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Beyond the Four Corners of the Contract: The Parol Evidence Rule, Implied Terms and the Duty of Good Faith

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Case commented on: *Bhasin v Hrynew*, 2013 ABCA 98, leave to appeal granted, 2013 CanLII 53400 (SCC)

This appeal is ultimately about contractual interpretation. It is about the types of obligations, over and above the express terms, that can be brought into the contract and the difficulties created as a result of the assertion that the contract goes beyond its express terms. Importantly, it considers the duty of good faith in the context of commercial relations and, as stated by the Supreme Court of Canada, which has granted leave to appeal, whether such duty could be excluded by an entire agreement clause.

Facts

Canadian American Financial Corp (Canada) Limited ("Canadian American"), a subsidiary of Allianz Life Insurance Company of North America, registers education savings plans. This registration is done through retailers, two of whom are Mr. Bhasin and Mr. Hrynew, the parties in this case.

The operation is governed by a contract between Canadian American and each dealer. Years into the contractual relationship, Canadian American proposed amendments to the contracts. The dealers were given an opportunity to consider the proposed wording; they obtained a legal opinion about the new wording, and when the dealers' counsel suggested changes in wording, Canadian American accepted much of it. Some dealers signed the new contract; others chose to remain under the old one. Mr. Bhasin received a copy of the legal opinion, which included a negotiation of clause 3.3 (which is in issue in these proceedings), and he signed the new contract.

When the Alberta Securities Commission, the regulator of the registered education plan industry, became concerned about what it perceived to be inadequate compliance to the regulations by the dealers, it directed Canadian American to appoint one of its members to monitor compliance, which included auditing the dealers. Canadian American appointed Mr. Hrynew to monitor compliance, and Mr. Bhasin was one of the dealers being audited. While Mr. Bhasin had no problem with being audited, he did object to being audited by Mr. Hrynew because Mr. Hrynew was a competitor and Mr. Bhasin did not wish to disclose to him his confidential information. To that end, Mr. Bhasin did not permit the audit by Mr. Hrynew.

While Canadian American did not disagree in principle with Mr. Bhasin's concerns, it nonetheless subsequently gave Mr. Bhasin notice that it intended to let the contract lapse when it came up for renewal. It did not rely on the clauses in the contract allowing for termination on

short notice, which it was permitted to do under clause 3.3; rather, it relied on the notice requirements in clause 3.3. Clause 3.3 allowed Canadian American to notify Mr. Bhasin that it would let the contract lapse, provided it gave him notice of at least 6 months:

> 3.3 The term of this Agreement shall be for a period of three years from the date hereof (the "Initial Term") and thereafter shall be automatically renewed for successive three year periods (a "Renewal Term"), subject to earlier termination as provided for in section 8 hereof, unless either CAFC or the Enrollment Director notifies the other in writing at least six months prior to expiry of the Initial Term or any Renewal Term that the notifying party desires expiry of the Agreement, in which event the Agreement shall expire at the end of such Initial Term or Renewal Term, as applicable.

Mr. Bhasin sued Canadian American. The trial lasted 24 days and the court heard a lot of parol evidence. At trial, Mr. Bhasin was awarded $381,000 in damages, based on breach of an implied term "that any decision whether or not to renew the contract had to be carried out in 'good faith'" (at para 15). The Court of Appeal allowed the appeal and dismissed the lawsuit.

Judgment/Analysis

The Court of Appeal dealt with a few issues, but I will only be discussing parol evidence, implied contractual terms and the duty of good faith. Most of these issues can be resolved with a few basic principles of contract law. Essentially, the agreement between Canadian American and Mr. Bhasin, on its face and according to the strict wording, allows Canadian American to terminate the agreement under these or any circumstances, providing timely notice was given. For Mr. Bhasin to assert a breach, he must be successful in arguing either for a contractual undertaking in the form of parol evidence, which is not part of the main written contract, or for an implied term importing a duty of good faith into the main contract.

Parol Evidence

Parol evidence is written or oral evidence not contained in the contract, used to vary the terms of the contract. The parol evidence rule maintains that parol evidence cannot be admitted to assist in interpreting the contract if the contract itself forms the full agreement, or if the contract is unambiguous or clear. There are some exceptions to the parol evidence rule, which will be visited below.

The trial judge let evidence on circumstances surrounding the negotiation of the contract be admitted, in addition to evidence on "what the parties felt and wished and expected" (at para 28) as well as evidence on the oral promises that were made. The trial court found, based on the evidence, that there were pre-conditions to the non-renewal under clause 3.3 (at para 25).

In this case, Mr. Bhasin did not argue that the contract was ambiguous or unclear (at para. 22), nor did the Court of Appeal make those findings (at para 30). Rather, he argued that the contract did not cover the circumstances that transpired, thereby creating the need for the admission of parol evidence (at para 22).

In this case, there is an entire contract clause in the contract:

> 11.2 This Agreement expresses the entire and final agreement between the parties hereto and supersedes all previous agreements between the parties. There are no representations, warranties, terms, conditions or collateral agreements, express, implied or statutory, other than expressly set out in this Agreement.

The inclusion of an entire-agreement clause bars the consideration of parol evidence, especially if the agreement is unambiguous. To that end, as the appellate court found, the trial court should not have allowed the inclusion of parol evidence. To the extent that, as Mr. Bhasin argued, the contract did not cover the circumstances in issue, it is typically the case that a contract cannot anticipate and account for every possible contingency. Rather, one of the things it can do is provide the ability by each party to terminate the contract upon certain events, or act reasonably.

In this case, clause 3.3 prescribes for the automatic renewal of the agreement every three years, unless the party is notified in writing at least six months prior to the expiry of the term of the agreement. According to the provisions set out in the judgment, and the reasons provided, it appears that there are no preconditions that need to be met for termination, so long as timely notice is provided. There is allowance for earlier termination under a different clause, where there is misconduct. When Canadian American notified Mr. Bhasin that it would not be renewing the contract when it next came up for renewal, it did so under clause 3.3, not the misconduct clauses. Pursuant to the agreement, Canadian American was allowed to terminate the agreement in this way.

Given the above, the trial court was not permitted to rely on parol evidence to interpret this agreement, unless one of the exceptions to the parol evidence rule applied. One exception to the parol evidence rule is evidence on the validity of the agreement, such as unconscionability. If there is evidence to show there was unconscionability at the time the parties entered into the contract, the evidence could be admitted to show the invalidity of the contract. The trial judgment mentioned inequality of bargaining power or sophistication but the appellate court found the factual conclusions to be unsustainable (at para 34). Inequality of bargaining power is present in most contracts, and, alone is not enough to support a claim of unconscionability. If that inequality is coupled with independent legal advice, which Mr. Bhasin received, a claim of unconscionability would be difficult to advance.

Therefore, if Mr. Bhasin wished to advance a claim based on duties or understandings not expressly included in the contract, getting around the parol evidence rule was not the most fruitful path. Given the structure of the agreement, and the circumstances in which the agreement was entered into, the parol evidence rule would be applicable in these circumstances, which bars the admission of parol evidence and leaves us only with the obligations contained in the main contract.

Implied Terms/Duty of Good Faith

In *Skye Properties Ltd v Wu*, 2010 ONCA 499 at para 79, the court maintained that it was its goal, when interpreting a contract, to give effect to the intention of the parties at the time the contract was made. To that end, the court may imply terms into the contract, implied terms being those not expressed in words. However, imposing implied terms is a judicial tool that can cause much uncertainty and instability, and as a result, the test for implying a term is not the standard test typically applied in contract law, being one of reasonableness, but rather, the test is a more onerous one of necessity. As Justice Iacobucci stated in *M.J.B. Enterprises Ltd. v Defence Construction (1951) Ltd.*, [1999] 1 SCR 619 ("*M.J.B. Enterprises Ltd.")*:

> [29] A court, when dealing with terms implied in fact, must be careful not to slide into determining the intentions of reasonable parties. This is why the implication of the term must have a certain degree of obviousness to it, and why, if there is evidence of a contrary intention, on the part of either party, an implied term may not be found on this basis.

Given the consequences of implying contractual terms, in principle, the tool must therefore be used carefully and restrictively, but, that all said, it is not infrequent for judges to imply terms (S.M. Waddams, *The Law of Contracts, Fifth Edition* (Toronto: Canada Law Book, 2005), at 493-4)). As a result, rules have been developed, to allow for the imposition of implied terms only in specific circumstances, namely, as specified in *M.J.B. Enterprises Ltd.* (at 634-35), in three situations: (1) if the parties presumptively intend for the term to be there; (2) if the custom or usage of the trade requires it; or (3) to give business efficacy to the agreement (otherwise known as the "officious bystander" test).

Additionally, the argument has been made, and there is case law on the point, regardless of the presumed intention, that terms can be implied into an agreement "when a court believes that, whether or not the parties thought about the point, an obligations has to be imposed on one side" (Angela Swan & Jakub Adamski, *Canadian Contract Law, Third Edition* (LexisNexis Canada Inc., 2012) at §8.102.7. Swan and Adamski go on to cite *Liverpool City Council v Irwin*, [1976] UKHL 1, [1977] AC 239, [1976] 2 All ER 39 (HL), where the plaintiff landlord, who had not maintained the building appropriately, sued the tenants for rent arrears which the tenants had withheld in an effort to get the landlord to fix the facilities. The House of Lords, in upholding the majority judgment in the Court of Appeal, found that imposing an obligation on the landlord was necessary and reasonable. Lord Wilberforce said, with regard to the facilities that had not been maintained,

> All these are not just facilities, or conveniences provided at discretion: they are essentials of the tenancy without which life in the dwellings, as a tenant, is not possible. To leave the landlord free of contractual obligations as regards these matters, and subject only to administrative or political pressure, is, in my opinion, inconsistent totally with the nature of this relationship. The subject matter of the lease (high rise blocks) and the relationship created by the tenancy demand, of their nature, some contractual obligation on the landlord.

In *Canadian Pacific Hotels Ltd. v Bank of Montreal*, [1987] 1 SCR 711, Le Dain J. commented on *Liverpool City Council v Irwin* by noting that the House of Lords "held that [the proposed implied term] could, and should, be implied as a legal incident of that particular kind of contractual relationship, regardless of presumed intention" (at para 44). Therefore, even if the initial test for implied terms is not met, it may be possible to argue that it is necessary and reasonable to impose an implied obligation in this case. If so, what would the nature of the implied obligation be? Mr. Bhasin argued that the implied obligation ought to be one of carrying out the contract in good faith. Given that, can a duty of good faith be implied in a contract?

There is no standalone duty of good faith in Canadian law. It has been found in certain types of contracts, but not as a broad, overriding principle in all contracts. The approach by Canadian courts to the duty of good faith was aptly summarized in *Transamerica Life Canada v ING Canada* (2004), 68 OR (3d) 457 (CA):

> [53] Canadian courts have not recognized a stand-alone duty of good faith that is independent from the terms expressed in a contract or from the objectives that emerge from those provisions. The implication of a duty of good faith has not gone so far as to create new, unbargained-for, rights and obligations. Nor has it been used to alter the express terms of the contract reached by the parties. Rather, courts have implied a duty of good faith with a view to securing the performance and enforcement of the contract made by the parties, or as it is sometimes put, to ensure that parties do not act in a way that eviscerates or defeats the objectives of the agreement that they have entered into…

In addition, any implied duty of good faith cannot be used to alter the words of the contract (*Agribands Purina Canada Inc. v Kasamekas*, 2011 ONCA 460 at para 51).

Presuming the contract in issue is an employment contract, and the Alberta Court of Appeal neither agreed nor disagreed on this point (at para 27, no 1), there are some elements of it that could have a duty of good faith imposed on them. Employment contracts are different than other commercial contracts in that there is an inherent inequality of bargaining power between the employer and employee. As *Wallace v United Grain Growers Ltd*. [1997] 3 SCR 701, 152 D.L.R. (4th) 1 noted, "This results in employee vulnerability -- a vulnerability that is especially acute at the time of dismissal. The nature of the relationship thereby necessitates some measure of protection for the vulnerable party" (at para 138). However, this does not impose a duty of good faith on the carrying out of every aspect of the employment contract. It imposes it when an employer is dismissing an employee. Importantly, however, this good faith obligation "does not extend to prohibiting employers from dismissing employees without 'good faith' reasons… Both employer and employee remain free to terminate the contract of employment without cause. This is not inconsistent with the duty of good faith" (*Wallace* at para 135).

The difficulty in this case is determining the exact cause of action. Mr. Bhasin does not take issue with the contract itself (at para 22), nor with the way in which he was dismissed. He also does not base his claim on Canadian American's reasons for not renewing his contract (at para 16). The Court of Appeal alludes to the same issue, where it confirms that the issues referred to in the trial reasons were never pleaded. The appellate judgment also does not lay out the substance of the parties' arguments. It appears, and I will base my conclusion on this point, that Mr. Bhasin claims he was wrongfully terminated. The trial reasons say that the notice given to Mr. Bhasin by Canadian American was ineffective, and that the contract would automatically renew every three years "if the motive for giving the notice does not meet certain standards" (at para 33).

Could the commentary in *Liverpool City Council v Irwin* and *Canadian Pacific Hotels* be used to support the imposition of a duty of good faith on Canadian American? The trial court said a duty of good faith could be imposed on Canadian American, to have "a very good reason" not to renew the employment contract (at para 15, relying on the reasons at trial). But there is no reasonable likelihood of having a duty of that nature imposed, given the principles that have arisen through case law in the area, and given the contract in issue. As noted above, employers and employees can terminate the contract of employment without cause. Reasonable notice of the termination needs to be given, which is not an issue in this case, but beyond that, the contract can be terminated. However, we may still be able to apply *Liverpool City Council v Irwin* here, to argue that the subject matter of the contract itself could impose a duty of good faith. Consider also that in *Jacobs U.K. Limited v Skidmore Owings & Merrill LLP*, [2012] EWHC 3293 (TCC),

the court found general obligations of good faith could be imposed on both sides to make the contract work, which is about "mutual commercial conduct" (at para 20).

In my opinion, the claim (which is never directly stated in the appellate decision) is not about having or not having a reason not to renew the employment contract. Rather, the claim relates to the main factor that contributed to Canadian American's decision to terminate Mr. Bhasin, which was one created by Canadian American itself. When Canadian American appointed Mr. Bhasin's competitor to audit Mr. Bhasin, it created a situation which put Mr. Bhasin in a clear conflict – either he had to submit to turning over his confidential information to his competitor or refuse to be audited. When he voiced his concerns, Canadian American "did not disagree in principle" but it then proceeded to give him timely notice that when his contract came up for renewal, it would let it lapse. This leads to the argument that there could be a duty of good faith. Could a duty of good faith be imposed on an employer to ensure the employer does not create circumstances in which an employee faces the choice of performing his employment duties to his detriment, or not at all?

In *Culina v Giuliani,* [1972] SCR 343, the Court held that a party cannot make performance of the contract impossible, which is arguably a situation Canadian American created here. And in *Transamerica Life Canada*, Associate Chief Justice O'Connor said "[C]ourts have implied a duty of good faith with a view to security the performance and enforcement of the contract made by the parties, or as it is sometimes put, to ensure that parties do not act in a way that eviscerates or defeats the objectives of the agreement that they have entered into" (at para 51). Taking these principles together, as well as the fact that the doctrine of the duty of good faith is continuing to develop, and applying it to the situation created by Canadian American, it is arguable that a good faith duty could be imposed on an employer to refrain from putting its employee in a position where the employee must act to his detriment in carrying out his employment duties or face termination. By doing so, Canadian American simply undermined the contract and defeated the ability for the parties to act according to their contractual obligations.

These principles taken together can also support the argument for a good faith duty in these circumstances even if this is not an employment contract. In a purely commercial contract, as said in *Transamerica Life Canada*, parties cannot act in a way to undermine the goals of the agreement they entered into, which is arguably exactly what turning over confidential information to a competitor would do, even if a confidentiality agreement is signed. These principles do not need the higher measure of protection necessary in an employment contract in order to be applicable.

Conclusion

The Court of Appeal did not find a duty of good faith here, but depending on the issues pleaded (which are not all that clear from the appellate decision), it might have been possible to find one, especially if an employer/employee relationship did in fact exist between Canadian American and Mr. Bhasin. It would simply be an obligation of good faith imposed on an employer to not require its employee to act to its detriment, or failing so, face termination. And even without an employment relationship, there is nonetheless arguably a good faith duty here, to simply make it possible to carry out the contract without undermining its goals.

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