctrine of contract law that exists outside of the contract and operates irrespective of the intention of the parties. Because the source of good faith is external to the contract, its application is not precluded by the rejection of an implied term. In contrast, according to a restrained conception, good faith duties are terms implied into a contract; they ultimately arise from the parties’ implicit intentions. While *Callow* and *Wastech* clarify that the duty of honesty and the duty to exercise discretion in good faith are general doctrines of contract law, the issue remains unsolved with respect to all other existing manifestations of the organizing principle.¹⁴²

2. THE NORMATIVE SOURCES OF GOOD FAITH STANDARDS

The second unsettled aspect of good faith is the normative source from which judges may derive specific standards for assessing the parties’ conduct in performing the contract. Much of the uncertainty surrounding the definition of outer boundaries of good faith depends on the lack of transparency in the identification and definition of the substantive source of good

¹³⁷ Shannon O’Byrne & Ronnie Cohen, “The Contractual Principle of Good Faith and the Duty of Honesty in *Bhasin v. Hrynew*” (2015) 53:1 Alta L Rev 1 at 8 [footnotes omitted] (“Like a term, the duty [of honesty] can likely be defined or relaxed as between the parties so as to respect freedom of contract but, like a doctrine, its ‘minimum core requirements’ mandatorily govern the relationship between the parties”).

¹³⁸ *Wastech SCC*, *supra* note 19 at para 76 [citations omitted].

¹³⁹ *Ibid* at para 72.

¹⁴⁰ *Ibid* at para 132.

¹⁴¹ See Pasternak, *supra* note 40 at 137–40; MacQueen & O’Byrne, *supra* note 27 at 306–13.

¹⁴² In *Wastech SCC*, Justice Kasirer expressly acknowledged this uncertainty element (at para 90).

faith duties. The arbitrator's decision in *Wastech*¹⁴³ and the trial judge's decision in *Callow*¹⁴⁴ offer two expansionist examples based on a poorly defined normative source of good faith standard. In both, the decision-making authority relies on a generic notion of fairness to justify the imposition of obligations not defined in the contract terms; they neither articulate the substantive notion of good faith as applied to the facts, nor reference the expectations commonly accepted by the relevant community to which the parties belong. This shows the concept of good faith, if not coherently articulated through well-specified contract doctrines, may be used as a convenient conceptual shorthand to justify the judge's moral intuition in affording legal protection to sympathetic claimants. This is the source of the arbitrary expansion of good faith duties. Legal certainty could be fostered by judges who carefully articulate the use of normative sources from which good faith standards are derived. One approach suggests that good faith should reflect the standards of the community to which the parties belong; a second recommends that good faith should be informed by a substantive conception of fairness. Legal certainty could be established by justifying the use of either approach on the basis of the features of the transactional setting.

III. INSTITUTIONAL VARIABLES

A useful strategy for exploring the outer boundaries of good faith is to identify the features of judicial reasoning that most influence the use of the principle in contractual adjudication. I refer to these features as the "institutional variables" of good faith. I identify two main institutional variables: (1) the functional task assigned by the judge to the notion of good faith; and (2) the source of the evaluative criteria the judge employs to specify the prescriptive content of good faith.

A. FUNCTIONS

As many commentators emphasize, different versions of good faith are used by judges to address a variety of different legal issues.¹⁴⁵ Empirical observation and conceptual analysis suggest that three alternative models of good faith are associated with three distinct *functional tasks*: (1) interpreting; (2) supplementing; or (3) correcting the contract. Each model is characterized by a different relationship between good faith obligation and contract terms and, consequently, involves a different allocation of rule-making power between judges and private orderings. This *functional* differentiation of good faith models cuts across doctrinal constructs — that is, the same functional task can be performed by different doctrines; the same doctrine can perform different functional tasks. The caveat here is that, in reality, the distinction between them is not easily drawn and not always followed by judges.

¹⁴³ Arbitrator, *supra* note 41, cited in *Wastech BCSC*, *supra* note 41.

¹⁴⁴ *Callow* ONSC, *supra* note 92.

¹⁴⁵ See e.g. Raphael Powell, "Good Faith in Contracts" (1956) 9 *Current Leg Probs* 16 at 23–25; SM Waddams, "Good Faith, Unconscionability and Reasonable Expectations" (1995) 9 *J Contract L* 55 at 56; Wightman, "Good Faith," *supra* note 38; Brownsword, "Concepts," *supra* note 31; Brownsword, "Good Faith," *supra* note 31; Brownsword, "After *Investors*," *supra* note 31; Woo Pei Yee, "Protecting Parties' Reasonable Expectations: A General Principle of Good Faith" (2001) 1:2 *OUCLJ* 195 at 199–208; Collins, "Implied Terms," *supra* note 37; Suzanne Corcoran, "Good Faith as a Principle of Interpretation: What is the Positive Content of Good Faith?" (2012) 36 *Austl Bar Rev* 1.

1. INTERPRETIVE GOOD FAITH

The first model promotes a narrow view of good faith; it is closely tied to the terms of the contract and limited to cases in which a party has deliberately violated its contractually defined obligations. Under this model, there is no cause of action for breach of good faith in the absence of a breach of an express term of the contract. The judge identifies the appropriate standard of conduct by interpreting the terms of the agreement between the parties. Good faith's foremost task is to defend the reliance of one party on the express representation of the counterparty, and the relevant expectations are only those anchored in the contract terms codified by the parties' writing. The scope of operation of good faith is therefore limited to the meaning attributable to the contract terms. Since this version of good faith discharges a functional task similar to that performed by the process of contractual interpretation, I call it "interpretive" good faith.¹⁴⁶

The theoretical underpinning of interpretive good faith is the idea that contract documents are the sole repository of the parties' expectations and obligations about contractual performance. Based on this assumption, the judge must solve contractual disputes either by interpreting contractual terms or conforming to *stare decisis*. Absent these legal governing premises, if the judge remains faithful to contractual freedom and legal certainty, they must confine themselves to contractual interpretation and refrain from any reallocation of risk not supported by the terms of the contract. Any contracting party's expectation not embodied in the terms of the agreement is not protected by good faith. An important practical implication of the interpretive model is that any gap or omission left in the contract is interpreted by the judge as implicitly allocating the risk on the party who suffers the loss (that is, the *loss-lie rule*). The reasons for this strategy include both principled and practical concerns, which generally correspond to arguments advanced by the formalist strand of contract literature that favours a textualist approach to contract interpretation.¹⁴⁷

However, the move by courts toward contextual approaches to contractual interpretation has progressively restricted the distinctive role of this version of good faith. The contextual approach provides judges with all the epistemic resources for contextualizing judicial decision-making. In light of this development, one commentator refers to good faith as a "revered relic," alluding to its now exhausted historical function of tempering the formalistic excesses of the classic common law of contract.¹⁴⁸ Yet it may be argued that once contextual

¹⁴⁶ Judges' use of an "interpretive" standard of good faith is discussed in David Stack, "The Two Standards of Good Faith in Canadian Contract Law" (1999) 62:1 Sask L Rev 201. For criticisms of this model, see Michael P Van Alstine, "Of Textualism, Party Autonomy, and Good Faith" (1999) 40:4 Wm & Mary L Rev 1223; Harold Dubroff, "The Implied Covenant of Good Faith in Contract Interpretation and Gap-Filling: Reviling a Revered Relic" (2006) 80:2 St John's L Rev 559; Jay M Feinman, "Good Faith and Reasonable Expectations" (2014) 67:3 Ark L Rev 525.

¹⁴⁷ See Omri Ben-Shahar, "The Tentative Case Against Flexibility in Commercial Law" (1999) 66:3 U Chicago L Rev 781; David Charny, "The New Formalism in Contract" (1999) 66:3 U Chicago L Rev 842; Robert E Scott, "The Case for Formalism in Relational Contract" (2000) 94:3 Nw UL Rev 847; William J Woodward Jr, "Neoformalism in a Real World of Forms" (2001) 2001:3 Wis L Rev 971; John E Murray Jr, "Contract Theories and the Rise of Neoformalism" (2002) 71:3 Fordham L Rev 869; Howard O Hunter, "The Growing Uncertainty about Good Faith in American Contract Law" (2004) 20:1 J Contract L 50.

¹⁴⁸ Dubroff, *supra* note 146. For an analysis of the interpretive dimension of good faith, see Corcoran, *supra* note 145.

interpretation is adopted, good faith may still play a significant role as a tool for informing the interpretive process itself.

2. SUPPLETIVE GOOD FAITH

The second model conceives of good faith as a tool that supplements the contract. Suppletive good faith differs from interpretive good faith in two respects. First, contractual incompleteness is necessary for its legitimate use by the judge — that is, the judge uses good faith only if the express terms of the contract do not address the nature of the dispute. Good faith enables the judge to create and apply a rule not included in the agreement, going *beyond* the results of contractual interpretation.¹⁴⁹ Second, and relatedly, the rules of the contract ultimately trace back to the presumed intention of the parties. The outer limits of suppletive good faith are not defined by the semantics of the contract document but by the primacy attributed by the judge regarding the parties' presumed or hypothetical intentions.

The suppletive model of good faith has three practical implications. First, the outcome of suppletive good faith cannot be incompatible with the underlying agreement. As suppletive good faith seeks to be faithful to the parties' agreed common purpose, the judge is restricted to decisions compatible with the parties' common goals and intentions.¹⁵⁰ Second, suppletive good faith can be disclaimed or excluded by the express terms of the contract, as good faith requires faithfulness to the parties' agreement; if parties do not want the court to supplement their contract, the court will honour that intent. Third, the violation of good faith duties is subject to a contractual measure of damages. The contractual nature of the remedy is consistent with the idea that good faith ensures consistency with the parties' common agreed purpose.

Traditionally, in common law jurisdictions, the function of suppletive good faith is performed by the doctrine of implied terms. Recently, both case law and academic scholarship have recognized that good faith plays a crucial role in the process of implication of terms, both in fact and in law.¹⁵¹ The formula of implied terms is attractive as it reconciles the practice of imposing default rules with the need to attribute those terms to the parties' will. However, this formula tends to misrepresent the nature of judicial intervention. The rhetorical strategy of presenting these terms as being agreed by the parties conceals the fact that the content of contractual obligation is actually judicially determined by courts. Courts inquire about the rule parties would have agreed on had they anticipated the dispute, but this

¹⁴⁹ Courts and scholars often conceptualize this good faith model by saying it acts as a “gap filler.” However, the level of specificity the contract must achieve in order for a gap not to occur is usually unclear.

¹⁵⁰ The distinction between contractual *interpretation*, which ascribes meaning to the linguistic expressions of the parties in the contractual document to specify the contractual rules in the agreement, and *supplementation*, which involves the creation of a rule not provided in the contractual document but required to solve a conflict in accordance with the parties' agreed common purpose, is fairly substantial. Therefore, while contractual interpretation focuses on recognizing the semantic content of the legal text, contractual supplementation concentrates on identifying a rule the contract fails to supply. See Eyal Zamir, “The Inverted Hierarchy of Contract Interpretation and Supplementation” (1997) 97:6 Colum L Rev 1710.

¹⁵¹ *Bhasin*, *supra* note 1 at para 44; Collins, “Implied Terms,” *supra* note 37.

question invites a judicial reallocation of the contractual risks in the *absence* of the parties' actual intention.¹⁵²

3. CORRECTIVE GOOD FAITH

The third model of good faith conceives it as a legal tool for promoting normative ethical values external to the contract and to which the contract must conform. Typically, judges use the corrective version of good faith by referring explicitly to contractual *fairness*. Unlike the suppletive model, corrective good faith is not concerned with creating consistency with the parties' agreed purpose. Instead, its purpose is to reorient the substantive content of the contract to conform to external parameters.

Three implications differentiate corrective good faith from suppletive good faith. First, under the corrective model, the legitimate use of good faith is not conditioned upon contractual incompleteness. The judge uses good faith independent of whether the contract addresses the disputed issue. Second, corrective good faith manifests through mandatory rules that operate irrespective of the parties' intention. Thus, it is not disclaimable by the parties. Third, corrective good faith is often enforced through the nullification of contract or a specific contract provision. Because good faith expresses values that supersede the will of the parties, a contract inconsistent with the overarching normative concern underlying good faith duties is put to an end, either entirely or partially.

Traditionally, the corrective model of good faith has been foreign to the common law tradition.¹⁵³ More recently, however, elements of corrective good faith have infiltrated the common law of contract. The most emblematic example is the *unconscionability doctrine*. Courts distinguish procedural from substantive unconscionability: the former refers to defects in the bargaining process and the latter to considerations of fairness of the contractual terms. One may observe that the unconscionability doctrine pertains to contract formation and not to contractual performance. However, it is a feature of the corrective model of good faith — which focuses on substantive fairness — to extend the judicial scrutiny of contractual performance to the *content* of the performance, in addition to its *execution*. It is through this lens, for example, that one should read *Bhasin's* inclusion of unconscionability among the various manifestations of the principle of good faith. Consistent with the characteristics of the corrective model, the unconscionability doctrine operates irrespective of the express contractual terms and is enforced through the equitable remedy of rescission, which allows for the cancellation of the contract. The incorporation of elements of corrective good faith into the common law tends to narrow the historic gulf between common law and equity.

Substantive fairness can be applied in different ways depending on the specific features of the transactional setting. Judges may use the notion of “good” to insert into legal reasoning considerations concerning the fairness of the *outcome*, that is, the distribution of wealth between parties. Alternatively, the test for fairness may focus on *fair treatment*, meant

¹⁵² Waddams, *supra* note 145 at 56; Stephen A Smith, *Contract Theory* (Oxford: Oxford University Press, 2004) at 306–12; John D McCamus, *The Law of Contracts*, 3rd ed (Toronto: Irwin Law, 2020) at 834–35; Collins, “Implied Terms,” *ibid* at 305.

¹⁵³ Mariana Pargendler, “The Role of the State in Contract Law: The Common-Civil Law Divide” (2018) 43:1 Yale J Intl L 143.

to ensure impartiality in the way one party treats the other during their contractual relationship. Examples are the judicial control of terminations, renewals, or dismissals.¹⁵⁴ The functional task of corrective good faith is performed by various doctrines. In addition to unconscionability, another example is a good faith obligation implied as a matter of law to address power imbalances in certain types of contracts such as insurance, employment, or landlord-lessee.

The inherent indeterminacy of substantive fairness, on which corrective good faith is based, creates potential for an unbridled expansion of the outer limits of good faith. As discussed later, to limit the risks associated with uncontrolled judicial expansion, the corrective version of good faith must manifest through specific doctrines that narrowly define the circumstances under which the judge's corrective intervention is permitted.¹⁵⁵ Expansionists' post-*Bhasin* decisions have adopted a corrective version of good faith as a stand-alone doctrine.

B. CRITERIA

The second institutional variable affecting the scope and operation of good faith is the nature of the evaluative criteria from which judges derive the substantive content of good faith duties. Two types of evaluative criteria are: (1) criteria grounded empirically on the implicit understanding and expectations of the contracting community to which parties belong ("practice-based standards"); and (2) criteria grounded on abstract normative ethical conceptions ("non-practice-based standards").¹⁵⁶ The distinction between practice- and non-practice based good faith standards applies to each of the three versions of good faith identified in Part III.A, resulting in six possible combinations.

1. PRACTICE-BASED GOOD FAITH STANDARDS

Norms observed by the community to which contracting parties belong do not arise from the parties' immediate expression of assent. However, they are regarded as part of the binding contractual relationship, as they constitute part of the normative context within which the contractual relationship is situated.¹⁵⁷

First, it must be clarified that this version of good faith (practice-based, interpretive) plays a role only in those jurisdictions that adopt a contextual approach to contractual interpretation, and it is incompatible with the formalistic approach to interpretive good faith

¹⁵⁴ See Emily MS Houh, "Critical Interventions: Toward an Expansive Equality Approach to the Doctrine of Good Faith in Contract Law" (2003) 88:4 Cornell L Rev 1025 (arguing that courts should use the common law doctrine of good faith in contract law to prohibit the improper use of racial prejudice in contract formation and performance).

¹⁵⁵ Elisabeth Peden, "When Common Law Trumps Equity: The Rise of Good Faith and Reasonableness and the Demise of Unconscionability" (2005) 21 J Contract L 226; Mariana Pargendler, "Modes of Gap Filling: Good Faith and Fiduciary Duties Reconsidered" (2008) 82:4 Tul L Rev 1315; Leonard I Rotman, "The 'Fusion' of Law and Equity?: A Canadian Perspective on the Substantive, Jurisdictional, or Non-Fusion of Legal and Equitable Matters" (2016) 2:2 Can J Comparative & Contemporary L 497 at 534.

¹⁵⁶ Wightman, "Good Faith," *supra* note 38; Brownsword, "Good Faith," *supra* note 31.

¹⁵⁷ Community standards may reflect what people in a given community actually *do* or believe *ought to be done* under the circumstances. A detailed analysis of the different theoretical implications is beyond the scope of this article.

examined above. In ascertaining the intention of the parties at the time of contract formation, judges may assume they intended certain minimum standards of conduct commonly accepted in the contracting community to which the parties belong. Based on this assumption, judges may regard interpretations of the language of the agreement that conflict with these standards as being unreasonable and therefore struck down.

Second, common law judges make use of practice-based good faith to supplement the contract with rules derived from community standards. As clarified earlier, suppletive good faith ensures faithfulness to the common purpose of the parties in the face of contractual incompleteness. Judges may supplement the content of the contract by assuming the parties tacitly accept the normative expectations commonly accepted in their relevant contractual community. Based on this assumption, they may incorporate into the contract the customs or trade usages commonly practiced within the relevant community. The leading example of practice-based suppletive version of good faith is article 2 of the United States' Uniform Commercial Code, which states good faith is concerned with the parties' conduct being consistent with the actual standards of the contracting community to which they belong.¹⁵⁸

Third, practice-based criteria may be used to inform corrective good faith. This version of good faith, as explained earlier, seeks to integrate substantive fairness into contractual relationships. Depending on the conception of substantive fairness adopted by the judge, different types of practice-based criteria can be employed. If the judge is concerned about fairness of contractual outcome, the price established in a competitive market may provide the basis for deciding whether the price/performance ratio under a particular contract is fair. A contract that diverges significantly from the market price is regarded as being unfair and therefore not enforceable. Alternatively, the judge may be concerned with fairness concerning the modification, renewal, or termination of the contract. The benchmark for deciding these issues may be found in sector-specific norms.

The use of practice-based criteria (in each of the three versions identified above) raise several concerns regarding the outer boundaries of good faith. First, judges may encounter challenges in identifying the relevant contracting community on whose generated norms good faith should be drawn.¹⁵⁹ Uncertainty in identifying the relevant contracting community may in turn result in uncertainty over the outer boundaries of good faith. Second, the contracting community may be characterized by structural (power or information) imbalances. When such imbalances occur, the endorsement of community standards may result in giving legal effect to entrenched practices benefitting one group at the expense of another. Third, many argue the role of contract law is not to reflect the contingent needs,

¹⁵⁸ UCC, § 2-012 (1995). For discussion, see Robert E Scott, "The Rise and Fall of Article 2" (2002) 62:4 La L Rev 1009.

¹⁵⁹ For discussion of the methodological difficulties involved in identifying community standards and trade customs, see John Wightman, "Beyond Custom: Contract, Contexts, and the Recognition of Implicit Understandings" in Campbell, Collins & Wightman, *supra* note 31 at 143 [Wightman, "Beyond Custom"]; Jeannie Marie Paterson, "The Standard of Good Faith Performance: Reasonable Expectations or Community Standards?" in Michael Bryan, ed, *Private Law in Theory and Practice* (London, UK: Routledge-Cavendish, 2007) 153 at 165–78; Richard Craswell, "Do Trade Customs Exist?" in Jody S Kraus & Steven D Walt, eds, *The Jurisprudential Foundations of Corporate and Commercial Law* (Cambridge, UK: Cambridge University Press, 2000) 118; Alan D Miller & Ronen Perry, "Good Faith Performance" (2013) 98:2 Iowa L Rev 689 (showing that community standards must ultimately be derived by a method that coherently aggregates individual perceptions and whether any such method actually exists, at 724).

practices and expectations of the business community; rather, it should balance a broader range of considerations including a plurality of normative concerns.¹⁶⁰ Taken together, these considerations suggest that reliance on community standards does not release courts from the need to engage in normative or policy considerations independent of social practices.

2. NON-PRACTICE-BASED GOOD FAITH STANDARDS

When practice-based criteria are not available — either because a contracting community does not exist or because community standards cannot easily be identified — judges may draw normative standards from abstract moral principles or conceptions they believe inform their judicial reasoning. The normative conception referred to by the judge and the rhetorical strategy used will depend on the version of good faith used.

The interpretive version of good faith is buttressed by the value of certainty and predictability as typically summarized in the classic, formalistic understanding of the *pacta sunt servanda* principle.¹⁶¹ Under this model, judges tend to emphasize their role of ascertaining the objective meaning of the express terms of the contract. Courts recognize that parties have already determined what self-interested actions are permitted. Previously, I noted this normative premise is not compatible with the functioning of the good faith doctrine, whose essence is to imbue the contract with substantive content.

Second, the chief normative concern underlying suppletive good faith is to preserve the role of party autonomy in determining the content of the good faith duty. Therefore, in using non-practice-based, suppletive versions of good faith, judges tend to argue that the duty of good faith that they impose on the parties arises from their agreement. Judges use a host of rhetorical devices, such as stressing the reasonable expectations of the parties, the presumed intention of the parties, and the promotion of the business efficacy of the contract.¹⁶² In all these instances, behind the different linguistic formulations, lie a form of legal reasoning structurally similar to the application of an objective standard of reasonableness.¹⁶³

Third, the normative underpinning of the corrective model of good faith is the principle of fairness. In this model, as noted earlier, the focus of the judge's reasoning is on the fair balance between the parties' obligations. In using non-practice-based corrective good faith, judges make explicit reference to the abstract principle of "fairness," often in the context of structurally imbalanced contractual relationships, to afford protection to the disadvantaged contracting party. In addition, issues of substantive fairness (either outcome or fair treatment) in contractual relationships with unequal bargaining power are often more efficiently

¹⁶⁰ See John Gava, "How Should Judges Decide Commercial Contract Cases?" (2013) 30 J Contract L 133; Catherine Mitchell, *Contract Law and Contract Practice: Bridging the Gap between Legal Reasoning and Commercial Expectation* (Oxford: Hart, 2013) at 203–208 [Mitchell, *Contract Law*].

¹⁶¹ Bryan A Garner, ed, *Black's Law Dictionary*, 11th ed (St Paul, Minn: Thomson Reuters, 2019) sub verbo "pacta sunt servanda" (agreements must be kept).

¹⁶² Scholars debate whether implication of terms is part of the process of contractual interpretation. Certain contributions emphasize the suppletive function of implication of terms. See Rakoff, *supra* note 37; Collins, "Implied Terms," *supra* note 37. Others highlight the interpretive function. See Brian Langille & Arthur Ripstein, "Strictly Speaking: It Went Without Saying" (1996) 2:1 Leg Theory 63; Adam Kramer, "Implication in Fact as an Instance of Contractual Interpretation" (2004) 63:2 Cambridge LJ 384; Andrew Robertson "The Limits of Interpretation in the Law of Contract" (2016) 47:2 VUWLR 191.

¹⁶³ Stack, *supra* note 146; Paterson, *supra* note 159; Cotton-O'Brien, *supra* note 3; MacQueen & O'Byrne, *supra* note 27 at 307–13.

regulated through a legislative approach. The leading example of “legislated” good faith is the *European Directive on Unfair Terms in Consumer Contracts*,¹⁶⁴ which contains a non-exhaustive, indicative, “grey” list of potentially unfair contract terms. The general clause in article 3(1) defines as unfair any contractual term, not individually negotiated, that “contrary to the requirement of good faith ... causes a significant imbalance in the parties’ rights and obligations arising under the contract, to the detriment of the consumer.”¹⁶⁵ Other examples include franchise legislation in several jurisdictions, which impose a duty of good faith and state that unfair contract terms may be adjusted or set aside if their application leads to an unfair result.¹⁶⁶ Canadian franchise legislation has codified a corrective notion of good faith. The Ontario franchise disclosure law — the *Arthur Wishart Act (Franchise Disclosure), 2000* — defines fair dealing as a duty to act in good faith and in accordance with reasonable commercial standards.¹⁶⁷ In short, non-practice-based corrective good faith can either incorporate abstract notions of contractual fairness or be codified through legislation.

The non-practice version of corrective good faith raises a number of concerns in terms of potentially arbitrary, unbridled expansion of good faith. The indeterminacy of the abstract notion of substantive fairness entails the risk that judges may use corrective good faith to promote their own intuitive sense of justice in a nonprincipled, nontransparent way. Furthermore, the moral foundation of the legal doctrine of good faith remains a largely under-investigated topic at the scholarly level.¹⁶⁸ These considerations suggest that non-practice-based corrective good faith should be carefully constructed to reduce the risk of incoherent outcomes and unprincipled developments of the law. As explained later in greater detail later, a few post-*Bhasin* decisions use this version of good faith, combined with its conceptualization as a stand-alone duty, to apply expansionist approaches.

The various combinations of institutional variables result in six versions of good faith: the practice-based and non-practice-based versions of interpretive, suppletive, and corrective good faith. The next analytical step is to explore the judge’s choice of the most appropriate version in light of the specific features of the transactional settings in which good faith is applied.

IV. TRANSACTIONAL VARIABLES

In this part, I hypothesize that the judge’s choice of the version of good faith most suited for adjudicating the dispute is a function of the particular features of the transactional setting within which the good faith principle is to be applied. I refer to these features as “transactional variables” of good faith.

¹⁶⁴ EC, *Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts*, [1993] OJ, L 095/29 at 29–34.

¹⁶⁵ *Ibid.*, art 3(1).

¹⁶⁶ See Mark Abell & Victoria Hobbs, “The Duty of Good Faith in Franchise Agreements – A Comparative Study of the Civil and Common Law Approaches in the EU” (2013) 11:10 *Intl J Franchise L* 5.

¹⁶⁷ SO 2000, c 3, s 3(1).

¹⁶⁸ But see Brownsword, “Concepts,” *supra* note 31; Brownsword, “Good Faith,” *supra* note 31; Brownsword, “After *Investors*,” *supra* note 31; Daniel Markovits, “Good Faith as Contract’s Core Value” in Gregory Klass, George Letsas & Prince Saprai, eds, *Philosophical Foundations of Contract Law* (Oxford: Oxford University Press, 2014) 272.

A. COMMERCIAL CONTRACTS

Based on insights provided by contract scholarship, I hypothesize there exist two fundamental connections between institutional and transactional variables of good faith in commercial contracts. First, the judge's choice of the functional task of good faith is a function of both the level of legal *sophistication* of contracting parties and the degree of *uncertainty* surrounding the transaction. The level of sophistication and level of uncertainty surrounding the performance affects the parties' ability to write a contract that specifies *ex ante* the outcome in each future relevant contingency (that is, a state-contingent contract).¹⁶⁹ Legally sophisticated parties have greater economic and cognitive resources than unsophisticated ones to negotiate specific and efficient contract terms addressing future contingencies. Uncertainty, which is generated by changes in the market or technological conditions, make future states of the world not easily observable or verifiable. To the extent that sophistications and uncertainty levels allow parties to write a state-contingent contract, the need for the judge to intervene *ex post* and supplement the content of the agreement on the basis of good faith is reduced. In short, the level of legal sophistication and degree of uncertainty influences the judge's choice between interpretive and suppletive good faith.

Second, the judge's choice between practice-based and non-practice-based criteria is a function of the *thickness* of the market. The thickness of the market is the number of traders engaged in a class of transactions with similar characteristics.¹⁷⁰ Market thickness allows the trade community to exploit economies of scale when developing a common contracting infrastructure that addresses the most frequent transactional risks. Empirical observation suggests the thicker the market, the more likely an established trading practice will emerge.¹⁷¹ In turn, this likely affects the judge's use of practice-based good faith standards when a contract dispute arises.

1. LOW UNCERTAINTY

At *low uncertainty* levels, sophisticated parties are likely to engage in a state-contingent contract that specifies in advance the relevant future states of the world and establishes specific rules for each possible future contingency. This contract design strategy by the parties dramatically reduces the need for courts to supplement the contract and inquiry into the context of the transaction. The *thinness* of the market reinforces the incentive for parties to specify the content of a state-contingent contract. Thin markets do not support the emergence of stable, commonly accepted trade practices that contracting parties may rely on to specify contract terms. Thus, parties must directly negotiate the terms of the contract by choosing their optimal level of *ex ante* specificity. These considerations suggest that in a transactional setting characterized by legally sophisticated parties, a thin market, and low

¹⁶⁹ For discussion on legal sophistication, see Alan Schwartz & Robert E Scott, "Contract Theory and the Limits of Contract Law" (2003) 113:3 Yale LJ 541. For discussion on incomplete contracts, see Alan Schwartz, "Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies" (1992) 21:2 J Leg Stud 271; Gillian K Hadfield, "Judicial Competence and the Interpretation of Incomplete Contracts" (1994) 23:1 J Leg Stud 159; Robert E Scott, "The Law and Economics of Incomplete Contracts" (2006) 2:1 Annual Rev L & Soc Science 279.

¹⁷⁰ For the impact of market thickness on contract design, see Ronald J Gilson, Charles F Sabel & Robert E Scott, "Text and Context: Contract Interpretation as Contract Design" (2014) 100:1 Cornell L Rev 23.

¹⁷¹ *Ibid* at 44.

levels of uncertainty, the need for courts to engage in *ex post* specification of contractual terms is significantly reduced. Parties are likely to invest resources in negotiating and drafting a complete agreement. If good faith is to play any role, it will be the narrow, interpretive version as a requirement closely tied to the obligations arising under the express terms of the contract. Given the thinness of the market, it will be non-practice-based.

Where markets are thick, as noted earlier, economies of scale support the emergence of specialized collective regimes for the definition of contractual terms or for the resolution of commercial disputes. Trade practices are likely to be codified into specific, detailed rules, which come close to designing a complete contingent set of rules. Parties can rely on these private specialized regimes and direct courts to interpret the contract by making reference to these rules. When a dispute arises, courts defer to the institutionalized contractual regime that emerges from the trade community. Therefore, when the market is thick, the parties are sophisticated, and uncertainty is low, judges are likely to use an interpretive, practice-based form of good faith reasoning.

2. MODERATE UNCERTAINTY

As the uncertainty level increases, the cost of *ex ante* specification of contractual terms increases. If uncertainty can be fixed by the passage of time, the judge can supplement the contract once the uncertainty is resolved. Under these circumstances, legally sophisticated parties are more likely to include general standards in their contracts, deferring to courts the task of specifying *ex post* the substantive terms of their agreement. If contracting parties operate in a thin market, stable trade practices are unlikely to be available to judges. Therefore, when a dispute arises, judges are likely to resort to a non-practice-based version of good faith to supplement the content of the contract. On the other hand, if contracting parties operate in a thick market, legally sophisticated parties have the opportunity to exploit the common knowledge of trade by relying on collective normative regimes developed through private organizations. Given the availability of stable and predictable commercial practices, the version of good faith used by judges will be suppletive and practice-based.

3. HIGH UNCERTAINTY

At high uncertainty levels, it is impossible for contracting parties to predict all future contingencies. This happens when the circumstances surrounding the performance of the contract evolve over time and new elements of uncertainty arise. These may include uncertainty over whether the outcome of the contract will be reached, whether the parties will continue to interact in the future, and whether the interests of the parties will continue to align. Uncertainty continues and cannot be resolved by the passage of time, delegating to judges the task of *ex post* supplementing the contract. The parties' approach to contract design switches from providing state-contingent rules to defining governance mechanisms for keeping their reciprocal interests aligned over the long term.

This situation frequently occurs when legally sophisticated parties enter long-term complex relationships that generate a high level of interdependence. Examples include strategic alliances, joint ventures, major construction projects, and public-private partnerships. Under these circumstances, the chief problem of contracting parties is not

defining the substantive terms of state-contingent contracts, but rather developing protocols aimed at controlling the risk of parties' opportunistic behaviour as the contractual relationship unfolds. The literature describes this form of contract design in various terms. Ronald Gilson, Charles Sabel, and Robert Scott call this "collaborative contracting."¹⁷² They argue that under these transactional circumstances, "parties create their own means of enforcing their commitments to each other through a contractually specified process."¹⁷³ David Frydlinger, Oliver Hart, and Kate Vitasek call this design a "formal relational contract."¹⁷⁴ They contend parties have "a vested interest in each other's success"¹⁷⁵ and thus "the development of the contract becomes a joint problem-solving exercise rather than an adversarial contest."¹⁷⁶ Hugh Collins calls this class of contracts "networks" or "quasi-integration arrangements," whose primary characteristic is a high level of economic integration between commercial entities that generates intensified incentives to co-operate.¹⁷⁷

In a transactional context, the role of the court is to identify and sanction the opportunistic behaviours of the parties hoping to evade the collectively defined protocols of contractual governance.¹⁷⁸ Frydlinger, Hart, and Vitasek suggest contracting parties should add to their contract a number of principles, such as reciprocity, autonomy, and integrity.¹⁷⁹ The similarity between these principles and the *Bhasin*'s characterization of good faith is striking. If both contracting parties are sophisticated, the nature and incidence of good faith duties in this type of transactional settings share most of the characteristics of the interpretive model of good faith. Gilson, Sabel, and Scott suggest that when parties choose collaborative contracting the role of judicial intervention is limited to "sanctioning 'red-faced' abuse of the process-oriented regime . . . without inviting a court to convert the exploration of collaborative possibilities into a contractual obligation to actually do so."¹⁸⁰

4. NON-SOPHISTICATED PARTIES

A significant portion of commercial contracts involve non-sophisticated parties. It is useful to distinguish three transaction scenarios: (1) both parties are unsophisticated; (2) one sophisticated and one unsophisticated party, in a thin market of infrequent purchasers; (3) one sophisticated and one unsophisticated party, in a thick market with a high degree of interdependence.

In the first scenario (both unsophisticated) a state-contingent contract that specifies in advance all future states of the world relevant to contractual performance is a highly inefficient form of contract design. The costs of *ex ante* contractual specification are prohibitively high for small and legally unsophisticated business; in addition, the economic value of the individual transaction is likely to be too small to justify the expenditure in high drafting costs. In this context, parties use standardized forms and resort to courts in case of

¹⁷² *Ibid* at 63–65.

¹⁷³ *Ibid* at 65.

¹⁷⁴ David Frydlinger, Oliver Hart & Kate Vitasek, "A New Approach to Contracts: How to Build Better Long-Term Strategic Partnerships" (2019) 97:5 *Harvard Bus Rev* 116 at 119.

¹⁷⁵ *Ibid* at 121.

¹⁷⁶ *Ibid* at 123.

¹⁷⁷ Collins, "Implied Terms," *supra* note 37 at 323–30.

¹⁷⁸ See Gilson, Sabel & Scott, *supra* note 170 at 65.

¹⁷⁹ Frydlinger, Hart & Vitasek, *supra* note 174 at 123.

¹⁸⁰ Gilson, Sabel & Scott, *supra* note 170 at 65.

dispute. The lack of specific, bargained-for contractual rights makes it unlikely that judges use an interpretive version of good faith. The most suited model of judicial intervention is the suppletive version of good faith, which may or may not be practice-based depending on the thickness of the market.

The second scenario (sophisticated versus unsophisticated, infrequent purchaser in a thin market) involves problems similar to those encountered in non-commercial contracts — that is, an imbalance in sophistication levels tends to be associated with asymmetry of information and bargaining power. For example, a small or medium-sized organization that purchases a high-value item from a large-scale supplier. The position of the small or medium-sized organization resembles that of a consumer in standardized mass product markets, in that it is generally an infrequent purchaser dependent on information provided by the supplier, who cannot rely on the support provided by a purchaser's community. The asymmetric features of this transactional setting justify a shift in the normative focus of contract law from the enforcement of the common purpose of the parties to the protection of the party at a disadvantage. In this transactional setting the most suited version of good faith is corrective, non-practice-based.

The third scenario (sophisticated versus unsophisticated in a thick market with interdependence) is also characterized by structural inequality between parties. Unlike the previous scenario, however, the contract is relational in nature and there is a high level of economic integration between the parties. Collins maintains the incentive structure embedded in these types of transactional settings (or “quasi-integrated production regimes”) requires intensified duties of loyalty and co-operation implied by law.¹⁸¹ He states, “[t]hese contracts demand obligations of good faith in performance ... which lie closer to the end of the spectrum of good faith near fiduciary duties.”¹⁸² The thickness of the market allows for the emergence of trade organizations within the relevant community. In this transactional setting, the most suited version of good faith is corrective, practice-based. Franchise relationships are a good example.¹⁸³ Canadian courts recognize the transactional features of franchise contracts and derive legal consequences from them.¹⁸⁴ They apply a common law duty of utmost good faith to “shelter [the franchisee] from improper use of a discretion and other abuses [by the franchisor]”¹⁸⁵ and, as O’Byrne shows, the franchisor is more susceptible to an award of punitive damages for breach of the good faith duty.¹⁸⁶ Furthermore, private trade organizations now provide a normative framework for defining community standards of conduct.¹⁸⁷ This version of good faith has the characteristics of the practice-based, corrective

¹⁸¹ Collins, “Implied Terms,” *supra* note 37 at 326–29.

¹⁸² *Ibid* at 329.

¹⁸³ While the franchisee is typically an inexperienced, unsophisticated businessperson managing a small business, the franchisor is generally a legally sophisticated corporate entity. See also Gillian K Hadfield, “Problematic Relations: Franchising and the Law of Incomplete Contracts” (1990) 42:4 *Stan L Rev* 927.

¹⁸⁴ See e.g. *Shelanu Inc v Print Three Franchising Corp* (2003), 64 OR (3d) 533 (CA).

¹⁸⁵ Shannon Kathleen O’Byrne, “Breach of Good Faith in Performance of the Franchise Contract: Punitive Damages and Damages for Intangibles” (2004) 83:2 *Can Bar Rev* 431 at 444.

¹⁸⁶ *Ibid* at 445–47.

¹⁸⁷ See e.g. Canadian Franchise Association, *Code of Ethics* (Toronto: Canadian Franchise Association, 2007), online: <cfa.ca/about-cfa/code-ethics/>.

model: the duty of good faith is not disclaimable by the parties; the judge redresses the structural imbalances of the relationship.¹⁸⁸

B. NON-COMMERCIAL CONTRACTS

While most of the debate about good faith focuses on commercial contracts, it plays an important role in non-commercial (or personal) agreements. This category includes contracts in which at least one party is pursuing a *personal utility* rather than an economic profit such as consumer contracts, employment contracts, family agreements, and residential tenancies. While in commercial contracts the objective is to promote the common goals of the parties, in personal contracts the focus shifts to contractual fairness. The normative shift occurs at the presence of two distinct transactional features. In certain cases, the transactional setting skews the contractual relationship by systematically empowering one party at the other's disadvantage (for example, consumer contracts). In other cases, the subject matter of the contract involves personal services, such as family agreements or residential tenancies. In employment agreements, both personal subject matter and structural imbalance are present.

1. CONSUMER CONTRACTS

Three features of consumer contracts skew the contractual relationship by systematically and disadvantageously disempowering consumers. First, sellers are legally sophisticated actors who engage frequently in the same type of transaction, while consumers tend to be unsophisticated and infrequent purchasers. As a consequence of this asymmetric setting, consumers play no meaningful role in the specification of the substantive content of the contract. Second, a severe transaction-costs asymmetry between buyers and sellers puts consumers at a serious disadvantage in organizing collective action. Third, a large subset of consumer transactions concern products characterized by a high degree of complexity, which require specialist knowledge to assess (for example, vehicles, household services, electronic products, and domestic appliances). This is often the source of severe asymmetry of information as to the quality of the product or service, which puts consumers at further disadvantage.

The combination of these three features of consumer transactions influence the way in which implicit expectations are generated and disseminated within the market. Because the information that circulates in the market tends to be predominantly one-sided, this transactional setting provides unfavourable circumstances for the emergence of customary implicit understandings and consumer expectations.¹⁸⁹ Although mass markets are thick with low levels of uncertainty, consumers are fragmented and face insurmountable collective action problems. They are buying in a market in which others are unfamiliar, unsophisticated buyers of technically complex goods. In this setting, consumers lack incentive to share knowledge and create commonly institutionalized trade practices. As a result, the understandings and expectations surrounding the transactions tend to be shaped by

¹⁸⁸ For criticism of good faith as a strategy for regulating franchise contracts, see Andrew Terry & Cary Di Lernia, "Regulating the Franchise Relationship: Franchisor Opportunism, Commercial Morality and Good Faith" in Mika Tuunanen et al, eds, *New Developments in the Theory of Networks: Franchising, Alliances and Cooperatives* (Heidelberg: Physica-Verlag, 2011) 179.

¹⁸⁹ Wightman, "Beyond Custom," *supra* note 159 at 161–65.

information flow generated by suppliers or manufacturers, irrespective of consumers' interests. The one-sided flow of information generated in mass markets is often coupled with one-sided institutional arrangements for dispute resolution. Standardized consumer contracts are often characterized by boilerplate consumers' rights deletion schemes (such as exclusion liability clauses, forum selection clauses, and class action waivers).¹⁹⁰ These elements undermine the ability of consumers to establish customary implicit understandings and expectations permitting the realizations of their interests.

The previously examined transactional differences between consumer contracts and commercial contracts affect the type of judicial intervention required in disputes. In particular, the principle of good faith tends to operate differently. In commercial contracts, the relatively more balanced bargaining power and greater homogenous levels of legal sophistication of the parties favour the emergence of shared understandings and expectations between contracting actors. In this setting, courts are likely to use a suppletive version of good faith to insert the parties' implicit understating and expectations into the legal reasoning. By contrast, in standardized contracts between sophisticated sellers and unsophisticated purchasers, the consumers' interests and expectations are far less likely to be embodied in customary trade practices and therefore in binding contractual undertakings. Consumers are especially vulnerable to exploitation by way of contract terms that serve only the interests of one party. In this transactional environment, suppletive good faith is not a sufficient tool for realizing the tacit understanding of the parties, as common understanding is lacking. Good faith is best understood as a tool to protect the vulnerable party who cannot meaningfully participate in the design of the contract. In addition, as the market is unlikely to generate customary implicit understandings, the corrective version of good faith is likely to rely on either legally constructed criteria or in some form of moral reasoning. In short, in mass-market, standardized contracts between sophisticated sellers and unsophisticated purchasers judges are likely to use a corrective, non-practice-based form of good faith reasoning.

2. OTHER PERSONAL CONTRACTS

Other personal contracts involving subject matter concerned with non-commercial dimensions, such as home, family, and employment, entail a shift in the normative focus of contract law.¹⁹¹ As John Wightman has observed, these contracts involve an expectation of *personal* enjoyment and use (of the promised good, service, revenue) that, when defeated, results in a deeper sense of loss than that experienced by firms or other business organizations in commercial contracts.¹⁹² This point is understood by examining the different ways a breach of contract may affect the contracting party in commercial and non-commercial contracts. In commercial contracts, performance is not wanted for its own sake, but because it contributes to the business' ability to profit. Hence, the immediate impact of a contractual breach is monetary in nature. By contrast, in personal contracts the immediate consequence of a breach "is the loss of *use* of the good or service, of employment, of home,

¹⁹⁰ See Margaret Jane Radin, *Boilerplate: The Fine Print, Vanishing Rights, and the Rule of Law* (Princeton: Princeton University Press, 2013).

¹⁹¹ Joseph P Tomain, "Contract Compensation in Nonmarket Transactions" (1985) 46:4 U Pitt L Rev 867; Wightman, "Good Faith," *supra* note 38 at 41.

¹⁹² Wightman, *Contract*, *supra* note 38 at 97.

of membership.”¹⁹³ Because the loss is *experiential* in nature, it results in a much deeper impact on the life of the contractual party than the purely pecuniary loss characterizing commercial contracts. Furthermore, the difference between experiential losses and pecuniary losses is exacerbated by the ability of the parties to escape the loss or mitigate it. Commercial parties can often mitigate loss by spreading it or passing it on to other actors within the system of production and distribution. Meanwhile, non-commercial parties typically “do not have the means available to shift or spread the loss by scattering it among many other customers, workers or shareholders”;¹⁹⁴ the loss “falls on their shoulders and can be large as a proportion of an individual’s ‘turnover.’”¹⁹⁵

Because personal contracts affect individuals’ lives more deeply than commercial contracts, personal contracts imposition of duties on the parties and mandatory restrictions on the freedom of contract is usually regarded as more legitimate.¹⁹⁶ In particular, because of the distinctiveness of the personal interest involved, it is considered more appropriate for the law to promote a degree of protection of the parties’ interest that goes beyond protecting the expectations embedded in contractual terms. Should the judge apply a *corrective* version of good faith, to protect the expectation of the well-being of employees, tenants, cohabitants, and other parties involved in personal contracts, it is seen as more acceptable. Parties involved in personal contracts may operate within markets thick enough to allow judges to use a practice-based version of corrective good faith. This is true of residential tenancies. In other cases, parties operate in a thin market or the transaction presents unique features. Under these circumstances, corrective good faith is non-practice-based.

V. EXPLORING THE OUTER BOUNDARIES OF GOOD FAITH

This part revisits the disputes in *Callow* and *Wastech* in light of the analytical framework developed in Parts III and IV. The analysis includes the decisions of lower courts and the Supreme Court of Canada; these decisions usefully exemplify the judges’ use of restrained and expansionist approaches. The analysis highlights that courts often fail to incorporate into their decisions a systematic inquiry into the relationship between good faith and the transactional setting, and for this reason, they tend to either unduly restrict or unduly expand the outer limits of good faith. I do not argue that these decisions reach incorrect conclusions on the issue of good faith. I contend that the manner in which they reach and justify these conclusions is unsatisfactory, as they do not properly justify the choice of the version of good faith applicable to the fact, thereby contributing to a lack of clarity and transparency.

A. REVISITING *WASTECH SERVICES LTD. V. GREATER VANCOUVER SEWERAGE AND DRAINAGE DISTRICT*

1. THE ARBITRATOR DECISION: CORRECTIVE GOOD FAITH

The arbitrator’s decision in *Wastech* provides an example of an expansionist use of corrective good faith. Although *Wastech*’s expectation of reaching the Target OR was not

¹⁹³ *Ibid* [emphasis added].

¹⁹⁴ *Ibid* at 98.

¹⁹⁵ *Ibid*.

¹⁹⁶ Wightman, “Good Faith,” *supra* note 38 at 41.

embodied in the terms of the contract, the arbitrator considered it a legitimate contractual interest falling within the scope of *Bhasin*. Reasoning this way, the arbitrator used *Bhasin* to justify the use of a free-standing corrective version of good faith. It introduced in its reasoning a consideration concerning the fairness of the outcome, intended as a fair allocation of wealth between the contracting parties. That the arbitrator uses a corrective version of good faith is confirmed by the fact that he explicitly declined to imply the term invoked by *Wastech*, thereby excluding the use of a suppletive version of good faith. Once the path of using suppletive good faith was ruled out, the expansionist corrective route was the only way to provide legal ground to *Wastech*'s claim; however, the manner in which the arbitrator reaches his conclusions is unsatisfactory. First, he refers to the duty of good faith as a stand-alone concept, independent of existing doctrine. This is inconsistent with *Bhasin*'s conceptualization of good faith as a general organizing principle. Second, based on the proposed framework, if using a new good faith duty was the path the arbitrator was travelling, he should have expressly identified the features of the transactional setting justifying the focus on substantive fairness and the use of a corrective version of good faith. As previously argued, the use of corrective good faith is most likely to be justified in structurally unbalanced transactional settings when the subject matter of the contract involves non-commercial dimensions; however, both elements are missing in *Wastech*. In the absence of a careful explanation of why corrective good faith was warranted, the arbitrator's use of corrective good faith appears to be unjustified.

2. THE SUPREME COURT OF BRITISH COLUMBIA DECISION: INTERPRETIVE GOOD FAITH

The trial judge's decision in *Wastech* provides a more coherent use of an interpretive version of good faith as it explicitly grounds a restrained approach based on the characteristics of the transactional setting.¹⁹⁷ As previously explained, the issue arose out of *Wastech*'s failure to achieve its targeted financial objectives following Metro's discretionary decision to reallocate significant quantities of waste across disposal sites. This aspect of contractual performance was uncertain at the time of contract formation and not predictable with confidence by the parties. Both parties were legally sophisticated actors and, after considering the inclusion of a clause dealing with radical reallocations of waste, agreed to leave the provision out. Given the thinness of the relevant market, community standards dealing with the risks of waste reallocation were not available. The framework proposed in this article suggests that in this type of transactional setting (sophisticated commercial parties, thin market, moderate uncertainty) the use of a suppletive, non-practice version of good faith in the face of an incomplete contract is warranted. However, the legal significance of contractual incompleteness is itself the result of an interpretive assessment in light of the transactional setting. As the trial judge correctly pointed out, under these specific circumstances, the lack of a provision dealing with radical reallocation of waste should not be read as a gap requiring a suppletive intervention by the judge, but rather as the parties' acceptance of the loss-lie rule. The trial judge justifies their line of reasoning by explicitly considering the features of the transactional setting. He emphasized that this was a case in which two "sophisticated parties" deliberately left aside a term that might have addressed the

¹⁹⁷ *Wastech BCSC*, *supra* note 41.

issue;¹⁹⁸ that is, there was a common intention not to include such a provision in their agreement. Given the high level of legal sophistication of both parties, there was no basis to justify a suppletive intervention by the judge based on good faith and impose limitations on Metro's discretionary power that parties had considered and rejected.

3. THE BRITISH COLUMBIA COURT OF APPEAL DECISION: INTERPRETIVE GOOD FAITH

The British Columbia Court of Appeal upheld the trial judge's decision.¹⁹⁹ The Court's line of reasoning is another example of restrained strategy centered on the central proposition that an expectation can be described as contractual, and therefore be protected by the duty of good faith, only if it is embodied in the agreement between the parties. The adoption of this line of reasoning is justified, in this case, in light of the transactional setting within which the parties were contracting. However, the language used by the appellate Court to reject Wastech's claim of breach of good faith generalizes the restrained approach independent of the features of the transactional settings.

4. THE SUPREME COURT OF CANADA DECISION: AN AMBIGUOUS GOOD FAITH FRAMEWORK

The Supreme Court of Canada — perhaps in an effort to bridge restrained and expansive approaches — developed a conceptually ambiguous framework of the duty to exercise discretion in good faith. A large part of the Supreme Court's reasoning fits a restrained, interpretive version of good faith. Justice Kasirer stated, “[i]t is in properly *interpreting* the contract ... that the range of good faith behaviour comes into focus and breaches can be identified.”²⁰⁰ In addition, he repeatedly emphasized that the parties' intention, as they are disclosed in the terms of the contract, define the scope of the duty to exercise discretion in good faith. Furthermore, as noted, the Supreme Court clarified that when the text of the contract makes the parties' contractual purpose clear, the duty of good faith merely requires parties to exercise discretion according to the parties' bargain rather than interfering with their objectives or imposing duties beyond their reasonable contemplation.

However, several elements of the decision fit a more expansive version of good faith, including both suppletive and corrective aspects. First, the Supreme Court emphasized that “[p]arties who provide for discretionary power cannot contract out of the implied undertaking that the power will be exercised in good faith.”²⁰¹ This feature fits the corrective model of good faith in which the normative principle embedded in good faith (corrective justice according to the Supreme Court) supersedes the will of the parties. Second, the Supreme Court clarified that when the text of the contract does not clarify the parties' purpose, the outer boundaries of the duty of good faith are susceptible to a potentially unbridled expansion. That is, when the discretionary clause is “entire general,” the judge must look at the broader business relationship between the parties to identify the inherent limitations of the judge's power to scrutinize the exercise of contractual discretion. This part of the

¹⁹⁸ *Ibid* at para 57.

¹⁹⁹ *Wastech BCCA*, *supra* note 51.

²⁰⁰ *Wastech SCC*, *supra* note 19 at para 76.

²⁰¹ *Ibid* at para 94.

majority's ruling lends itself to justify the use by judges of a suppletive version of good faith, as the judicial intervention is rooted in the absence of contractual constraints to the exercise of discretion; however, it should be emphasized, once again, that the legal significance of an entirely general discretionary clause is itself the result of an assessment in light of the transactional setting. By failing to identify the transactional *variables* a judge should consider in constructing the sources and limits of judicial scrutiny, the Supreme Court equates *automatically* a general discretionary clause to a contractual gap that authorizes the judge's suppletive intervention. As the concurring opinion critically observes, "[t]his is not an exercise in interpretation. Rather, it is the imposition, *post facto*, of a judicial view."²⁰² That is, "[a]pproaching the interpretive task from such a starting point risks, even invites, undermining freedom of contract and distorting the parties' bargain by imposing constraints to which they did not agree."²⁰³

The framework proposed in this article suggests that the scope of judicial good faith scrutiny should vary according to the transactional features in which the duty of good faith operates. In contracts between legally sophisticated parties with relatively equal bargaining power, a general discretionary clause may reflect a cognizant allocation of risks by the parties. In this case, treating general discretionary clauses as contractual gaps enabling a judge's suppletive intervention may constitute undue interference with the parties' freedom of contract. Furthermore, if both sophisticated parties operate in a thick market community that supplies commonly accepted standards, the scope of judicial intervention shall be determined by community norms rather than by a judge's construction of its own power. By contrast, in contracts between parties with unequal bargaining power and an unequal level of legal sophistication, a general discretionary clause may not reflect a cognizant allocation of risks by the parties but rather the structural imbalance of the transactional environment. Thus, a more nuanced consideration of the features of the transactional settings within which the duty to exercise discretion in good faith operates would enable judges to more precisely and coherently define, on a case-by-case basis, the outer limits of judicial scrutiny. The lack of guidance for how to rationalize the judicially constructed scope of good faith scrutiny in the presence of a facially unfettered contractual discretion is the source of legal uncertainty regarding the outer limits of good faith.

It is worth noting that the concurring judges' reasoning overgeneralizes in the opposite direction than that of the majority. Justices Brown and Rowe state, "[w]ith careful drafting, parties can largely immunize the exercise of discretion from [judicial] review ... they may choose to specify the purpose for which a discretion has been granted in order to provide a clear standard against which the exercise of discretion is to be assessed."²⁰⁴ By reasoning this way, the concurring justices automatically equate a general discretionary clause to a clear manifestation by the parties of the intention to grant an unfettered discretion, thereby mirroring Justice Kasirer's overgeneralization — albeit in the opposite direction. In contracts between sophisticated parties with symmetrical bargaining power, it may be entirely appropriate to treat general discretionary clauses as the result of a cognizant allocation of risks enabling a narrow interpretive good faith regime; however, in the context of structurally

²⁰² *Ibid* at para 132.

²⁰³ *Ibid*.

²⁰⁴ *Ibid* at para 133.

unbalanced transactional settings, the use of a narrow interpretive good faith regime may actually defeat the purpose of good faith. In this latter scenario, the use of a corrective version of good faith may be justified to afford protection to the weaker party.

Finally, it is useful to emphasize that in the case at hand, the application of the suggested framework does not lead to a different substantive outcome than that reached by the Supreme Court. Rather, a transactional analysis would reinforce Justice Kasirer's reasoning that Metro's unfettered discretion reflected the parties' cognizant allocation of risks. The problematic aspect of the decision is not its substantive conclusion; it is rather the weak conceptualization of the general relationship between freedom of contract and good faith. By failing to incorporate the consideration of the features of the transactional settings into the conceptual framework delimiting the scope of the judicial scrutiny of contractual discretion, the decisions fail to coherently articulate the possible ways of structuring the role and content of the doctrine. The result is a spurious analytical framework failing to rationalize the use of various versions of good faith.

B. REVISITING *C.M. CALLOW INC. V. ZOLLINGER*

1. THE ONTARIO SUPERIOR COURT OF JUSTICE DECISION: CORRECTIVE GOOD FAITH

The trial judge's decision in *Callow* provides a useful example of an expansive corrective version of good faith as a stand-alone duty. Justice O'Bonsawin extended the duty to an act in good faith (as stated in *Bhasin*) to the termination of the contract. She found the defendant owed to the plaintiff a duty to disclose the intention to terminate the contract in advance of the formal notice period.²⁰⁵ Justice O'Bonsawin referred to the notion of "fairness" to correct the substantive content of the contract.²⁰⁶ Based on this non-practice-based version of corrective good faith, she imposed a contractual duty regardless of the parties' intention as expressed in the terms of the contract. In light of the proposed framework, the Court fails to properly articulate the use of an expansive corrective approach to good faith. The transactional setting in *Callow* is characterized by an unequal bargaining power and an asymmetric legal sophistication of the contracting parties (a small business dealing with ten condominium corporations). These features may warrant the use of a corrective version of good faith, and the Court could have relied on the analysis of these elements to more solidly justify the use of corrective good faith.

2. THE COURT OF APPEAL FOR ONTARIO DECISION: INTERPRETIVE GOOD FAITH

The Appellate Court's decision provides a useful illustration of the restrained strategy relying on an interpretive version of good faith. The Court's reasoning relies on the proposition that good faith should not extend beyond the expectations codified in the express

²⁰⁵ The trial judge stated, "as a result of *Bhasin*, it is arguable that the duty to act in good faith in performing a contract also extends to terminating a contract": *Callow* ONSC, *supra* note 92 at para 68.

²⁰⁶ She contends that parties must be able to rely on a minimum standard of honesty to ensure "a fair opportunity to protect their interests if the contract does not work out," *ibid* at para 60, quoting *Bhasin*, *supra* note 1 at para 86 [emphasis added].

terms of the contract.²⁰⁷ It denied compensation for damages based on the plain language of the agreement and determined that the duty of honesty, as stated in *Bhasin*, must not be extended to limit the exercise of an expressly bargained-for right. In light of the proposed framework, the Court's reasoning is lacking a proper justification for the use of the restrictive approach to good faith. The structural imbalance embedded in this transactional setting may prevent the implicit expectations of *both* parties to be addressed in formal contractual undertakings. Under these circumstances, the use of a corrective version of good faith, justified on the basis of a detailed consideration of the transactional setting, may be warranted. This does not suggest that Callow's expectation should have been automatically enforced by the judge as a legitimate contractual interest. Instead, the Court should have explained why the narrow interpretive version of good faith was warranted despite the fact that the underlying transactional setting put Callow at a disadvantage in furthering its own interests, although the stronger party had engaged in admittedly misleading behaviour. The structural imbalance of the transactional setting in *Callow* could have justified the adoption of a broad understanding of the contractual relationship. Ultimately, both the restrained approach of the Appellate Court and the extensive approach of the trial judge fail to justify their use of good faith on the basis of the transactional setting.

3. THE SUPREME COURT OF CANADA DECISION: CORRECTIVE GOOD FAITH

The Supreme Court's decision contradicted the Appellate Court's merely interpretive application of *Bhasin*, while at the same time correcting the trial judge's overly expansive corrective approach. While the Supreme Court upheld the trial judge's conclusion that the duty of honesty had been breached, it clarified that the trial judge had erred in stating that the duty required the corporation to inform Callow of perceived performance issues and to provide prompt notice of its intention to terminate. This went beyond what was needed to comply with the duty of honesty, which does not equate to a duty to disclose material information where such disclosure is not otherwise required by contract. The duty only requires the avoidance of knowingly misleading the counterparty regarding the future of the contractual relationship and that any misapprehension be corrected. Although the Supreme Court attempted to contain the trial judge's unduly expansive approach, the majority's reasoning still expands the duty of honest contractual performance by using a corrective version of good faith. The language used by the Supreme Court excludes both suppletive and interpretive versions of good faith — Justice Kasirer stated that good faith is not used “to provide, by implication, a new contractual term or a guide to interpretation of language.”²⁰⁸

The majority's use of a corrective version of good faith further obfuscates the contracting parties' good faith obligations under this duty. While the majority stressed that an assessment of whether a party has knowingly misled its counterparty is a highly fact-specific determination, it fails to identify the contextual variables that are relevant to that determination. Moreover, the Supreme Court emphasized that the breach of the duty of honesty must be directly linked to the performance of the contract, but insistence on an ill-defined “link” between dishonesty and contractual performance is not enough to clarify

²⁰⁷ *Callow* ONCA, *supra* note 97.

²⁰⁸ *Callow* SCC, *supra* note 16 at para 53.

whether and when a defendant's omissions or silence rise to the necessary level of dishonesty required to establish a breach of contract. Due to the incomplete conceptual framework articulated in *Callow*, legal uncertainty will likely persist in the near future as litigants test the outer limits of the duty of honest performance and courts endeavor to interpret and apply *Callow*.

Based on the proposed framework, I contend that an appropriate method for defining the scope of the parties' good faith obligations would have been to identify the features of the transactional setting underlying the case that justified the use of a corrective non-practice-based version of good faith. For example, in *Callow* the use of corrective good faith could have been justified in light of the structural imbalance of the transactional setting, whereby a small independent contractor was contracting with large condo corporations. It is possible that an application of corrective good faith was warranted in light of the inequality of bargaining power and asymmetry of legal sophistication between the parties. The thinness of the relevant market, and the related absence of an established community standard, could have justified the judge's use of a non-practice version of good faith; however, as these considerations are not captured by existing good faith doctrines, the judge could have clarified that a new doctrine of good faith is necessary to address the disclosure of the intention to terminate a contract between parties in structurally unbalanced transactional settings. This doctrine would impose a duty on the stronger, more sophisticated party to disclose the intention to terminate the contract to ensure a fair opportunity for the weaker party to protect its interests. The criticism of the majority's reasoning in *Callow* is independent of whether the substantive outcome reached in the decision was correct. My claim is that *if* the judge wanted to apply a corrective version of good faith, he should have followed the *Bhasin* procedure as operationalized on the basis of the framework proposed in this article. Justice Côté's dissenting opinion has partially captured this point by noting that what constitutes dishonest conduct will clearly depend upon the context, which includes — among other elements — the nature of the parties' relationship.²⁰⁹

C. REVISITING RESTRAINED STRATEGIES

The analysis of *Wastech* and *Callow* has emphasized the relevance of transactional factors in applying the general doctrines of faith grounded on *Bhasin*. While expansionist and restrained approaches rhetorically emphasize the fact-specific nature of good faith, they both fail to adequately account for the highly contextual nature of both the general organizing principle of good faith and the general contractual doctrines that derive from it.

One restrained strategy courts adopt relies on the proposition that good faith should not extend beyond the expectations codified in the express terms of the contract. That is, judges must use good faith *only* in its narrow, interpretive version. This proposition is in tension with *Bhasin*'s conceptualization of a general organizing principle of good faith and its related doctrines for three reasons. First, by tying it closely to the terms of the contract, good faith becomes essentially a surrogate of contractual interpretation. Because the task of providing legal recognition to the expectations embedded in the terms of the contract is fully accomplished by contract interpretation, good faith is redundant. This is especially true in

²⁰⁹ *Callow* SCC, *ibid*, Côté J dissenting.

a jurisprudential context in which contextualism is the preferred method of interpretation. Second, the idea that good faith is limited to its interpretive version is incompatible with *Bhasin's* proposition that good faith manifests itself through a variety of doctrines aimed at protecting parties' reasonable expectations. It is widely recognized in contract scholarship that written contracts are incomplete and that contracts' express terms fail to fully reflect the reasonable expectations of the parties.²¹⁰ These expectations arise from the broader normative context within which the agreement is formed. In light of these considerations, *Bhasin's* purported goal of promoting a greater fit between contract law and the actual expectations of the parties implies that its scope must include the *suppletive* version of good faith. This is also confirmed by *Bhasin's* express recognition that the doctrine of the implication of terms (usually employed by judges to discharge a suppletive version) is informed by good faith. Contractual interpretation *alone* is an insufficient tool for providing legal recognition to the parties' expectations as it operates within the limits of contract terms.²¹¹ Third, the idea that good faith must be tied closely to the terms of the contract is incompatible with the idea, stated in *Bhasin*, that good faith informs the doctrine of unconscionability, which is the manifestation of a normative version of good faith. Hence, the scope of good faith cannot be limited to its interpretive version; it must include its normative version as well. Furthermore, *Bhasin* and *Callow* emphasize that the duty of honesty (which stems from good faith) operates irrespective of the intentions of the parties, and as such, it cannot be excluded by an entire agreement clause. This contradicts the proposition that the good faith principle is limited by the express contract terms.

A second restrained strategy conceptualizes good faith as an implied term (as opposed to a judicial doctrine). Because implied terms can be disclaimed or overridden by the express terms of the contract, judicial interference with the parties' contractual freedom is contained. A few post-*Bhasin* decisions have adopted this restrained strategy,²¹² while others have clarified that good faith cannot be qualified as an implied term.²¹³ This divergence in the case law has been partially due to the fact that *Bhasin* does not originally clarify whether the *manifestations* of the good faith principle take the form of implied terms or contractual doctrines. On the one hand, the Supreme Court stated that the principle of good faith underlies several common law doctrines that are explicitly characterized as implied terms. On the other hand, *Bhasin* emphasizes that the newly created manifestation of the good faith principle, the duty of honesty, "should not be thought of as an implied term,"²¹⁴ as it "operates irrespective of the intentions of the parties, and is to this extent analogous to equitable doctrines which impose limits on the freedom of contract."²¹⁵ Initially, these statements could be read as a sign of the incoherent or contradictory nature of the Supreme

²¹⁰ See Ian R Macneil, "Relational Contract: What We Do and Do Not Know" (1985) 1985:3 Wis L Rev 483; Mitchell, *Contract Law*, *supra* note 160 at 104–24; Hugh Collins, *Regulating Contracts* (Oxford: Oxford University Press, 1999) at 154–57; Stewart Macaulay, "The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules" (2003) 66:1 Mod L Rev 44; Catherine Mitchell, "Contracts and Contract Law: Challenging the Distinction Between the 'Real' and 'Paper' Deal" (2009) 29:4 Oxford J Leg Stud 675.

²¹¹ Mitchell, *Contract Law*, *ibid* at 107, 239.

²¹² See *Energy Fundamentals Group Inc v Veresen Inc*, 2015 ONSC 692; *Energy Fundamentals Group Inc v Veresen Inc*, 2015 ONCA 514.

²¹³ *High Tower Homes Corporation v Stevens*, 2014 ONCA 911 at para 36; *Moulton Contracting Ltd v British Columbia*, 2015 BCCA 89; *Styles*, *supra* note 25. For detailed discussion, see Pasternak, *supra* note 40 at 137–40.

²¹⁴ *Bhasin*, *supra* note 1 at para 74.

²¹⁵ *Ibid*.

Court's reasoning. I argue, instead, that the Supreme Court's conceptualization can be coherently read as one emphasizing that good faith must be used by judges in different versions, depending on the transactional context in which good faith is to be applied. In this respect, the framework proposed here provides insights into how to coherently operationalize *Bhasin's* conceptualization of good faith.

The Supreme Court decisions in *Callow* and *Wastech* confirm that parties are not free to exclude the duty of honesty²¹⁶ and the duty to exercise discretion in good faith,²¹⁷ respectively. However, uncertainty remains on the proper qualification of other manifestations of good faith. Much of the uncertainty regarding to properly qualify the manifestations of good faith stems from the fact that judges use the doctrine of the implication of terms to perform quite different functional tasks.²¹⁸ As a consequence of the multiple functions discharged by the implication of terms, framing the issue of the proper qualification of the manifestations of good faith in terms of the choice between implied terms or contractual doctrines may be analytically misleading. This way of posing the issue fails to capture that different functions (interpreting, supplementing, or correcting the contract) may be performed by judges depending on the features of the transactional settings. The judge should first properly define the functional task pursued through good faith in light of the specific features of the transactional setting. On this basis, it is possible to clarify whether a manifestation of good faith should be properly qualified as a disclaimable contractual term rather than a judicial doctrine.

It is also worth noting that the fictional language of the implication of terms based on the presumed intention of the parties would not be required if the use of good faith is conceptualized in light of the proposed framework. A careful analysis of the features of the transactional setting supports using a corrective version of good faith. Inequality of bargaining power exists between the parties, the contract involves a personal dimension, and one party is locked into the relationship as a result of a specific investment. The use of corrective good faith could have been coherently and more transparently justified according to this framework.

D. REVISITING EXPANSIONIST STRATEGIES

While the majority of the post-*Bhasin* lower court decisions have consistently followed *Bhasin*, a few decisions have applied an expansive corrective version of good faith as a stand-alone duty.²¹⁹ These decisions have incurred in the same type of overgeneralization that underpins restrained strategies, by failing to incorporate a careful inquiry into the relevant transactional variables. The Court of Appeal for Ontario's decision in *Mohamed v. Information Systems Architects Inc.*²²⁰ provides an example. Mohamed entered into an Independent Consulting Agreement (ICA) with Information Systems Architects Inc. (ISA). The ICA provided a standard form contract that contained a termination clause providing that

²¹⁶ *Callow* SCC, *supra* note 16 at para 84.

²¹⁷ *Wastech* SCC, *supra* note 19 at para 94.

²¹⁸ See Rakoff, *supra* note 37; Collins, "Implied Terms," *supra* note 37.

²¹⁹ See e.g. *Styles*, *supra* note 25. For a useful assessment of post-*Bhasin* decisions, see Goswami, *supra* note 14.

²²⁰ *Mohamed* ONCA, *supra* note 25.

ISA had full discretion to terminate the contract together with an entire agreement clause. Before signing, Mohamed disclosed his criminal record. One month after the ICA was signed, a third-party client of ISA, with which Mohamed consulted, realized his criminal record and requested he be removed. The company terminated the ICA without considering him for other consulting projects. The motion judge stated good faith was recognized in *Bhasin* “as an operative principle in the performance of contracts.”²²¹ As such, the judge found the company’s unwillingness to find a solution other than outright dismissal a breach of the ISA’s duty of good faith in contractual performance. The trial judge essentially used a corrective version of good faith, expanding the scope of *Bhasin* to implement a cause of action independent of the existing doctrines.²²² He is not using an interpretive version of good faith, as he is *adding* a term to the contract rather than interpreting one. Neither is he using a suppletive version, which is meant to be faithful to the parties’ intention. Instead, the motion judge added a term that contradicts the contract express terms and is clearly inconsistent with ISA’s intention. The Court of Appeal upheld the motion judge’s expansionist approach and stated that although ISA had a right to terminate the contract, “it had an obligation to perform the contract in good faith and therefore to exercise its right to terminate the contract only in good faith.”²²³ In so doing, the Court confirmed the motion judge’s use of a free-standing good faith requirement aimed at enforcing considerations of substantive fairness irrespective of the express contract terms. It used a corrective version of good faith to enforce a weaker party’s expectation that was neither part of the contract nor grounded in *stare decisis*.²²⁴ This is not to say that the outcome of the decision is incorrect, but rather that the Court’s use of good faith is inconsistent with *Bhasin* and not supported by a sufficiently articulated and transparent justification of the use of good faith.

One may wonder whether *Mohamed* would be decided differently on the basis of the ruling in *Wastech*. *Mohamed* is a case of facially unfettered discretionary clause in which, according to *Wastech*, courts must look to the broader business relationship to identify the contractual objectives against which assessing the parties’ exercise of contractual discretion. One could speculate that the *Wastech*’s framework would not prevent a hypothetical judge from using a corrective version of good faith and impose their own view of what constitute a reasonable exercise of discretion. A hypothetical judge could argue, for example, that the reason ISA terminated the contract had no connection with the performance of the contract; despite the contract conferred to ISA an unfettered discretionary right to terminate and contained an entire agreement clause, ISA’s exercise of its discretionary power was unreasonable as it was unconnected with the purposes for which discretion was granted by the contract. This illustrates, at least in part, the limited effectiveness of *Wastech*’s conceptual framework in providing a coherent delimitation of the outer boundaries of judicial review.

Based on the proposed framework, once the court chooses to use a corrective version of good faith outside the existing doctrines, it should justify this choice based on a careful analysis of the underlying transactional environment. The transactional setting in *Mohamed*

²²¹ *Mohamed v Information Systems Architects Inc*, 2017 ONSC 5708 at para 40 [*Mohamed* ONSC].

²²² The judge did not consider the case law addressing whether a contractual discretion clause embodies a good faith standard.

²²³ *Mohamed* ONCA, *supra* note 25 at para 18.

²²⁴ For a similar criticism of the decision, see MacQueen & O’Byrne, *supra* note 27 at 310.

possesses the features that typically justify the use of a normative version of good faith. The contract is personal in nature (consulting service agreement) and an inequality of bargaining power exists between ISA and Mohamed. One weaker party is locked into the relationship and is exposed to the risk of an arbitrary exercise of contractual discretion by the stronger party. Under these circumstances the judge could coherently justify the use of a corrective version of good faith. A more articulate justification of an expansionist approach, in light of the features of the transactional setting, would not have changed the outcome of the decision, but it would have explained why the court expanded the scope of good faith and did not enforce the express terms of the contract. In turn, this would have clarified certain conditions under which good faith may be used by future courts to override the contractually defined allocation of risk.

As previously noted, corrective good faith carries the risk of a potentially arbitrary expansion. This stems from the indeterminacy of the notions of fairness that typically inform corrective good faith. Cognizant of this point, the Supreme Court of Canada repeatedly stated in *Bhasin*,²²⁵ *Callow*,²²⁶ and *Wastech*²²⁷ that good faith is not a free-standing duty. Parties cannot call upon courts to enforce a general duty of good faith, and judges cannot apply good faith outside the scope of specific contract doctrines such as, for example, the duty of honesty in contractual performance or the duty to exercise discretion in good faith. In addition, both *Callow* and *Wastech* attempt to anchor the scope of good faith to the parties' reasonable contemplation by emphasizing that the scope of the duty of honesty is controlled by its direct link to contractual performance (*Callow*) and that the fulfillment of the duty to exercise contractual discretion in good faith should be assessed against contract purposes. This is how the Supreme Court attempts to prevent the emergence of ill-defined, independent, general duties of good faith against which judges could assess all aspects of contractual performance. The analysis of *Wastech* and *Callow* reveals that margins ambiguity and uncertainty surrounding the definition of the outer limits of the doctrines of good faith persist as these doctrines are derived from *Bhasin*. The proposed framework suggests that once the court chooses to use a corrective version of good faith, it should justify this choice based on a careful analysis of the underlying transactional environment.

VI. CONCLUSIONS

The incomplete conceptualization of the duty of good faith in *Bhasin* fails to show how the organizing principle can provide guidance to identify the content and extension of both the current manifestations of good faith and the newly derived ones. Legal uncertainty over the outer boundaries of good faith has resulted from this lack of explanation. The analysis of the Supreme Court of Canada's decisions in *Wastech* and *Callow* reveals that two major sources of ambiguity and uncertainty surrounding the definition of the outer limits of the doctrines of good faith persist when these doctrines are derived from *Bhasin*. A few scholars and judges have reacted to the problems left unsolved in *Bhasin* by reading it narrowly or rejecting the idea that the case imparts a general duty of good faith into Canadian contract law. Rather than resisting the recognition of a general principle of good faith, this article

²²⁵ *Bhasin*, *supra* note 1 at para 64.

²²⁶ *Callow* SCC, *supra* note 16 at para 44.

²²⁷ *Wastech* SCC, *supra* note 19 at paras 50–51.

offers methodological guidelines to operationalize the organizing principle of good faith stated in *Bhasin*, thereby providing judges with a framework for a coherent, transparent justification of the use of alternative versions of the good faith principle.

The analysis of the decisions in *Wastech* and *Callow* reveals two major sources of uncertainty regarding the outer boundaries of the duty of honesty in contractual performance or the duty to exercise discretion in good faith: (1) the required nexus between the particular terms of the contract and a contracting party's legitimate contractual expectations; and (2) the unclarified normative sources of good faith standards. In my proposed framework, these two unsettled elements are conceptualized as institutional variables: functional tasks and substantive criteria, respectively. The way these two institutional variables operate within the process of contract adjudication varies depending on the transactional setting within which good faith operates. Therefore, a systematic inquiry into how the transactional variables inform the institutional variables helps explain the varying scope of good faith duties across different transactional contexts. The conceptual framework enables judges to reconcile the legitimate concerns underlying restrained and expansionist strategies by formulating more nuanced propositions concerning the definition of the outer boundaries of good faith in relation to specific features of the transactional settings.

I identify three distinct functional models of good faith: interpretive, suppletive, and corrective. Each model is characterized by a different relationship between good faith obligation and contract terms and can rely on either practice-based or non-practice-based substantive criteria to define the applicable good faith standards. Determining whether a judge should apply an interpretive, suppletive, or corrective version of good faith is not easy. Based on the vast scholarly and jurisprudential debate on good faith, I hypothesize that the choice of the appropriate model of good faith hinges in large part on a few key features of the transactional setting.

The level of legal *sophistication* of the contracting parties and the level of *uncertainty* surrounding contractual performance affect the parties' ability to engage in *ex ante* specification of contract terms. This affects the judge's choice of the appropriate functional task of good faith. The higher the level of sophistication and lower the level of uncertainty, the less the contracting parties need to rely on the suppletive intervention of the judge. In this transactional context, an interpretive version of good faith is likely to be appropriate. At moderate levels of uncertainty, a suppletive version of good faith is fitting. At very high level of uncertainty, the role of the judge is to identify and sanction forms of opportunistic behaviours aimed at violating the procedures established by the parties to define the mechanism of contractual governance. In this context, a restrained, interpretive version of good faith is likely more suitable.

The *thickness* of the market, or the number of traders engaged in a class of transactions with similar characteristics, allows the community to develop a common contracting infrastructure that addresses the most frequent transactional risks. In a thick market, with legally sophisticated entities, any actor wishing to participate will normally have to accept the commonly adopted practices. It is plausible that where the market is thick, parties engaged in contract design are likely to rely on these community standards to define their

normative expectations. Any use of good faith by judges will be practice-based. Conversely, in thin markets any use of good faith by judges will be non-practice-based.

Power inequality or informational asymmetries between the parties provides a prima facie case for the adoption of a corrective version of good faith. I examine the distinctiveness of the use of good faith in personal contracts and show that the normative focus of contract law shifts from promoting the goals of the parties to promoting contractual fairness and protecting the weaker party. This explains why, unlike commercial contracts, personal contracts courts are more likely to use a corrective version of good faith. The principle of good faith is more legitimately used to compel one party to serve or protect the interests of the other party.

The use of corrective good faith involves a heightened risk for an unbridled, potentially arbitrary expansion of the scope of good faith. As such, a corrective version of good faith should be carefully articulated through specific contractual doctrines. This emphasizes the importance of the analytic process established in *Bhasin* for the promulgation of new good faith duties. Courts should first determine whether an issue falls within the existing doctrines; they should then determine whether a new doctrine should be derived; finally, they should define the substantive content of the newly derived good faith duty. The proposed analytical framework provides guidelines on how to operationalize these three steps and prevents the use by lower courts of a corrective, stand-alone duty of good faith in disregard of the express terms of the contract. The proposed framework is applied to *Callow* and *Wastech* to show how judges could have improved the transparency of their decisions by using the analysis of the transactional context to justify the use of different versions of good faith.