Decomposing Bhasin v Hrynew: Toward an Institutional Understanding of the General Organizing Principle of Good Faith in Contractual Performance

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In Bhasin v Hrynew, the Supreme Court of Canada recognized good faith in contractual performance to be a 'general organizing principle' of the common law of contract. The true impact of Bhasin on the future development of the Canadian contract law remains the subject of considerable debate among legal scholars and practitioners. This article explores Bhasin’s evolutionary impact on the Canadian common law of contract, by providing an institutional understanding of the general organizing principle of good faith in contractual performance. It is contended that Bhasin’s contribution to the common law of contract is institutional rather than substantive – Bhasin fundamentally alters the organization of the sources of contract law by introducing a new law-making mechanism (that is, ‘law-making through good faith’) that is separate from, and potentially supersedes, the traditional doctrine of precedent. To support the central claim that Bhasin's contribution is institutional rather than substantive, I employ three different kinds of arguments that correspond to three distinct, but closely related, dimensions of the principle of good faith in contractual performance: (a) semantic structure; (b) historical origins; and (c) economic function. Although these three lines of inquiry rest on quite different methodological premises, they converge in supporting the central idea that good faith performance is best understood as an institutional mechanism to allocate law-making power rather than a substantive legal principle.

Keywords: good faith, sources of law, legal reasoning, doctrine of precedent, economics of law-making
A ANALYTICAL GOALS

In *Bhasin v Hrynew*, the Supreme Court of Canada undertook two fundamental steps.\(^1\) First, it recognized good faith in contractual performance to be a ‘general organizing principle’ of the common law of contract. Second, it articulated a new ‘duty of honesty’ in contractual performance that emanates directly from the principle of good faith. The Court’s purported intent was to bring coherence to contract law, thereby fostering legal certainty and protecting reasonable commercial expectations.\(^2\) Yet, the true impact of *Bhasin* on the future development of the Canadian common law of contracts remains the subject of considerable debate among legal scholars and practitioners.\(^3\) Supportive commentators have welcomed the decision as an important step towards greater clarity in contract law.\(^4\) More critical commentaries have raised the

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1 2014 SCC 71, [2014] 3 SCR 494 [*Bhasin SCC*].

2 Ibid at para 62.


4 See e.g. Hall, ‘Bhasin,’ supra note 3 at 336: ‘*Bhasin* is a huge and welcome step in that it rationalizes a heretofore hopelessly confused area of law’; Swan, ‘The Obligation,’ supra note 3 at 404: ‘The development of the new organizing principle will contribute to certainty because it shows [or prescribes] where judges should now start to think about the obligations on [and the consequences for] parties who tell lies. . . . The
spectre of legal uncertainty and expressed deep concerns that the new general doctrine of good faith may interfere with the principle of freedom of contracts. Others scholars have debunked the precedential significance of *Bhasin* or diminished its practical relevance, emphasizing that the decision is unlikely to revolutionize the Canadian common law of contracts.

The debate has seldom considered, however, the institutional dimension of *Bhasin*—that is, the impact of the general organizing principle of good faith on the institutional mechanisms underlying the evolution of the common law of contracts. In particular, commentators have generally fallen short of identifying the institutional mechanisms explaining the purported beneficial or disruptive impact of *Bhasin* on legal certainty and contractual freedom. Yet, lacking a rigorous institutional analysis, the debate has thus far missed the potentially profound evolutionary implications of the new, overarching doctrine of good faith. In addition, the Supreme Court of Canada has left some crucial institutional questions unanswered. *Bhasin* does not comprehensively discuss the nature and characteristics of the general organizing principle of good faith or its role in the adjudication process. To the extent that these fundamental questions remain unanswered, the meaning of *Bhasin* and its impact on the future development of contract law remain difficult to appreciate fully.

Based on these considerations, this article turns to the institutional dimension of good faith to analyze *Bhasin*’s contribution to the common law of contracts. The underlying methodological assumption is that, because the substantive content of good faith is inherently indeterminate, good faith is better understood as an institutional tool for allocating law-making power than as a substantive principle for allocating legal entitlements. Based on this methodological premise, this article’s central

effect of the new organizing principle is that a number of disparate “heads of recovery” are brought within a powerful and useful analytical framework”;

Finkelstein, ‘Honour,’ supra note 3 at 370: ‘[T]he decision serves as a map that brings some cohesion to the large and confusing body of case law on the application of good faith to contracts, which has been difficult, if not impossible to reconcile.’

5 See e.g. Peters, ‘Tell Me,’ supra note 3 at 6: ‘Commercial certainty will necessary suffer, particularly where the Court has signalled that the law will continue to develop incrementally.’

6 See e.g. Hunt, ‘Good Faith,’ supra note 3 at 7 (claiming that the new general principle of good faith ‘has the potential to generate an unforeseen host of discrete obligations, and, with respect, seems inescapably to pose a significant threat to freedom of contract’).

7 See e.g. Bolieiro, ‘Bhasin,’ supra note 3 at 6: ‘[T]he organizing principle of good faith will not break contract law. As Justice Cromwell made clear, claims of good faith will generally not succeed unless they fall within one of the existing categories of relationships or situations already recognized in common law Canada.’
thesis is that Bhasin’s contribution to the Canadian common law of contracts is institutional rather than substantive. Bhasin fundamentally alters the organization of the sources of contract law by introducing a new law-making mechanism (that is, ‘law-making through good faith’) that is separate from, and potentially supersedes, the traditional doctrine of precedent. On this view, Bhasin significantly expands the power of courts to introduce new contractual doctrines independent of well-consolidated cases, thereby incrementally shifting the allocation of law-making powers from private actors to adjudicating bodies.

To support the central claim that Bhasin’s contribution is institutional rather than substantive, this article employs three different kinds of arguments that correspond to three distinct, but closely related, dimensions of the principle of good faith in contractual performance: (a) the semantic structure; (b) the historical origins; and (c) the economic function. Although these three lines of inquiry rest on quite different methodological premises, they converge in supporting the central idea that good faith performance is best understood as an institutional mechanism to allocate law-making power rather than a substantive legal principle.

First, semantic analysis illuminates two fundamental aspects of good faith. On the one hand, good faith exhibits the characteristics of ‘general clauses,’ which are structurally designed to empower judges to choose among competing evaluative criteria. When faced with a general clause, the interpreter must choose an evaluative criterion to provide prescriptive content in a particular case. That is, good faith involves a supplementary activity on the part of the judge, thereby allocating a portion of the law-making power to courts. On the other hand, the semantic indeterminacy of good faith, combined with its recognition by the Supreme Court of Canada as a ‘general organizing principle,’ alters the reasoning structure underlying the application of the principle of good faith. Bhasin introduces the possibility of courts construing new meanings of good faith by reasoning deductively from an abstract general requirement of justice and deriving additional, specific good faith duties outside the limits of the rules of precedent.

Second, historical analysis confirms the foregoing intuition that good faith is structurally shaped for conferring law-making power on the adjudicating authority. As a matter of historical fact, the ‘bona fides’ (good faith) emerged in the Roman legal system as a procedural tool that enabled the Roman peregrine praetor to create principles of substantive law for adjudicating contractual disputes between Roman and non-Roman citizens. The subsequent progressive recognition of bona fides as a general principle of Roman contract law had profound, long-lasting evolutionary implications at both the procedural and substantive level. As will be seen, the introduction of the ex fide bona clause in Roman civil
procedure enabled the Roman praetor to decisively contribute to the modernization of Roman substantive law by recognizing new forms of legal actions and remedies.

Finally, economic inquiry converges with these semantic and historical analyses to clarify that private parties may have recourse to the principle of good faith to empower a judge to specify \textit{ex post} contractual terms when the costs of negotiating them \textit{ex ante} are too high. That is, good faith allows for efficiently allocating law-making power to judges when alternative sources of law (for example, private bargaining processes) prove inadequate or inefficient. As we will see, this economic insight proves useful to address the delicate issue of the outer boundaries of good faith that \textit{Bhasin} left unsolved. It is argued that the outer boundaries of good faith performance should be drawn primarily on the basis of comparative economic advantage – that is, by asking what the better law-making mechanism for solving the problem of contractual opportunism would be from the standpoint of economic efficiency. Analogously, economic analysis suggests that any reliable assessment of \textit{Bhasin}'s impact on the principles of freedom of contract and legal certainty should be based on a careful analysis of the comparative advantages and disadvantages of alternative law-making mechanisms in dealing with the problem of contractual opportunism.

\section*{B METHODOLOGY}


In particular, legal scholars have focused on identifying a unified general notion of good faith. Typically, they have proceeded by examining both judicial decisions and relevant statutes in an attempt to define the common denominator of a general theory of good faith in
contractual performance. The ultimate goal is to provide substantive content to the indeterminate standard of good faith to bring coherence to the law and enhance legal certainty. In general, these intellectual endeavours have produced two types of analytical results. Some authors have provided definitions of good faith hinging on concepts as indeterminate as good faith. The two most prominent examples are Robert Summers’s ‘excluder’ conceptualization of good faith\(^9\) and Steven Burton’s ‘foregone opportunity’ approach.\(^10\)

These perspectives offer useful frameworks for enhancing our understanding of good faith, although they do not overcome the problem of its inherently indeterminate substantive content. In particular, these approaches are unable to identify the external boundaries of good faith. Other authors have concluded that it is impossible to provide a unified *ex ante* definition of good faith that is sufficiently meaningful to provide prescriptive content and, at the same time, sufficiently general in scope to include all possible cases of bad faith performance. From this perspective, good faith is seen as an ‘empty vessel’\(^11\) or a ‘cover’ used by courts to avoid openly recognizing their law-making role.\(^12\) These accounts contain important elements of truth, but they are incomplete as they tend to overlook the institutional dimension of good faith. In particular, they do not fully recognize the impact of good faith on the distribution of law-making authority among alternative sources of law.

Unlike most legal scholarship, this article’s proposed line of inquiry is based on the recognition of two different problem orders. The first-order problem is to allocate legal entitlements to plaintiffs and defendants so as

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9 According to Summers, good faith in contract law is used as an ‘excluder’ – that is, a phrase that ‘serves to exclude a wide range of heterogeneous forms of bad faith.’ Summers, ‘Good Faith,’ supra note 8 at 201. In this view, to identify which standard of behaviour good faith imposes in a given context, one should first identify the kind of bad faith behaviour that is excluded in that particular context and then derive the content of good faith ‘by way of contrast with the specific and variant forms of bad faith which judges decide to prohibit’ (at 202).

10 According to Burton, bad faith performance occurs when contractual discretion is used ‘to recapture opportunities forgone upon contracting’: ‘Good faith performance, in turn, occurs when a party’s discretion is exercised . . . to capture opportunities that were preserved upon entering the contract, interpreted objectively.’ Burton, ‘Breach of Contract,’ supra note 8 at 373 [emphasis added].


to minimize the overall costs of bad faith contractual behaviour. The second-order problem is to identify the decision maker that is better suited to deal with the first-order problem; this involves assessing and comparing the relative ability of alternative institutions to minimize the costs of bad faith behaviour through the adequate allocation of legal entitlements. The first-order problem speaks to the ‘substantial’ aspect of law—that is, the allocation of property rights. The second-order problem concerns the ‘institutional’ aspect of law-making—that is, the choice between alternative sources of law for allocating property rights.

While traditional legal scholarship relates good faith to the first-order problem by conceptualizing it as a substantive legal principle, this article contends that conceptualizing good faith as an institutional response to the second-order problem provides a useful, complementary understanding of good faith. Good faith is an institutional tool developed to allow *ex post* judicial specification of parties’ obligations, thereby minimizing the costs of contractual opportunism. Rather than focusing on the (indeterminate) substantive content of the duty of good faith, the proposed line of inquiry is to ask under what conditions the judicial specification of contractual duties is the most appropriate response to the problem of contractual opportunism. In short, the fundamental question is not what the duty of good faith prescribes *ex ante* but, rather, who is better suited to specify the content of good faith duties.

This article is organized as follows. The second section provides an institutional understanding of the Supreme Court of Canada’s decision in *Bhasin*. First, the main points of the decision are summarized, emphasizing Justice Cromwell’s peculiar and innovative line of reasoning. Second, *Bhasin* is examined in the context of the recent trend in the common law world towards increasing recognition of the need for good faith in contractual dealings. This comparative analysis illuminates the distinctive way in which *Bhasin* conceptualizes good faith by shifting its institutional basis from the conventional common law methodology of implication of terms to the idea of the general organizing principle. Third, the semantic structure of good faith is examined. It is contended that conceptualizing good faith as a ‘general clause’ illuminates the institutional implications of *Bhasin*. Fourth, this article argues that *Bhasin* introduces a new law-making mechanism into the area of contract law (identified as ‘law-making through good faith’) that fundamentally differs from the doctrine of precedent. Finally, it is emphasized that the new general organizing principle of good faith exhibits certain structural similarities with the civil law approach to good faith, which raises the delicate question of its structural compatibility with the Canadian tradition of a common law of contract.
The third section of the article inquires into the historical origins and development of the principle of good faith. From this perspective, the emergence of *bona fides* in Roman law and its impact on the evolution of the Roman law of contracts is examined. This analysis provides valuable insights into the potential impact of *Bhasin* on the future development of the Canadian common law of contract. The fourth and fifth sections examine the economic function of good faith by building on intuitions provided by law and economics theory. It is contended that an economic approach is useful for defining the outer boundaries of good faith and assessing the impact of *Bhasin* on legal certainty and freedom of contract. The sixth section of the article concludes.

II Bhasin and the sources of law

A THE DECISION IN BHASIN

1 Cromwell J’s line of reasoning

In *Bhasin*, the plaintiff, Harish Bhasin, brought an action for breach of contract against Canadian American Financial Corporation (Can-Am). Bhasin and Can-Am had a commercial dealership agreement (Agreement) under which Bhasin was paid compensation and bonuses for selling education savings plans. For the purposes of our analysis, three elements of the Agreement must be emphasized: (a) the Agreement was not qualified as a franchise agreement to which a statutory duty of fair dealing would apply; (b) the Agreement provided an express renewal clause establishing that it would automatically renew at the end of the three-year term unless one of the parties provided a non-renewal notice six months in advance; and (c) the Agreement contained an entire agreement clause stipulating that no other express or implied contracts applied.

The relationship between Bhasin and Can-Am deteriorated for a variety of reasons. In 2001, Can-Am exercised the non-renewal provision and provided Bhasin the required six month’s notice. As a result, Bhasin’s business lost value because Hrynew, the enrolment director operating the largest agency under Can-Am, recruited the majority of his sales agents. The trial judge made a number of factual findings supporting the conclusion that Can-Am repeatedly misled Bhasin during the events preceding the non-renewal, leaving him unable to protect the value of his business.13 In essence, had Can-Am acted honestly, Bhasin could have acted to retain the value of his agency.

13 Among the main findings, Can-Am appointed Hrynew (Bhasin’s direct competitor) as a provincial trading officer to perform an audit of Bhasin’s compliance with provincial
According to Cromwell J – and this is a crucial premise of the Supreme Court of Canada’s line of reasoning – ‘the objection to Can-Am’s conduct in this case [did] not fit within any of the existing situations or relationships in which duties of good faith have been found to exist.’\(^{14}\) First, the factual scenario did not fall within any of the established *ad hoc* exceptions allowing an obligation of good faith to be inferred. Second, because the Agreement was governed by an entire agreement clause, a duty of good faith governing the parties’ discretionary renewal power could not be implied.\(^{15}\) Moreover, establishing an implied term would have violated the parole evidence rule.\(^{16}\) Third, because the Agreement was construed as a commercial dealership agreement, Bhasin could not be afforded the statutory protection provided to franchisees.\(^{17}\) Thus, in Cromwell J’s view, no common law precedents or contractual terms or relevant statutes enabled the Court to construe a duty of good faith and on this basis afford protection to Bhasin’s reasonable commercial expectations.

Confronted with this scenario, the Supreme Court of Canada essentially rejected the plaintiff’s argument that the defendant had breached an implied term imposing a duty of good faith in the exercise of contractual discretion. ‘[I]nasmuch as none of the existing rules achieved a favorable result for the plaintiff,’ the Court created a new duty of honesty in contractual performance – a legal doctrine that operates independently of parties’ intentions – providing the basis for an award of damages for breach of contract, thereby enabling the Court to protect the plaintiff’s reasonable commercial expectations.\(^{18}\) Importantly, the newly recognized duty of honesty flows directly from the general organizing principle of good faith, which ‘underpins and informs’ various existing doctrines that require good faith performance.\(^{19}\) That is, instead of construing good faith as a contractual obligation to be directly imposed on parties to a contract, the Court conceptualizes good faith as a general organizing principle of the common law of contract through which judges may derive more specific legal doctrines imposing minimum

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\(^{14}\) *Bhasin SCC*, supra note 1 at para 72.

\(^{15}\) Ibid.

\(^{16}\) This point has been clearly emphasized by the Court of Appeal in its reasons for judgment. See *Bhasin v Hrynew*, 2013 ABCA 98, 362 DLR (4th) 18 at paras 27–30 [*Bhasin CA*].

\(^{17}\) *Franchises Act*, RSA 2000, c F-23, s 7: ‘Every franchise agreement imposes on each party a duty of fair dealing in its performance and enforcement.’


\(^{19}\) *Bhasin SCC*, supra note 1 at para 33.
standards of behaviour; the new duty of honest performance is the first application of the new general doctrine of good faith.\(^\text{20}\)

2 Alternative remedies protecting the plaintiff’s expectations

At this point, it is worth emphasizing that some of Can-Am’s misconduct could have qualified as tortious fraudulent or negligent misrepresentation.\(^\text{21}\) In addition, the Supreme Court of Canada could have considered using equitable instruments – such as, for example, estoppel by representation – to provide Bhasin with a remedy. However – and this is relevant from an institutional perspective – the Court seems to have suggested that, compared with existing rules, the new duty of honest performance enhances the protection against contractual dishonesty. The tort of fraudulent misrepresentation, for example, requires the defendant to intend that a false statement be relied on.\(^\text{22}\)

Similarly, estoppel by representation requires the defendant to intend that his or her representation be relied on.\(^\text{23}\) By way of contrast, as the Court clarifies, to establish a breach of the new duty of honest performance, it is unnecessary to satisfy a court that the defendant ‘intended’ the plaintiff to rely on the falsehood.\(^\text{24}\) Therefore, even in those cases where the defendant did not intend reliance, lying and knowing misrepresentation support a claim for contractual, rather than tortious, damages.\(^\text{25}\) In this respect, Bhasin establishes a less onerous standard for establishing contractual liability in which ‘equivocating’ – a behaviour that was present on the facts of Bhasin – can count as a form of actionable dishonesty. In brief, the Court seems to suggest that the new duty of honesty more effectively protects Bhasin’s expectations compared with alternative remedial tools under Canadian law.

It must be emphasized that the Supreme Court of Canada could have construed the duty of honest performance as an implied term based on the presumed intentions of the parties. This standard of commercial dealing – not to lie or otherwise knowingly mislead others about matters

\(^\text{20}\) From this perspective, as O’Byrne and Cohen observed in ‘The Contractual,’ supra note 3, at 2, the recognition of the new duty of honesty in contractual performance is simply the first example of applying the new general organizing principle of good faith.

\(^\text{21}\) However, no tortious misrepresentation against Can-Am was indicated or found by the trial judge. As Robertson has observed, the trial judge did not attributed Bhasin’s loss of his agency to his reliance on Can-Am’s falsehoods. Robertson, ‘Good Faith,’ supra note 3 at 863–4.

\(^\text{22}\) Bhasin SCC, supra note 1 at para 88.

\(^\text{23}\) Ibid.

\(^\text{24}\) Ibid.

\(^\text{25}\) Ibid.
directly linked to the performance of a contract – is so generally accepted in the business community that contracting parties would reasonably be understood to take them as read without explicitly stating them in their contractual document. This raises the question of why the Court chose to ground the duty of honest performance on the concept of the ‘general organizing principle of good faith’ rather than on the conventional, well-established common law methodology of implication of terms.

An institutional understanding of the concept of good faith provides one possible answer to this query. Good faith operates as a source of law-making power. This is not a peculiar argumentative strategy adopted by Cromwell J; it is inherent in the institutional nature of good faith. As the Supreme Court of Canada explicitly recognizes, by shifting the dogmatic basis of the duty of honesty from implication of terms to the general principle of good faith, the Court turns this duty into a general doctrine of contract law that ‘operates irrespective of the intentions of the parties’ and ‘impose[s] limits on the freedom of contract.’ The Court could not be clearer in its intent to create a new tool for limiting contractual autonomy: ‘Because the duty of honesty in contractual performance is a general doctrine of contract law . . . the parties are not free to exclude it.’ The Court uses the concept of good faith to provide a theoretical basis for a new judicial power to create mandatory rules capable of interfering with the freedom of contract.

This crucial point will be discussed at length in the remainder of this article. Before proceeding, however, the issue of the precedential significance of Bhasin should be briefly examined, as the language adopted by Cromwell J is broader than the facts before him seem to allow for.

3 Bhasin’s precedential impact
The precedential significance of Bhasin remains the subject of much debate because Cromwell J’s line of reasoning goes far beyond the relatively narrow issue ultimately decided. It is therefore useful to briefly examine the scope of Bhasin’s precedential effect, while emphasizing that the institutional impact of the decision is not confined to its precedential impact. On its facts, Bhasin focuses on the circumstances surrounding Can-Am’s exercise of its right not to renew the Agreement. At trial, the judge implied a term of good faith performance as a matter of law based on a structural analogy of the commercial dealership agreement between Bhasin and Can-Am with a franchise or employment

26 Ibid at para 74.
27 Ibid at para 75.
contract. The judge found that Can-Am exercised its right in a dishonest and misleading manner and for the improper purpose of inducing Bhasin to merge his agency with that of Hrynew. Based on this factual finding, the judge held that Can-Am breached its duty to act in good faith in performing its contractual obligations. The Court of Appeal reversed and held that there had been no breach of contract since any implication of a duty of good faith was precluded by the entire agreement clause.

On appeal before the Supreme Court of Canada, therefore, the crucial legal issue was whether the right of non-renewal in a dealership or distributorship agreement amounted to an exercise of ‘contractual discretion’ so as to be included within those types of contractual relationships in which the duty of good faith performance had been earlier recognized by courts. The Court held that it would constitute a significant extension of decided cases to classify the decision not to renew as an exercise of contractual discretion subject to a good faith duty. According to Cromwell J, doing so would have turned a three-year contract subject to an express non-renewal provision into a contract of indefinite duration. Based on this premise, the Court decided the dispute by articulating a new duty of honesty in contract performance that could be breached in the context of the exercise of a non-renewal clause. It relied on the findings at trial – that ‘dishonesty on the part of Can-Am was directly and intimately connected to its performance of the Agreement and its exercise of the non-renewal provision’ – to conclude that Can-Am breached the contract with Bhasin by failing to act honestly in exercising its right not to renew the contract.

Based on these facts and strict legal theory, one could certainly argue that all the Supreme Court of Canada does in Bhasin is to recognize a new duty of honesty in contractual performance and in the context of the exercise of a right of non-renewal. This is ultimately the holding in Bhasin. However, was the scope of Bhasin limited to this narrow duty of honesty, one must ask why the decision has sparked so much debate

28 ‘The non-renewal clause was not intended to permit Can-Am to force a merger of the Bhasin and Hrynew agencies, but that was the purpose for which Can-Am exercised this power.’ Bhasin v Hrynew 2011 ABQB at para 261 (this passage of the trial judge’s decision is quoted in Bhasin SCC, supra note 1 at para 26).

29 Bhasin SCC, supra note 1 at para 72. Robertson has emphasized the precedential significance of this specific point: ‘To the legal practitioner and judge alike, that question alone may well overshadow the precedential significance of the new duty of honest performance.’ Robertson, ‘Good Faith,’ supra note 3 at 816.

30 Ibid at para 72.

31 Ibid at para 103.
among legal scholars and practising lawyers. As Geoff Hall has neatly observed,

The new duty of honest performance is unsurprising and does relatively little. . . . While the duty is new, it is hardly a bold or radical step. Indeed, it is somewhat surprising that it took until 2014 to establish that the law of contract does not countenance dishonesty in the performance of contractual obligations.32

However, what is striking in Bhasin is its approach to the doctrine of good faith, with potentially profound implications. Lisa Peters states, for example: ‘It is the Court’s treatment of the good faith claim that is precedent-setting and that will be the reason for this case being repeatedly cited over the next decade, and perhaps longer.’33 In this sense, one can identify a broader holding – one that includes Bhasin’s treatment of the good faith doctrine. As emphasized above, the recognition of a general organizing principle of good faith provides the logical basis for construing the decision rule of the case (that is, the duty of honesty).34 One might question whether this is conclusive enough to include good faith in the case’s holding. Yet, the fact that good faith provides the logical premise for construing the decision rule on which the outcome of the case depends suggests that the precedential significance of Bhasin’s doctrine of good faith should not be underestimated.35

Furthermore, from an institutional perspective, Bhasin’s impact is not limited to its precedential effect. Although not formally binding, dicta can exert significant institutional impact, as they are strong indications of how a court will decide future cases. Many trial and intermediate appellate court judges consider it their role to apply the law as the higher court would and, therefore, give great deference to Supreme

32 Hall, ‘Bhasin,’ supra note 3 at 1.
34 As Robertson has clarified, ‘the plaintiff’s good faith performance argument was doomed to fail had the Court not based its decision on the duty of honest performance.’ Robertson, ‘Good Faith,’ supra note 3 at 816. On this point, see also McCamus, ‘The New General Principle,’ supra note 3 at 107.
35 Many commentators have acknowledged the precedential significance of the first incremental step. See e.g. Robertson, ‘Good Faith,’ supra note 3 at 866: ‘[T]he precedential significance of the decision in Bhasin] goes far beyond recognition of a duty of honest performance. There is now a solid foundation upon which the tenets of the good faith doctrine can be applied in such a manner that certainty and predictability in the law are preserved.’ Hunt, ‘Good Faith,’ supra note 3 at 7: ‘[T]he more significant impact of Bhasin concerns the precise meaning and future development of “good faith” as a “general organizing principle” of contractual performance.’ Or O’Byrne & Cohen, ‘The Contractual,’ supra note 3 at 1: ‘Bhasin’s largest and most lasting contribution is likely in how it expressly legitimates and defends the role of good faith in the common law of contract.’
Court of Canada *dicta*. This justifies the analytical focus of the remainder of this section on *Bhasin’s* repeated references to the general principle of good faith. Independent of *Bhasin’s* formally binding impact on future cases whose scope remains subject to debate, its evolutionary impact on the Canadian common law of contract will be profound.

4 A procedural definition of ‘general organizing principle’

*Bhasin’s* conceptualization of good faith raises the fundamental question: ‘what principle is a “general” “organizing” principle?’ Cromwell J articulates its working properties in the following terms:

> [A]n organizing principle states in general terms a requirement of justice from which more specific legal doctrines may be derived. An organizing principle therefore is not a free-standing rule, but rather a standard that underpins and is manifested in more specific legal doctrines and may be given different weight in different situations. . . . It is a standard that helps to understand and develop the law in a coherent and principled way.36

This definition is procedural in nature. That is, apart from the (quite indeterminate) reference to the requirement of justice, the focus is on the logical relationship between the general organizing principle and various, more specific, rules derived from it. What Cromwell J tells us is that an organizing principle provides a logical (that is, formal) basis for the creation of more specific legal doctrines. An organizing principle does little substantive work;37 it establishes in general terms what courts can develop into concrete rules of law. In a subsequent step specifically referring to good faith performance, Cromwell J reiterates the procedural nature of an organizing principle:

> [G]ood faith contractual performance is a general organizing principle of the common law of contract which underpins and informs the various rules in which the common law, in various situations and types of relationships, recognizes obligations of good faith contractual performance.38

Again, the focus is procedural. Cromwell J emphasizes the logical relationship between the general organizing principle and various, more specific, rules. Consistent with this framework, in the following paragraph, Cromwell J articulates the substantive content of good faith in similarly broad terms:

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36 *Bhasin SCC*, supra note 1 at para 64.
37 See Young, ‘Justice Beneath the Palms,’ supra note 3 at 97.
38 *Bhasin SCC*, supra note 1 at para 64.
The organizing principle of good faith exemplifies the notion that, in carrying out his or her own performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner. While ‘appropriate regard’ for the other party’s interests will vary depending on the context of the contractual relationship, it does not require acting to serve those interests in all cases. It merely requires that a party not seek to undermine those interests in bad faith.\textsuperscript{39}

This definition hinges on undetermined terms, such as ‘appropriate regard,’ ‘legitimate contractual interests,’ and ‘bad faith,’ thereby vesting lower courts with the ability to specify their normative content. Importantly, it leaves unanswered the question of the principle of good faith’s external boundaries. This confirms that Cromwell J’s chief concern was procedural in nature – that is, empowering courts to develop good faith doctrines rather than developing a substantive notion of good faith.

Though Cromwell J’s procedural intent is clear, the way the organizing principle operates in the context of the adjudication process is left unclear. To explore this fundamental issue, the remainder of this section compares Bhasin’s conceptualization of good faith with alternative conceptions of good faith in other common law jurisdictions. It then examines the semantic structure of the term good faith by drawing on the well-developed literature of general clauses in private law and its implications for the structure of judicial reasoning. Finally, the structural compatibility of Bhasin’s conception of good faith with the Canadian tradition of the common law of contract is discussed.

B BHASIN AND THE COMMON LAW WORLD: SHIFTING THE INSTITUTIONAL BASIS OF GOOD FAITH

A brief comparative overview of the evolving role of good faith in other major common law jurisdictions can help illuminate the distinctive features of Bhasin and its institutional implications. While there is no doubt that Bhasin is inscribed in a broader recent tendency to recognize contractual good faith in the common law world, the way the Supreme Court of Canada constructs a general overarching doctrine of good faith is somewhat eccentric compared with the interpretive strategies adopted in other common law jurisdictions.

It can be said that Bhasin’s new conception of good faith exhibits some structural similarities with the civil law approach.\textsuperscript{40} In particular, Bhasin shifts the institutional foundations of the general duty of good faith from the process of contract construction to the process of logical

\textsuperscript{39} Ibid at para 65.
\textsuperscript{40} See, arguing in this sense, Young, ‘Justice Beneath the Palms,’ supra note 3 at 98.
derivation from a general organizing principle. To illustrate this point, Bhasin is succinctly compared with some recent developments in England and Australia and with the role contractual good faith plays in US contract law.41

In English law, courts have traditionally rejected a general doctrine of good faith performance. It is generally understood that there is no duty of good faith between commercial contractual parties unless an express obligation has been specified or an implied term is read into a contract. However, a recent jurisprudential trend is emerging in favour of an implied obligation to act in good faith, particularly in what are referred to as ‘relational’ contracts, such as franchise agreements, distribution agreements, and joint venture agreements. In Yam Seng, a February 2013 decision, the High Court stated that, although English law had not yet reached the stage where a general requirement of good faith could be implied ‘by law’ into all commercial contracts, a requirement of good faith could be implied into ‘any ordinary commercial contract’ through the established methodology for the implication of terms based on the presumed intention of the parties.42 While these comments were obiter dicta, they provide a sign that the English attitude towards a general duty of good faith might be slowly changing.

On the other hand, it should be noted that, in deciding subsequent cases, the Court of Appeal has restated obiter the orthodox view that no general doctrine of good faith exists, indicating that it is unlikely to follow the High Court’s positive attitude towards implying good faith.43 Ultimately, the English law on implied good faith remains unsettled until the Court of Appeal provides binding authority on this point. However, it is clear that the dogmatic basis for a more general duty of good faith would be grounded, if at all, in the process of implication of terms.

In the United States, a general obligation of good faith is recognized in major types of contractual relations. First, the Uniform Commercial Code – a body of statute law part of which has been adopted by all state legislatures and that applies to the sale of goods and other commercial transactions – provides in section 1-203 that ‘every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.’ Second, the Restatement (Second) of Contracts, which

41 For a more detailed, comparative overview of the most recent developments of the common law of good faith in Canada, Australia, and Great Britain, see Anthony Gray, ‘Development of Good Faith in Canada, Australia and Great Britain’ (2015) 57:1 Can Bus LJ 84 [Gray, ‘Development’].
43 See e.g. Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (t/a Medirest), [2013] EWCA Civ 200, and, more recently, MSC v Cottonex Anstalt, [2016] EWCA Civ 789.
has a substantial influence on state courts, establishes in section 205 that ‘every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.’

Finally, many state courts have explicitly acknowledged a general obligation of good faith applicable to contractual relations. Although there is no commonly agreed framework for defining the dogmatic basis of good faith (neither on the doctrinal nor the judicial level), the prevailing view conceptualizes good faith as an implied term. The implied covenant of good faith enables courts to find a breach of contract even when no express contractual term has been violated.44 It is worth emphasizing with respect to the reciprocal limitations of judicial power and contractual autonomy that courts do not normally imply any term that conflicts with express contractual terms. On the other hand, parties cannot entirely exclude the duty of good faith by agreement, although they can significantly reduce its scope.45

In Australia, the recognition of a general duty of good faith is gathering momentum as well.46 Although the federal High Court of Australia has not yet ruled on this point, a line of authority that creates a common law obligation of good faith in commercial contractual performance has emerged from the decisions of some state appellate courts.47 In the seminal case of Renard Constructions v Minister for Public Works, the New South Wales Court of Appeal recognized an implied duty of good faith in commercial contracts.48 The court stated that people generally ‘have grown used to the courts applying standards of fairness to contract which are wholly consistent with the existence in all contracts of a duty upon the parties of good faith and fair dealing in its performance.’49 Since Renard, the Court of Appeal has not retreated from the position that the good faith duty may be imposed by implication as a matter of fact on parties to a contract. However, subsequent cases suggest that implication ‘in law’ is the correct basis on which to develop a duty of good faith. In Burger King v

45 For a more detailed discussion of how, under US law, parties to a contract can limit their duty of good faith by agreement, see O’Byrne & Cohen, ‘The Contractual,’ supra note 3 at 15–23.
49 Ibid at para 268 [emphasis added].
Hungry Jacks, the same court recognized a duty of good faith in contractual performance to be implied in law if it is reasonable and necessary for the particular class of contract involved in the instant case.\textsuperscript{50}

Along these lines, in Overlook Management v Foxtel Management, the Supreme Court stated that an additional term requiring the exercise of good faith in the performance of commercial contracts ‘is now in this State a legal incident of every such contract.’\textsuperscript{51} In Vodafone Pacific v Mobile Innovations, the Court of Appeal restated that an obligation of good faith in the performance of a contractual obligation can be implied as a matter of law as a legal incident of a commercial contract.\textsuperscript{52} In South Australia, courts have largely adopted the New South Wales approach to good faith. In deciding Alstom Ltd v Yokogawa, the South Australian Supreme Court established that a duty of good faith is to be implied into every commercial contract.\textsuperscript{53} The court seemed to suggest that such a term should be readily implied in law when failure to act in good faith would make the contract unworkable as a matter of business.\textsuperscript{54} It is too early to suggest that in South Australia a duty of good faith is an incident implied by law into all commercial contracts, but the underlying point – that a duty of good faith may be imposed by implication on the parties to a contract – is valid.\textsuperscript{55}

This brief comparative overview enables us to recognize a striking feature of Bhasin compared with other recent common law developments. In general, common law courts that have shown a willingness to recognize good faith as a general duty in contract law have tended to conceptualize good faith as an implied contractual term (either in fact or in law). However, Bhasin, as already noted above, expressly refrains from falling back on this well-established common law methodology for implying terms.\textsuperscript{56} In support of this strategy, Cromwell J advances institutional arguments that suggest the desirability of an alternative strategy to that of deeming good faith a legal incident of every commercial contract.  

\textsuperscript{50} Burger King, supra note 47.
\textsuperscript{52} Vodafone Pacific Limited v Mobile Innovations Limited, [2004] NSWCA 15 at para 189.
\textsuperscript{53} Alstom Ltd v Yokogawa Australia Pty Ltd & Anor (No 7), [2012] SASC 49 at para 62.
\textsuperscript{54} Ibid at para 588
\textsuperscript{55} In some recent cases, the court has found that an implied duty of good faith in commercial contracts may be imposed, but only in certain circumstances. See e.g. Starlink International Group Pty Ltd v Coles Supermarket Australia Pty Ltd, [2011] NSWSC 1154, where the court found that commercial contracts are not a class of contract that, as a legal incident, have an implied obligation of good faith, and whether good faith is implied will depend on the specific features of the individual contract.
\textsuperscript{56} See Gray, ‘Development,’ supra note 41 at 93: ‘By defining good faith as an organising principle, the Supreme Court sidestepped some of the difficulties encountered in those jurisdictions where good faith was considered as an implied term.’
of reading good faith as an implied term.\textsuperscript{57} Implied terms, Cromwell J argues, generate legal uncertainty and a lack of jurisprudential coherence.\textsuperscript{58} Based on these considerations, \textit{Bhasin} reshapes the doctrinal basis of good faith by conceptualizing it as a general organizing principle of the common law of contract.

The conceptual shift of good faith from an implied term to a general organizing principle has profound institutional implications. First, it expands the scope of judicial interference in private parties’ contractual autonomy. The methodology for terms’ implication promotes the process of contract interpretation. Within this dogmatic framework, the contractual agreement is the main ‘source of law’ between the parties. The ambit and scope of the contract defines the outer boundaries of the duty of good faith. Express contractual terms normally trump terms that courts would otherwise imply in either fact or law. To the extent that good faith arises as an implied term, it cannot override an express contractual term.\textsuperscript{59}

By way of contrast, the general organizing principle of good faith promotes the process of judicial interpretation and development of the common law of contract. It states in general terms a requirement of justice from which judges may derive more specific legal doctrines to develop the law in a coherent and principled way.\textsuperscript{60} From this view, the role of the judge acquires a new centrality in the process of specifying the content of good faith, and good faith manifests in general doctrines developed by courts for ‘classes’ of situations through a process of logical specification of the general organizing principle into more specific doctrines that operate irrespective of the parties’ intentions.\textsuperscript{61} Within this dogmatic framework, the common law process (as informed by the general principle of good faith) is the main source of private parties’ good faith obligations.

Second, the institutional shift parallels a concomitant shift in the structure of the legal reasoning. On the one hand, the methodology of implication of terms requires reasoning upwards from the factual matrix underlying the contractual agreement. This judicial method is likely to produce an outcome based on an obligation precisely determined for the

\textsuperscript{57} Of course, this is in addition to more specific legal arguments, discussed above, concerning the specific merit of the case before the Court.

\textsuperscript{58} \textit{Bhasin} SCC, supra note 1 at para 52.

\textsuperscript{59} See on this point Swan, ‘The Obligation,’ supra note 3 at 402; Robertson, ‘Good Faith,’ supra note 3 at 817.

\textsuperscript{60} See note 36 above.

\textsuperscript{61} Ibid at para 74 (clarifying that the new duty of honest performance that flows directly from the principle of good faith, ‘should not be thought of as an implied term, but a general doctrine of contract law that imposes as a contractual duty a minimum standard of honest contractual performance’).
particular agreement between the parties through a process of context-specific construction of contractual terms. On the other hand, the new general organizing principle of good faith involves reasoning downwards from an abstract requirement of justice from which more specific duties of good faith are derived. In this respect, it can be said that Bhasin introduces a new conception of good faith that exhibits structural similarities with the civil law approach. Rather than directing judges to apply a well-determined substantive conception of good faith, Bhasin establishes an institutional framework within which judicial decision making on issues of good faith proceeds from a general, indeterminate statement of principle to specification as more concrete contractual doctrines.

Third and relatedly, the recognition of good faith as a general organizing principle of the common law enables courts to overcome some limits of the doctrine of precedent. It allows judges to overcome the restricted boundaries of the pre-Bhasin piecemeal approach, which recognized good faith duties only in a limited number of ad hoc exceptions established by case law. The new organizing principle underpins the common law formation process, thereby enabling courts to create new legal doctrines outside of judicial precedents. In this specific respect also, Bhasin’s doctrine of good faith exhibits a structural similarity with the civilian approach.

The remainder of this section explores in greater details these three institutional implications of Bhasin by first inquiring into the semantic structure of good faith as a general clause and then examining its impact on the judicial reasoning structure and the doctrine of precedent. A brief analysis of the problematic implications of importing this new conception of good faith into the Canadian common law of contract concludes the discussion.

C GOOD FAITH AS A ‘GENERAL’ ‘ENABLELING’ CLAUSE

Bhasin provides no clear explanation of the way a ‘general organizing principle’ operates in the context of the adjudication process. In particular, three specific issues demand clarification: (a) what is it that has to be organized; (b) who is entrusted with the task of organizing; and (c) how does the general principle of good faith inform this organizing activity. In this and the following subsection, these questions are explored.

62 On the differences between reasoning ‘upwards from the fact’ and ‘downwards from abstract principles,’ see Lord Goff, ‘The Wilberforce Lecture 1997: The Future of the Common Law’ (1997) 46 ICLQ 4 745 at 753 (claiming that one of the fundamental differences between English and European legal cultures is judges’ recourse to these two alternative styles of legal reasoning).
The first point to be clarified is what the general principle of good faith is organizing. Cromwell J suggests that the principle organizes both the interpretation and the development of the common law of contracts. On the one hand, he recognizes that the overarching principle ‘manifests itself through existing doctrines,’ suggesting that good faith is an interpretative principle of the common law of contracts. On the other hand, he clarifies that the list of doctrines and duties through which good faith manifests itself ‘is not closed’ and that good faith ‘may be invoked in widely varying contexts’ to help ‘understand and develop the law in a coherent and principled way.’ These words suggest that good faith enables judges to create new common law duties imposing minimum standards of contractual behaviour on private parties. Therefore, good faith informs both the judicial interpretation of contractual rules and the judicial creation of new legal doctrines. Furthermore, Cromwell J explicitly recognizes that the new legal doctrine of honest performance (which derives from the general principal of good faith) operates ‘irrespective of the intentions of the parties’ and imposes limits on the freedom of contract. This reinforces the conclusion that good faith enables judges to perform law-making functions in the area of contract law. In short, good faith is a source of law.

The second element to be clarified is who is vested with the task of organizing the development of the common law of contract. To investigate this question, the Supreme Court of Canada emphasized that, by shifting the source of contractual good faith from an implication of contractual terms to an organizing principle, Bhasin introduced a new conception of good faith that exhibits structural similarities with the civil law approach. From this perspective, the vast scholarly literature on civil law good faith performance may provide some useful insights into the meaning of the new general organizing principle of good faith. In particular, it is contended that the concept of a ‘general clause’ provides useful insights into Bhasin’s contribution to Canadian contract law. We turn now to examine this point.

From a semantic point of view, good faith can be usefully conceptualized as a general clause. The main characteristic of general clauses is
the indeterminacy of the evaluative criterion specifying their content – that is, their interpretation can be supported by recourse to different, potentially competing criteria among which the interpreter must choose. Crucially, one should distinguish between general clauses and standards. A general clause is an ‘open norm’ – one that empowers the interpreter to choose the standard of conduct by which the behaviour of a party may be judged. A standard is an evaluative criterion needed to apply a general clause to a single case. On the one hand, a general clause enables an interpreter to choose between competing standards. For brevity of expression, we can refer to this as an ‘enabling effect.’ On the other hand, by virtue of the decision-making authority conferred to her or him by the general clause, an interpreter chooses the appropriate normative standard to be applied to the specific case (that is, the concretization of the meaning of the general clause). In this manner, the concept of a general clause allows us to identify two separate functional steps that conventional terminology tends to collapse into one: enabling effect and judicial concretization. These steps concern, respectively, the second-order problem of allocating law-making power and the first-order problem of allocating legal entitlements.

One advantage of this terminology is to usefully emphasize the connection between the abstract semantics of general clauses and their enabling effect. It is the semantic indeterminacy of the general clause that empowers courts to choose between competing standards of behaviour. Because the substantive content of good faith is inherently indeterminate, the interpreter must choose the relevant normative standard. This analysis sheds some light on the meaning and implication of Cromwell J’s conceptualization. In Bhasin, good faith acts as an enabling clause that empowers judges to establish normative standards of behaviour either by interpreting existing contractual doctrines or by elaborating new ones. Indeed, as clarified above, the general duty of good faith enables Cromwell J to elaborate the new duty of honest performance as the decision rule of the instant case. This crucial point will be expanded on in the next subsection.

One could reasonably object that the very notion of a ‘general clause’ only makes sense in the context of codified law. However, the preceding analysis suggests that the institutional implication of a general clause (that is, its enabling effect) is a function of its abstract semantics and is therefore independent of the presence of a codified law. This is not to say that the presence of a codified law does not have any bearing on the


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functioning of a general clause. On the contrary, it deeply impacts the way judges articulate the content of an obligation flowing from a general clause. More specifically, the characteristics of the legal context in which a general clause operates deeply affect the structure of the sources of legal content from which courts draw legal meaning. It is for this reason that general clauses result in quite different styles of legal decision making depending on the legal–institutional context in which they operate. But, the underlying point – that the abstract semantics of general clauses generate an enabling effect that increases the scope of judicial law-making power – remains valid. The judicial choice of the applicable normative standard remains an invariant structural feature of general clauses.

To summarize, by recognizing good faith (a general clause) as a general organizing principle of the common law of contracts, Bhasin organizes the interpretation and development of the common law of contracts by requiring courts to choose the evaluative criterion that defines the normative standards to be applied in a single case. The fact that Cromwell J’s conceptualization is centred on a general clause (which involves, by definition, a certain degree of judicial supplementing activity) makes it clear that Bhasin’s chief concern is the allocation of law-making authority to judges. To put it bluntly, by expanding the scope of application of a general clause of good faith to a general organizing principle, Bhasin generalizes the principle that courts are entitled to create the content of specific rules in situations where one party unilaterally defeats the legitimate contractual expectations of the other in violation of principles of contractual fairness. In this manner, Bhasin critically impacts the judicial law-making process in the area of contract law by altering the structure of legal reasoning specifying the content of good faith, thereby introducing a new mechanism of judicial legal change. This leads to the last of the three questions identified above: how the principle of good faith informs this organizing activity. To answer this question, the next subsection takes a closer look at the structure of ‘law-making through precedents’ and compares it with ‘law-making through good faith.’

69 The use of the adjective ‘general’ on the part of the Supreme Court of Canada to qualify the organizing principle of good faith confirms the plausibility of the proposed interpretation of Bhasin’s conceptualization (good faith as a general clause). The adjective ‘general’ qualifies the way the principle operates in organizing the interpretation of contract law. That is, it refers to the semantic structure of good faith as a ‘general’ clause – a clause whose undetermined evaluative criterion calls for judicial specification.
D JUDICIAL LAW-MAKING THROUGH ‘GOOD FAITH’

The reason-based model of precedent proves useful for comparing ‘law-making through precedents’ with ‘law-making through good faith,’ thereby illuminating the potential impact of Bhasin on the development of the common law of contracts.70 The reason-based model emphasizes that the principle of stare decisis requires judges to decide cases before them ‘in a way that is consistent with the correctness of the earlier decision’ and to treat earlier cases ‘as correctly decided on their facts.’71 The criterion of correctness does not simply refer to the ratio or the rule established in previous cases; correctness requires adherence to the balance of reasons assessed by previous courts with respect to the facts.

Consider a precedent case \( P_1 \). This is defined by the set of decision-relevant factual circumstances \( F_1 = \{a_1, b_1, c_1, d_1, e_1, f_1, g_1\} \) and by the reasons grounding the decision: \( R_1 = \text{if } \{A, B, C\} \text{ then } K \), where \( R_1 \) is the ratio grounding the decision; \( A, B, \) and \( C \) are the factual categories that the judge considers sufficient to apply the ratio to the case;72 and \( K \) is the conclusion following the logical reasoning. It is crucial to identify with precision the content of the binding effect of precedent. With the decision of \( P_1 \), the judge establishes that in the context of \( F_1 \):

1. \( A, B \) and \( C \) provide sufficient grounds to conclude \( K \).
2. \( D, E, F, \) and \( G \) do not defeat the ratio provided by \( R_1 \) as sufficient grounds to conclude \( K \).

Simply stated, the judge proclaims that, among the set of decision-relevant facts,73 (a) some factual elements are sufficient to conclude \( K \) and (b) other elements are insufficient to defeat the grounds provided by \( R_1 \). To understand the implications of this point, Grant Lamond uses the concepts of first-order reasons and exclusionary reasons. ‘First-order reasons’ are the grounds sufficient to conclude \( K \). ‘Exclusionary reasons’ are the grounds sufficient to exclude other first-order reasons from defeating the first-order reasons supporting \( K \). In our example, first-order reasons are the reasons binding the future judge to conclude \( K \) on the ground of \( R \), when the factual categories \( \{A, B, \) and \( C\} \) are present; exclusionary reasons are the reasons binding future judges not to defeat \( K \) if additional categories \( \{D, E, F, G\} \) are present. Crucially, both first-order reasons and exclusionary reasons constrain future decisions, even

71 Grant, ‘Precedents,’ supra note 70 at 16.
72 A, B, and C are abstract descriptions including \( a_1, b_1, \) and \( c_1 \).
73 The relevance of factual elements is established on the basis of \( R \).
if they do so in different ways. Future judges will be bound (a) to conclude $K$ on the ground of $R_1$ in the presence of the first-order conditions supported by $\{A, B, \text{and } C\}$ and (b) not to defeat $R_1$ in the presence of the exclusionary reasons considered in case $P_1$ and associated with $\{D, E, F, \text{and } G\}$.

This illuminates the mechanism underlying legal change through precedents. Consider the alternative between following and distinguishing precedent cases. Judges distinguish a new case from precedent if they identify some decision-relevant factual elements as not being present in previous cases. Distinguishing innovates the common law, in the sense that the judge produces a new rule based on a different ratio supported by different circumstantial elements. It is generally thought that judges innovate when they distinguish a new case, whereas they merely confirm existing law when they follow precedent. However, the reason-based model emphasizes the functional symmetry between following and distinguishing in creating legal rules. Judges produce rules not only when innovating but also when confirming precedents under partially new circumstances.

To illustrate, suppose that a new case $N$ is brought before a judge. The set of decision-relevant circumstances of the case is $F_2 = \{a_2, b_2, c_2, d_2, e_2, h_2, l_2\}$ where $F_2$ contains the first-order reasons $A, B, \text{and } C$, which are sufficient to conclude $K$ based on the precedent $P_1$. It also contains $D$ and $E$, which are insufficient to defeat $A, B, \text{and } C$ based on $P_1$. In addition, $F_2$ includes $h_2$ and $l_2$, which are not considered in $P_1$. This implies that the judge must decide whether (a) $h_2$ and $l_2$ support first-order reasons $\{H \text{ and } L\}$ sufficient to defeat first-order reasons $\{A, B, \text{and } C\}$ or whether (b) $h_2$ and $l_2$ are insufficient to provide first-order reasons defeating $\{A, B, \text{and } C\}$. In the former case, the judge distinguishes $P_2$ from $P_1$, and $P_2$ is grounded on $R_2 = \{H \text{ and } L\}$. In the latter case, $\{H \text{ and } L\}$ are exclusionary reasons insufficient to defeat $R_1$ in the presence of $\{A, B \text{ and } C\}$.

In both cases, the judge’s decision changes the law. If the judge distinguishes and creates a new precedent $P_2$, then future judges will be bound in the presence of $F_2$ to conclude $K_2$ on the grounds of $R_2$. If the judge follows $P_1$, the content of the law changes because $\{H \text{ and } L\}$ are added to the set of factors that are insufficient to defeat the first-order reasons provided by $\{A, B, \text{and } C\}$. In this latter case, as the precedents accumulate, the number of factual elements covered by exclusionary reasons increases, enriching the constraint on future judges.

It is now possible to identify the structural differences between precedents and statutory rules. A legal precedent is “a decision that is
sufficient in the context of the case to reach a [legal] conclusion; it produces consequences in other contexts only to the extent that the same facts are present. By contrast, the ratio contained in a statutory rule applies to the set of cases falling within its scope of application as defined by the factual predicate. It follows that the scope of the exclusionary reasons covered by a legal precedent differs greatly from the scope of the exclusionary reasons embedded in a statutory rule. Statutory rules pre-empt a decision on the set of cases falling within the generalization embedded in the factual predicate. The exclusionary reasons provided by statutory law are presumptive and general. It is presumed they apply to any cases falling within the class identified by the factual predicate. In contrast, the exclusionary reasons provided by precedent are absolute and specific; they apply only to the specific factors that have been considered in prior cases.

The foregoing discussion illuminates the differences between the decision-making logic underlying the pre-Bhasin piecemeal approach and the Bhasin approach to good faith. The pre-Bhasin approach constrained judges to rely exclusively on first-order reasons established by precedent. In this way, it exempted judges from assessing substantive legal issues and balancing cases’ underlying reasons. Good faith was recognized only in those particular types of contracts, contractual provisions, 74 Grant, ‘Precedents,’ supra note 70 at 18 [emphasis added].

75 The concept of ‘factual predicate’ is borrowed from Frederick F Schauer, Playing by the Rules, a Philosophical Examination of Rule-Based Decision Making in Law and in Life (Oxford: Oxford University Press, 1991). According to Schauer, any rule prescribing a type of conduct can be divided into two components. First, the rule defines ‘the factual conditions triggering the application of the rule’ (at 23). This component has a hypothetical structure and can be called a ‘factual predicate,’ thereby emphasizing its function of describing the facts that are relevant to the law. The second component prescribes ‘what is to happen when the conditions specified in the factual predicate obtain’ and can be called the ‘consequent’ (ibid).

76 To be clear, in this context the qualification of the exclusionary rule provided by statutes as ‘presumptive’ is opposed to the qualification of the exclusionary rule provided by precedents as ‘absolute.’ That is, in the absence of legal precedents that identify and establish the relevant exclusionary rules, statutes are based on the presumption that the first-order reasons not included within the scope of application of the rule do not defeat the first-order reasons covered by the scope of application of the statute. Thus, over time, the application of statutes to individual cases identifies and establishes the first-order reasons that are not covered by the presumptive general exclusionary rules. The mechanism is opposite to that of the legal precedent. With statutes, the cumulative process regards first-order reasons that are excluded by the scope of the general presumptive exclusionary rule embedded in the statute; with precedents, the cumulative process regards specific exclusionary rules that exclude first-order reasons by the set of those sufficient to defeat the first-order reason covered by the precedent.

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or contractual relationships on which good faith performance duties had been consistently imposed.

The facts of Bhasin provide a useful example of the limitations of the piecemeal approach. Pre-Bhasin courts have implied a duty of good faith in cases concerning a party’s abuse of a discretionary contractual power. However, in Bhasin, the defendant fully complied with the six-month notice of non-renewal requirement. Under these circumstances, it was difficult for the plaintiff to seek a remedy by arguing that the defendant’s non-renewal of the agreement amounted to an unreasonable or bad faith exercise of a discretionary contractual power. This is because, as previously noted and as Cromwell J explicitly emphasizes, ‘classifying the decision not to renew the contract as contractual discretion would constitute a significant expansion of the decided cases under that type of situation.’ That is, coherent with the doctrine of precedent, previous decisions do not produce consequences in other contexts unless the same facts are present.

An alternative strategy – and one pursued by the plaintiff at trial – would be to assert that the contract contained an implied duty of good faith. However, as clarified by the Alberta Court of Appeal, this line of argument was not viable for three reasons: (a) a court cannot imply a term that conflicts with an express term; (b) establishing an implied term would violate the parole evidence rule; and (c) the contract was governed by an entire agreement clause. Therefore, to conclude in Lamond’s terminology, first-order reasons established by precedents supported neither a finding of an unreasonable exercise of non-renewal discretion nor a finding of bad faith performance.

To overcome the limitations of the pre-Bhasin piecemeal approach, the Supreme Court of Canada elaborates a conceptual framework (centred on the general organizing principle of good faith) for the judicial creation of new general contractual doctrines capable of imposing new standards of contractual behaviour outside the boundaries imposed by first-order reasons established by precedent. That is, Bhasin gave courts the power to create the ratio grounding a decision even when

77 However, for a criticism of the Supreme Court of Canada’s finding of dishonest performance, see Robertson, ‘Good Faith,’ supra note 3 at 863 (saying the trial judge’s findings do not support the conclusion that Bhasin had lost the value of his agency because he relied on Can-Am falsehoods; instead, Bhasin lost value ‘because Can-Am exercised its right of non-renewal for an improper purpose: to force Bhasin to merge his agency with that of Hrynew’).
78 See e.g. Greenberg v Meffert (1985), 18 DLR (4th) 548 at 553–6 (Ont CA); Mesa Operating Limited Partnership v Amoco Canada Resources Ltd (1994), 149 AR 187 (CA); Nickel Developments Ltd v Canada Safeway Ltd (2001), 156 Man R (2d) 170 (CA).
79 Bhasin SCC, supra note 1 at para 72.
first-order reasons established through case law do not support it. In developing new legal doctrines, courts act more as legislators than as adjudicating bodies. They establish a ratio that pre-empts decision making on the set of future cases falling within its scope and provide a \textit{prima facie} solution to those cases. Once a legal doctrine is established, it ‘applies to all contracts as a manifestation of the general organizing principle of good faith,’ unless a court can identify first-order reasons that are sufficient to defeat the application of the new contractual duty. The exclusionary reasons provided by a new doctrine are presumptive and general. 

The profound innovation that \textit{Bhasin} introduced into the creation of the common law of contract is clear. The conceptual framework of \textit{Bhasin} unlashes courts from the constraint of the doctrine of precedent. A precedent applies if the elements of the factual matrix from which it was generated are present in the instant case. By comparison, a general legal doctrine applies to cases falling within its scope unless the factual matrix of those cases contains elements that defeat the first-order reasons supporting the ratio embedded in the legal doctrine. Prior to \textit{Bhasin}, courts did not recognize a duty of honest performance outside the \textit{ad hoc} exceptions applied in previous cases. As Peters observes, ‘[i]f you search for cases discussing a duty of honesty in contract law prior to this landmark decision you will find precious few.’ This state of the law was consistent with the operation of the doctrine of precedent. Courts recognized a duty of honesty in contractual performance only in the presence of the factual matrix covered by established precedents. However, after \textit{Bhasin}, courts will be able to apply a duty of honest performance to cases before them unless they identify elements that defeat the first-order reason embedded in the legal doctrine of honesty in contractual performance. 

In conclusion, \textit{Bhasin} fundamentally affects the mechanism of judicial legal change with respect to issues concerning the duty of good faith in contractual performance. Prior to \textit{Bhasin}, the succession of decisions innovated the law by accumulating factual elements covered by exclusionary reasons established through \textit{ad hoc} exceptions (that is, the piecemeal approach). After \textit{Bhasin}, an additional mechanism of legal change was put in place. Courts will be able to innovate the law by identifying a general doctrine that grounds the decision of the case even in the absence of first-order reasons covered by binding precedents (that is, law-making through good faith). Once the new contractual doctrine has been

80 See Bolieiro, ‘\textit{Bhasin},’ supra note 3 at 24 (emphasizing the difference between rules and principles: ‘Principles not only help judges apply rules, they allow judges to create new rules where necessary in order to do justice in a particular case.’)

81 \textit{Bhasin} SCC, supra note 1 at para 93.

82 Peters, ‘\textit{Tell Me}’ supra note 3.
created, subsequent decisions will be able to further innovate the law by
identifying first-order reasons that will defeat the general presumptive
exclusionary rule embedded in the general doctrine.

This conceptualization of good faith, as repeatedly emphasized, exhibits some structural similarities with the civil law approach. This raises
the central question of whether the notion of good faith can be severed
from its civilian roots and transplanted into the very different institutional context of the Canadian common law of contracts. We now turn
to discuss this important point.

LEGAL TRANSPLANT, LEGAL IRRITANT, OR JUDICIAL CROSS-FERTILIZATION?

While some useful insights into the institutional implications of Bhasin
can be gained from the continental experience with the general clause
of good faith, it should be recognized that, once a general clause is im-
ported into the common law context, the concretizing technique
adopted by courts will undergo a fundamental change due to the differ-
ent legal culture and the overall organization of the sources of law within
which the adjudication process takes place. It would be therefore unwise
to read Bhasin as an attempt by the Supreme Court of Canada to trans-
plant a civilian conception of good faith into the Canadian common law
of contracts. Bhasin should rather be seen as ‘cross fertilization’ between
judicial cultures. Let us briefly expand on this point.

1 The challenges of legal transplantation

The vast literature on legal transplants has long demonstrated that legal
concepts and institutions cannot be easily moved from one context to
the other.83 When a foreign element is severed from its historical origins
and transplanted into a domestic culture with quite different historical
roots, it is not easily adapted to the new cultural context. The meaning
of the external element is often fundamentally reshaped, and the
domestic legal context can undergo radical changes as well. In short,
legal transplants often trigger evolutionary dynamics with unintention-
ally disruptive consequences.

The transplantation of the continental principle of bona fides into the
body of British contract law through the European Consumer Protection
Directive issued in 1994 provides a useful example to illustrate the dif-
ficulty of implanting a general doctrine of good faith into a common law

83 See e.g. Otto Kahn-Freund, ‘On Uses and Misuses of Comparative Law’ (1974) 37:1
system of contract law. In a well-known article published a few years after the enactment of the European Consumer Protection Directive, Gunther Teubner predicted that the continental principle of *bona fides* would act as a legal ‘irritant’ to the British tradition by producing unintentionally disruptive consequences. He identified two structural reasons why good faith would be a poor fit for British contract law. First, once imported into British legal culture, good faith would need to be reconstructed from a common law perspective. This raises the challenge of adapting a legal tool originating in a context characterized by a tendency towards dogmatization and systematization to a system characterized by casuistic methodology and lawyers’ reluctance to work from general principles. Second, Teubner observed that, because ‘the principles of good faith play the role of the major binding arrangement between the rules of private law and economic production regimes’, applying a principle of good faith is bound to generate much different results because of the differences in the production regimes underlying diverse legal systems.

Teubner’s analysis provides useful lessons concerning the potentially problematic implications of recognizing good faith as a general organizing principle of Canadian common law. In searching for the meaning of the new general doctrine of good faith, one should be cognizant of the institutional differences between continental *bona fides* and common law

86 On this point, see also J Cartwright, Contract Law: An Introduction to English Law for the Civil Lawyer, 2d ed (Oxford: Hart Publishing, 2013) at 72 (explaining that one of the reasons for English lawyers’ distrust of good faith is their reluctance to work from general principles).
87 Teubner, ‘Legal Irritants,’ supra note 85 at 35.
88 Teubner emphasizes the correlation between the specific characteristics of the German ‘business-coordinated market economy’ and the extensive series of good faith obligations developed by German courts. The prevalence, in this type of production regime, of long-term cooperative relationships between economic organizations supports the use of good faith as a legal tool for dealing with collective hold-up and moral hazard problems, which are typically associated with these type of economic relations. According to Teubner, the implantation of this conceptual–legal apparatus into the British system ‘would not find its roots in a corresponding economic culture.’ Teubner, ‘Legal Irritants,’ supra note 85 at 26. The British economic culture supports, indeed, an economic system characterized by a smaller role for organized business and where on the one hand free market forces and on the other hand external government regulation play a greater role. In this context, economic relations tend to be either shaped by the competitive interplay of market forces or regulated by centralized institutions through low-discretionary forms of regulation. This structural context ‘does not appear to be a fertile ground on which continental *bona fides* would blossom’ (at 27).
good faith duties. In the European continental tradition, good faith is a central tenet of contract law that governs all of the aspects of a contractual relationship, from contract formation to discharge. Good faith is statutory in nature and operates in the context of a codified legal system. Its meaning is constructed by scholars and practitioners in a highly systematized and dogmatized fashion. As a general clause, good faith is concretized through deductive legal reasoning based on principles developed in a well-consolidated, long-lasting jurisprudential tradition.

In contrast, *Bhasin*’s doctrine of good faith is a judicial construction that breaks with a long tradition of hostility towards the recognition of a general duty of good faith. This new doctrine will therefore operate in an institutional context where courts have less experience with this type of contractual duty. In addition, the fundamental principle of contractual freedom, which fundamentally underpins the Canadian common law of contract, marks a fundamental difference with the recognition in much European private law of a ‘social dimension’ of contract law. All of these elements suggest the need for caution when importing elements of the civilian dogmatic tradition into the Canadian common law context.

2 The opportunity of cross-fertilization

There are convincing structural arguments, however, suggesting that *Bhasin*’s doctrine of good faith is not likely to act as a legal ‘irritant.’ First, as Cromwell J emphasizes, the principle of good faith already informs many significant aspects of the Canadian common law of contract. Many common law doctrines are grounded in the notion of good faith – for example, the implication of terms, unconscionability, various kinds of estoppel, the enforceability of exclusion clauses, and compliance with condition precedent. In addition, consolidated pre-*Bhasin* judicial trends have shown a willingness to enforce a duty of good faith performance in a variety of situations (for example, the duty to cooperate, the exercise of contractual discretion, and the exercise of a contractual power) and with respect to a variety of contractual relationships (for example, real estate contracts, employment contracts, insurance contract, franchise agreements, contracts of adhesion, and tendering contracts). Finally,
considerations of good faith inform the process of contract interpretation,\textsuperscript{93} and hundreds of statutory provisions use the concept of good faith (for example, franchise legislation, labour law, and insurance law).

Second, the Canadian juridical system has a distinctive structural element. The common law tradition coexists with Quebec civil law and its French heritage. The civil law of Quebec is characterized by a robust model of good faith – a general principle that applies to all stages of the contracting process (from contract formation to performance and execution).\textsuperscript{94} It must be emphasized, in this respect, that one of the structural reasons given by Cromwell J to justify the recognition of good faith as a general organizing principle of the common law of contract was to harmonize Canadian common law with Quebec civil law.\textsuperscript{95} Moreover, as Cromwell J emphasizes, the Quebec experience has shown that ‘even very broad conceptions of the duty of good faith have not impeded contractual activity or contractual stability.’\textsuperscript{96} From this perspective, Bhasin calls for a careful exercise of ‘comparative judicial methodology’ between civil law and common law traditions as a way to develop the meaning of the general principle of good faith.\textsuperscript{97} In this respect, it is worth noting that in the recent post-Bhasin decision of Churchill Falls (Labrador) Corporation Limited v Hydro-Quebec, the Quebec Court of Appeal emphasized the similarities of judicial reasoning in the common law and civil law systems when


\textsuperscript{94} In Quebec before the enactment of the Civil Code of Quebec (CCQ), three landmark Supreme Court of Canada cases established a general duty of good faith in the area of contract law: Banque National v Soucisse, [1981] 2 SCR 339, 2; Banque National du Canada v Houle, [1990] 3 SCR 122 and 3; and Banque du Montréal v Bail, [1992] 2 SCR 554. The CCQ, which came into effect on 1994, contains three relevant provisions that codify this jurisprudence by establishing a general duty of good faith. Art 6 requires everyone to exercise his or her civil rights in good faith. Art 7 states that no right may be exercised with the intent of injuring another or in an unreasonable manner, which is contrary to the requirements of good faith. Art 1375 requires parties to conduct themselves in good faith at the time the obligation is created, performed and extinguished.

\textsuperscript{95} See Bhasin SCC, supra note 1 at para 41: ‘[T]he current law is out of step with the reasonable expectations of commercial parties, particularly those of at least two major trading partners of common law Canada – Quebec and the United States.’ Hall has also emphasized this point. Hall, Canadian, supra note 3 at 49: ‘[O]ne of the rationales for the new organizing principle of good faith has been to harmonize Canadian common law with Quebec civil law.’

\textsuperscript{96} Bhasin SCC, supra note 1 at para 85.

\textsuperscript{97} This expression is borrowed from Rosalie Jukier’s slide presentation entitled ‘Good Faith in Contractual Relations, February 24, 2015,’ Slide no 36, online: <https://www.mcgill.ca/law/files/law/cle-24-fev-2015-rosalie_jukier.pptx>.
applying the notion of good faith. Based on this premise, the court explicitly drew on Bhasin’s legal methodology to interpret the general principle of good faith under Quebec civil law. This provides an interesting example of how judicial cross-fertilization might usefully inform the future development of the general doctrine of good faith.

Third, as previously emphasized, a recent trend of judicial decisions is emerging in England and Australia aiming at changing (to a varying degree) the traditional piecemeal approach to good faith towards a more comprehensive overarching doctrine. Although this evolutionary process remains highly controversial due to the reluctance of common law lawyers to embrace good faith as a general doctrine, it shows a structural tendency towards the increasing recognition in the common law world of the need for gradually overcoming the limitations of piecemeal solutions in response to demonstrated problems of unfairness.

The foregoing considerations suggest that in the post-Bhasin era courts will face the challenging task of developing the new general organizing principle of good faith in a way that is appropriate for the specific features of the Canadian common law of contract. Given the Canadian judiciary’s legal style, it is unlikely that courts will articulate a system of general rules from which to deductively derive their decisions. In all probability, Canadian courts will avoid recourse to highly abstracted conceptual systematizations or finely circumscribed dogmatic constructs. They will instead approach good faith through a fact-oriented case analysis, so the new general principle of good faith will still develop incrementally as it is tested against different fact patterns. At the same time, however, courts will face new opportunities to innovate the common law of contract by identifying situations and/or relationships in which new contractual doctrines will apply. In brief, it is plausible to expect that Bhasin will not result in a highly systematized judicial doctrine of good faith but, rather, will support new forms of judicial activism in which fact-oriented case analysis will be combined with more discretionary principle-

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98 Churchill Falls (Labrador) Corporation Limited v Hydro-Quebec, [2016] QCCA 1229 at para 134 [Churchill Falls]: ‘Bhasin v Hrynew is a salutary example of the application of the specific requirement of good faith. Just as do courts of common law jurisdictions, the Quebec courts are required to define specific rules of conduct from general principles such as Articles 6, 7 and 1375 C.C.Q. ... As Justice Beetz reminded us ... : “The judge is bound by the issues before him, and does not extend his ruling beyond what is necessary to settle them.”’

99 Churchill Falls, supra note 98 at para 148: ‘There are many ways to articulate the contents of the obligation of good faith. As between general expressions open to all kinds of interpretation and rules drawn from specific experience (such as Bhasin v Hrynew) the court should prefer the latter in order to establish a judge-made rule based on the C.C.Q. and general legal principles.’
based judicial reasoning. Useful insights on the potential long-term evolutionary effects of Bhasin are provided by a historical inquiry into the origins of good faith. That is the analytical direction in which this article is now headed.

III Bhasin’s evolutionary impact: lessons from the Roman law

This section briefly looks at the historical origins of good faith performance, which traces back to the Roman law concept of bona fides. The discussion is not meant to be comprehensive but, rather, to provide a concise outline of the emergence and evolution of bona fides in Roman law, thereby illustrating the institutional operation of the general principle of good faith. From a methodological standpoint, because the evolutionary impact of legal rules takes place over a protracted period of time, comparative legal analysis often includes a large historical component. In this sense, the experience of the bona fides in Roman law provides the opportunity for a useful comparative exercise illustrating the long-term evolutionary implications of introducing a general overarching doctrine of good faith into a contract law system.

For this reason, the introduction of the aportere ex fide bona into the Roman law of contract is compared with the introduction of the new organizing principle of good faith performance into the common law of contract. This comparison serves the twofold purpose of (a) supporting my central claim that Bhasin’s contribution to contract law is institutional

100 No survey of a reasonable length can do justice to the richness and complexity of the vast literature on the role of bona fides in Roman law. For a brief, useful overview, see Martin Josef Schermaier, ‘Bona fides in Roman Contract Law’ [Schermaier, ‘Bona Fides’] in Simon Whittaker, ed, Good Faith in European Contract Law (Cambridge: Cambridge University Press, 2000) 63 [Whittaker, Good Faith]. For a more detailed and comprehensive analysis, see Mario Talamanca, ‘La “Bona Fides” Nei Giuristi Romani’ in Luigi Garofalo, ed, Il Ruolo della Buona Fede Oggettiva nell’esperienza Giuridica Storica e Contemporanea Atti del Convegno Internazionale di Studi in Onore di Alberto Burdese (Padova: Cedam, 2003), vol 4. In researching for this article, in addition to the contributions indicated on subsequent pages, the following monographic contributions were consulted: Luigi Lombardi Vallauri, Dalla “Fides” alla “Bona Fides” (Milan: Giuffre, 1961); Antonio Carcaterra, Intorno ai Bonae Fidei Iudicia (Napoli: Jovene, 1964); Lorenzo Franchini, La Recezione nel ‘Ius Civile’ del ‘Iudicia Bonae Fidei.’ Questioni di Metodo e di Merito (Naples: Jovene, 2015).

101 An experience in many respects analogous to the Roman bona fides is the evolution of equity in English common law. A historical comparison of these two systems is beyond the scope of this article. Commentators have emphasized the structural similarities between ius praeoturium and equity in legal history. See Giovanni Pugliese, ‘Ius Honorarium and English Equity’ in Giovanni Pugliese, ed, Scritti Giuridici (1985–1995) (Naples: Jovene, 2007).
rather than substantive and (b) illustrating the potentially profound evolutionary implications of introducing a general overarching doctrine of good faith into a legal system. As will be seen, the introduction of *bona fides* into Roman law enabled the Roman praetor to produce a body of laws (*ius praetorium*) that was ‘separate’ from those deriving from other legal sources and resting on quite different foundations. Since the praetor lacked formal law-making powers, he created this body of law indirectly – that is, by empowering the adjudicating authority to apply its equitable discretion (*ex fide bona*) to the facts of a case. These insights will prove useful in assessing the potential impact of *Bhasin* on the future development of the common law of contracts.

### A THE EMERGENCE OF THE IUDICIA BONA FIDEI

#### 1 The formulary system

Under Roman civil procedure the civil action was heard in two stages: the preliminary stage *in iure* before a praetor and a full trial *apud iudicem* in front of a judge. At the *in iure* stage, the parties were allowed to present the facts and formulate their respective claims before the praetor. Plaintiffs submitted draft formula that contained the essential elements of their claims, together with requests for an action to be allowed on that basis. Defendants could suggest amendments, raise defences, or advance counterclaims. After consideration of the parties’ pleadings, the praetor had to consider whether the law in fact provided a remedy for the plaintiff’s claim. If the praetor were satisfied, he or she would issue the formula and appoint a judge (*iudex*) to determine the dispute. The authority of the judge was limited to fact-finding and applying the terms of the formula to the facts.

The formula issued by the praetor contained instructions for the judgment: (a) it identified the plaintiff’s statement of claim and the defendant’s statement of defence and (b) it directed the judge to condemn the

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103 Reference is here made to the formulary system, within which the *bona fides* emerged and developed. The formulary system began with the creation of the *pergrine praetor* (discussed later in the text) in 242 BC and was formally abolished in AD 342, although it fell into disuse before then.
defendant if he found the plaintiff’s case to be proven or to absolve the defendant if he did not. The formula described the defendant’s alleged duty to perform in terms of oportere. As a legal term, ‘oportere’ refers to the existence of a legal obligation based on the ius civile. Therefore, the praetor had no power to create new actions. Only claims recognized by legislation were actionable.

2 The praetor peregrinus

Because the praetor could not introduce new forms of action or extend existing actions to private claims not recognized by the law, the system based on the old ius civile proved incapable of adequate expansion and evolution in response to evolving economic needs. In particular, in the third century BC, the expansion of Rome and the corresponding growth of commercial traffic in the Mediterranean region created a pressing demand for the efficient adjudication of disputes between Roman citizens and the increasing number of foreigners trading in Rome. To meet this need for a special, more informal procedure for cases involving foreigners, the praetor peregrinus (peregrine praetor) was created in 242 BC and given special jurisdiction over cases in which at least one party was a foreigner.

The peregrine praetor played a crucial role in modernizing the Roman law of contract through the development of the legal concept of bona fides. In the course of the second century BC, the formulas issued by the peregrine praetor began to contain actions based not on the old civil oportere but, rather, on the oportere ‘ex fide bona.’ The ex fide bona clause added to the formula directed the judge to adjudicate disputes in light of the requirements of good faith. As a result, judges were given large

104 E.g., the formula for the condictio certae pecuniae (the action for the repayment of a specific sum of money) reads as follows: ‘Let X be iudex. If it appears that the defendant ought to pay 10,000 sesterces to the plaintiff, let the iudex condemn the defendant to pay 10,000 sesterces to the plaintiff’ (English translation by Nicholas, Introduction, supra note 102 at 24).

105 This is the case in that the historical context legislation consists of the Twelve Tables and the plebiscite.

106 Two reasons explain the inadequacy of the traditional legal system. First, it was confined to Roman citizens; hence, disputes in which one of the parties was not a Roman citizen raised the problem of determining the applicable substantive law. See Sohm, The Institutes, supra note 102 at 64–8. Second, disputes with foreigners, which were mostly commercial in nature, required a speedier and more flexible procedure that was allowed by the narrow ius civile.

107 The judge was instructed by the formula to condemn the defendant to ‘quidquid dare facere oportet ex fide bona’ (whatever on that account the defendant should give to or do for the plaintiff in good faith). The English translation of the expression quidquid dare facere oportet ex fide bona comes from Whittaker & Zimmermann, ‘Good Faith in European Contract Law: Surveying the Legal Landscape’ [Whittaker & Zimmermann, ‘Good Faith’] in Whittaker, ed, Good Faith, supra note 100 at 16.
(and largely indeterminate) discretion to decide the case before them in accordance with what appeared to be fair and reasonable.\textsuperscript{108} Judgments based on the actions ex fide bona were called ‘iudicia bona fidei’ (claims that have to be adjudicated in accordance with good faith) to emphasize that the claims had no statutory basis and that the judge was enabled to assess parties’ claims based on equitable considerations.

Crucially, and from an institutional standpoint, the introduction in the formula of the ex fide bona clause significantly expanded the power of the judge. Whereas with the iudicia stricti iuris, the judge was confined to determining whether a claim asserted under the formula did or did not exist, with the iudicia bona fidei, the judge was enabled to weigh the interests of both sides of a dispute based on social and ethical considerations. The judge was still formally limited to the issue defined in the procedural formula, but the bona fides clause enabled him to balance both parties’ interests in light of all of the circumstances surrounding the conclusion of an agreement and on the basis of society’s ethical values.

As Martin Schermaier observes, ‘the officium (authority) of the judge was extended from fact-finding and merely applying the terms of the formula to these facts to an assessment of the legal merits of the cases. A significant element of the praetor’s task was thereby transferred to the judge.’\textsuperscript{109} In practical terms, ‘in assessing the value of the performance owed, the judge was bound neither by a specific sum asserted by the plaintiff . . . nor by a set of pre-established rules.’\textsuperscript{110} He was free to consider the claim himself and to assess, according to the principles of good faith, whether and to what extent it was substantiated.

3 \textit{The substantive specificity of good faith}

As a matter of substantive content, the bona fides included two fundamental normative standards. First, it expressed the principle of ‘fit quod dici tur’ (keeping one’s word). This was reflected by the fact that with the iudicia bona fidei the judge took into consideration collateral informal agreements that had no effect under the ius civile. For example, a ‘pactum de non petendo’ (an informal agreement not to sue) had no effect and could not discharge an obligation under the old ius civile, which required a formally created obligation to be discharged through formal release (acceptilatio). Hence, the judge could not reject a creditor’s claim arising out of a solemn promise (stipulatio) based on only the

\textsuperscript{108} For discussion on the oportere ex fide bona, see Javier Humberto Facco, ‘Oportere ex Fide Bona, Una Construcción Decisiva de la Jurisprudencia Romana’ (2015) 24 Revista de Derecho Privado 17 at 41.

\textsuperscript{109} Schermaier, ‘Bona Fides,’ supra note 100 at 76 [emphasis added].

\textsuperscript{110} Ibid at 75–6.
defendant’s allegation that the creditor promised not to sue; a formal act was necessary to release the debtor.\textsuperscript{111} By contrast, with the introduction of the \textit{bona fide iudicia}, an informal agreement not to pay a debt was actionable by a defendant simply alleging the existence of an informal agreement not to sue.

Second, the \textit{bona fides} expresses the principle of ‘\textit{age quod agis}’ (literally, ‘do what you are doing’), which required parties to comply with the substance of their promises (rather than merely with what they expressly undertook) and to be respectful of the reasonable expectations of contractual partners. From this perspective, \textit{bona fides} came to include honesty. Fritz Schultz explained this evolution of the normative content of \textit{bona fides} in Roman law as follows: ‘To guarantee \textit{bona fides} . . . no longer only means to keep one’s word, but also to act as honest persons do, to keep faith fairly and in accordance with customs.’\textsuperscript{112} As Schermaier neatly clarifies, the evolution of \textit{fides} into \textit{bona fides} ‘emphasises the substantive specificity of that standard of behaviour: It is the \textit{bene agere} of the Roman citizen who act(s) carefully and prudently and who respect(s) the interests of his contractual partner – who acted as \textit{bonus vir} (honest person).’\textsuperscript{113} Incidentally, if one compares Cromwell J’s definition of the principle of good faith with Roman \textit{fides}, it is difficult not to recognize a striking similarity.

**B THE ROLE OF BONA FIDES IN ADVANCING SUBSTANTIVE LAW**

This section illustrates the impact of the \textit{bona fides} on the evolution of Roman substantive law. As an illustrative example, the emergence of the \textit{bona fidei} contracts in commercial law – that is, contracts for which the informal consent of the parties is a sufficient basis for their validity, is briefly examined. In early Roman law, sales were made either by \textit{mancipatio} or by \textit{stipulatio}. On the one hand, the \textit{mancipatio} was the primary \textit{ius civile} mode for transferring ownership and consisted of a highly formal procedure in the presence of both parties and at least five witnesses. Ownership passed only when the price was paid and the thing conveyed. On the other hand, the \textit{stipulatio} was a formal promise made in answer to a formal question. It was unilateral and \textit{stricti iuris} – that is, it imposed an obligation on the promisor as a consequence of him answering a formal question with a promise in set terms. Crucially, the validity of the \textit{stipulatio} rested on its form and not on the agreement. Consequently, any

\begin{itemize}
  \item \textsuperscript{111} See Nicholas, \textit{Introduction}, supra note 102 at 198–9.
  \item \textsuperscript{112} Fritz Schultz, \textit{Principles of Roman Law} (Oxford: Clarendon Press, 1936) at 228.
  \item \textsuperscript{113} Schermaier, ‘Bona Fides,’ supra note 100 at 82.
\end{itemize}
alleged defect affecting the formation of the agreement did not constitute a valid ground for a contractual remedy.\footnote{114}

As a consequence of this rigid formalism of the \textit{ius civile} in early Roman law, a simple cash sale – where something is sold and the price is exchanged simultaneously – was problematic. A commercial contract of sale was generally effectuated by means of a \textit{stipulatio}, in which one party solemnly promised to transfer the property to another party through a subsequent act of delivery. The passage of ownership did not result from the \textit{stipulatio}; it occurred at a later time with the transfer of the thing: the ‘sale created an obligation to transfer the \textit{res}, but the actual transference had to be by a recognised form of conveyance.’\footnote{115} The rapid growth of the Roman economy in the middle Republic prompted the need to recognize the validity of agreements made without the rigid formalities required by the \textit{stipulatio}. In response, it gradually came to be acknowledged – in the context of the \textit{bona fidei iudicia} – that in certain transactions parties could be bound by a formless agreement.\footnote{116} That is, the (‘consensual’) principle emerged that valid, legal obligations depended not on their form (as in the \textit{stipulatio}) – not on something visible, external, or tangible (as in the \textit{mancipatio}) – but, rather, on the will of the parties. This was a great advantage over the old \textit{ius civile} modes of transferring ownership. As Barry Nicholas emphasizes, ‘[t]he acceptance of this principle was one of the most important factors in the adaptation of the law to the commercial needs of a vast empire.’\footnote{117}

The consensual principle is substantively grounded in the \textit{bona fides} – which, as previously noted, required people to keep their promises and be respectful of the reasonable expectations of contractual partners. The emergence of the consensual principle had a significant evolutionary impact. Based on this substantive principle and due to the expanded equitable discretion enjoyed by the Roman praetor, four consensual \textit{bona fidei} contracts gradually emerged in the context of the \textit{iudicia bona fidei}: the \textit{emptio venditio} (sale), the \textit{locatio conductio} (hire), the \textit{societas} (partnership), and the \textit{mandatum} (mandate).\footnote{118} This legal evolution is

\begin{thebibliography}{99}

\footnote{114} Conversely, as Nicholas clarified, ‘if the form had been defective (e.g., because the debtor said ‘\textit{promitto}’ instead of ‘\textit{spondeo}’) the creditor could not plead that there had nevertheless been an agreement in substance.’ Nicholas, \textit{Introduction}, supra note 102 at 160.

\footnote{115} Prichard, \textit{Leage}, supra note 102 at 353.

\footnote{116} Nicholas, \textit{Introduction}, supra note 102 at 162.

\footnote{117} Ibid.

\footnote{118} Watson, ‘The Origin of Consensual Sale: A Hypothesis’ (1964) 37 TR 245. These agreements are \textit{bona fidei} (stipulated according to good faith) as the obligations of parties are assessed according to the duty of good faith performance and based on the equitable discretion of the judge.

\end{thebibliography}
one of the greater achievements of Roman law. With specific respect to the transfer of ownership, the *emptio venditio* allowed for legal ownership to be validly acquired by means of a formless transaction. This was a great advantage over the old *ius civile* modes (that is, *mancipatio* and *stipulatio*) of transferring ownership because legal ownership passed when the vendor agreed to sell and the purchaser agreed to buy some object for a definite or ascertainable price. Once the parties agreed on the subject matter and the price, the contract was concluded, and enforceable legal obligations were generated 'regardless of whether the *res* had been handed over, the price paid, or anything given as earnest.' The Roman law concerning the *emptio venditio* – grounded as it was in the principle of good faith – had a great influence on both modern civil law and common law.

A further substantive evolution associated with the development of *bona fide* contracts was the recognition of legal remedies against fraudulent behaviour in contractual relationships. An example is provided by the protection of the innocent buyer against the seller’s fraudulent behaviour or, more generally, against the defects in the thing being sold. Under the old *ius civile*, the general rule was ‘*caveat emptor*’ (let the buyer beware). The buyer had no remedy for a defect in quality; the thing sold may be defective, but the buyer should have recognized this before the purchase. In this respect, the *bona fides* regime that characterized the *emptio venditio* mitigated the harshness of the *caveat emptor* rule. In *bona fidei* contracts, the *dolus* of the seller came to be regarded as bad faith behaviour, enabling the judge to determine that the innocent party should not be held to the contract. As Schermaier explains, ‘[t]he *exceptio doli* was inherent in the *bonae fidei iudicia*, and so the judge would always implicitly consider whether the plaintiff’s claim . . . was based on *dolus*.’ If the seller knew that the thing was defective and fraudulently concealed it from the buyer, the latter had a cause of action, while the former was liable for consequential loss.

119 See Sohm, *The Institutes*, supra note 102 at 103: ‘[T]he law of obligations, and it alone – and more particularly the law of those *bona fidei* negotia, and it alone – constitutes what is, in the truest and strictest sense, the imperishable portions of Roman law.’
120 This definition of *emptio venditio* is borrowed from Prichard, *Leage*, supra note 102 at 353.
121 Ibid at 354.
123 Schermaier, ‘*Bona Fides*’, supra note 100 at 86.

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C DID THE SUPREME COURT OF CANADA IN BHASIN ACT AS A PEREGRINE PRAETOR?

Despite the profound differences between the historical and institutional contexts of *bona fides* in Roman law and the principle of good faith in the contemporary Canadian common law of contracts, the historical analysis developed in the prior section provides valuable insights for understanding the potential impact of *Bhasin* on the future development of contract law. This section emphasizes, in particular, three lessons to be drawn from the historical experience of the *bona fides*.

1 *Good faith and the expansion of judicial power*

The introduction of the *ex fide bona* clause in the formula issued by the praetor determined a significant expansion of judicial power relative to alternative sources of law. Specifically, the *opportere ex fide bona* enabled the praetor to create a new procedure empowering the judge to apply judicial criteria independent of the law in force. This historical analysis suggests that a similar development could occur in the Canadian common law of contracts as a result of the recognition of good faith as a general organizing principle. Similar to the expanded powers of the Roman praetor, Canadian judicial power in the area of contract law has been expanded by *Bhasin* to include the ability to recognize new situations in which duties of good faith arise. Just as the *opportere ex fide bona* enabled the Roman praetor to create new law independent of the ordinary law, the new general organizing principle of good faith enables Canadian courts to develop new contractual doctrines independent of the well-developed case law established by binding precedent. Although Cromwell J cautiously warns that ‘*generally, claims of good faith will not succeed if they do not fall within these existing doctrines,*’ by recognizing good faith as a general organizing principle of the common law of contract, the institutional basis for a *bona fides*-like evolutionary impact has been laid. Differences in the historical and institutional contexts do not undermine the fact that good faith operates as a general clause enabling judges to enrich the set of actionable claims, thereby affecting the development of substantive law. As discussed subsequently in this section, the extent of this impact will largely be a function of the institutional context within which Canadian judges operate.

2 *Good faith and the advancement of substantive law*

In expanding the judicial power, the principle of good faith also enlarged the set of actionable substantive claims. The extension of the
equitable discretion of the judge in the *iudicia bona fidei* allowed the creation of remedies in cases where no remedies were contemplated by the civil law, thereby revising the rigid formalism of the *ius civile*. In this way, the peregrine praetor was capable of providing an institutional response to the demand for legal change arising out of Rome’s commercial expansion, despite the fact that he had no formal authority to innovate the law. The *bona fide* acted as a new source of legal obligations and resulted in the creation of an independent body of law resting on judges’ equitable discretion rather than on legislatively recognized causes of action. As already noted, once the emergence and development of the *iudicia bona fidei* was completed, a new category of contract arose. Despite the unitary character of jurisdictional authority in Rome, contracts were either *bona fide* or *stricti iuris*. *Stricti iuris* contracts were governed by the strict adherence to the formalities of *ius civile*, *bona fide* contracts were based on the requirements of good faith. Thus, a new body of substantive law emerged independently from the consolidated law (both statutory and judge made). A similar development could occur in the Canadian common law of contracts as a result of *Bhasin*. Although it cannot be predicted in detail how courts will apply the general clause of good faith, the conceptual framework introduced in *Bhasin* could potentially trigger forms of judicial activism introducing new constraints on contractual autonomy. More specifically, despite Cromwell J’s repeated emphasis on the ‘freedom of contracting parties to pursue their individual self-interest,’ it is possible that the general organizing principle of good faith could be translated into the establishment of new contractual duties on contracting parties.

3 Good faith and the institutional constraints to expanded judicial power

The Roman experience also speaks to the concern that the recognition of a general duty of good faith might impose a serious restriction on contractual freedom. In the Roman experience, the substantive

125 In this way, the *bona fides* played a central role in restructuring and innovating the Roman law. See Whittaker & Zimmermann, ‘Good Faith,’ supra note 107 at 17 (emphasizing that *bona fides* was ‘one of the most fertile agents in the development of Roman contract law’).

126 This point is widely accepted among Roman law scholars. See e.g., Sohm, *The Institutes*, supra note 105 at 80 (emphasizing that ‘Praetorian law . . . was not, strictly speaking, law, but the power involved in the right to allow or disallow actions and other legal remedies virtually raised it to the position of law.’)


128 *Bhasin SCC*, supra note 1 at para 70.

129 See e.g., Hunt, ‘Good Faith,’ supra note 6.
indeterminacy of the _bona fides_ did not translate into an arbitrary exercise of judicial discretion. The ‘incremental’ character of the legal change brought about by the praetor was ensured by the cultural and institutional context in which the _index_ operated. First, as Paul du Plessis explained, ‘[s]ince the praetors often lacked legal expertise, they tended to consult those learned in the law.’\(^{130}\) Second, the formulas through which claims could be laid before the praetor were defined in the praetor’s _edict_, which was issued at the beginning of the praetor’s year in office. Although there was no legal sanction for departing from the _edict_, public opinion provided a powerful incentive to compel the praetor to conform to his own _edict_. As du Plessis clarified, ‘[o]nce the _edict_ had been published, the praetor was expected to act in conformity with it.’\(^ {131}\) Third, although there was no such thing as a doctrine of precedent applicable to the praetor’s _edict_, in practice each praetor was bound by his predecessors’ _edicts_. As Nicholas explains: ‘[i]n theory each praetor’s _edict_ was independent of his predecessor’s and was valid only for his year’s office, but obviously a system in which a substantial part of the law changed every year would be unworkable.’\(^ {132}\) Therefore, in practice, ‘though in the earlier years there was no doubt a certain amount of experimentation, the main body of the _edict_ was carried over from year to year, successive praetors making only such additions and deletions as seemed necessary.’\(^ {133}\) These considerations show that constraints and counterbalances on judicial power, resulting from the recognition of a general organizing principle of good faith, should be sought in the cultural and institutional context within which Canadian judges operate (for example, the incrementalism deeply rooted in the Canadian common law and legal culture).\(^ {134}\)

The analysis developed so far emphasizes the twofold impact of _Bhasin_ on both the scope of judicial power relative to other sources of law and the evolution of substantive law. This analytical perspective poses the problem of how to define the outer boundaries of good faith – that is, the conceptual perimeter of the scope of application of the general organizing principle of good faith. This issue will be elaborated on in the remainder of the article.

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\(^{130}\) Du Plessis, *Textbook*, supra note 102 at 34.

\(^{131}\) Ibid at 35.


\(^{133}\) Ibid. The incremental nature of the legal change promoted through the praetorian _edict_ is well clarified by Sohm, *The Institutes*, supra note 102 at 79: ‘The praetors in general showed little taste for the sudden adoption of far-reaching general principles.’

\(^{134}\) For a useful critical analysis of the Supreme Court of Canada’s incremental change test, see Paul M Perell, ‘Changing the Common Law and Why the Supreme Court of Canada’s Incremental Change Test Does Not Work’ (2003) 26 Adv Q 345.
As repeatedly emphasized, in *Bhasin*, Cromwell J did not develop a conceptual framework that enables us to identify the circumstances under which the duty of good faith arises or to define the precise ambit of the new general organizing principle. In this section, it is contended that an economic approach to good faith provides useful insights on how to define the outer boundaries of good faith performance. The discussion is organized into two steps. First, the economic justification of good faith is summarized. This step reinforces the methodological claim that good faith is better understood as an institutional tool for allocating lawmaking powers to adjudicating authorities. If good faith is a tool for allocating law-making powers, it follows that the precise ambit of the new organizing principle should be defined by taking into account those circumstances in which courts prove to be an efficient mechanism for specifying contractual terms. Second, the efficiency conditions of good faith are examined. This step demonstrates that the economic perspective helps to identify the conditions under which good faith serves the functions of contract law better than alternative sources of law.

**A THE ECONOMIC EXPLANATION OF GOOD FAITH**

The duty of good faith goes together with the opportunity for bad faith: if there is no room for bad faith, there is no need to impose a duty of good faith. In economic terms, bad faith denotes ‘opportunistic’ behaviour. A party to a contract behaves opportunistically ‘where it seeks, by stealth or by force, to change to its advantage and to the detriment of the other party or parties the division of the contract’s joint gains that each party could normally look forward at the time of contracting.’

135 Ejan Mackaay, *Economics of the Civil Law of Contract and of Good Faith*, prepared for the Symposium in honour of Michael J. Trebilcock, Toronto (1–2 October 2009) at 11 [Mackaay, *Economics*]. Economics literature has identified various specific forms of opportunistic behaviour in contractual relationships, including freeriding, shirking, agency problems, moral hazards, holdouts, and holdups. A careful examination of these forms of opportunism is beyond the scope of this article. However, it is worth emphasizing that they capture the list of good faith claims that the Supreme Court of Canada has explicitly identified in *Bhasin*, which includes situations: (1) where the parties must cooperate in order to achieve the objects of the contract; (2) where one party exercises a discretionary power under the contract; and (3) where one party seeks to evade contractual duties (*Bhasin* SCC, supra note 1 at para 47). These are all forms of opportunistic behaviour in which one party faces the opportunity to obtain a larger share of the cooperative surplus than anticipated at the time of contracting. For a discussion of contractual opportunism and contract law, see Timothy J Muris, ‘Opportunistic Behavior and the Law of Contracts’ (1981) 65 Minn L Rev 4; Michael J Trebilcock, *The Limits of Freedom of Contract* (Cambridge: Harvard University Press,
The opportunity for bad faith is a product of incomplete contracts. From an economic perspective, incompleteness is not necessarily associated with a contractual gap (the lack of a contractual provision). A contract is incomplete when it fails ‘to fully realize the potential gains from trade in all states of the world’ – that is, it does not provide an efficient rule for future contingencies.\textsuperscript{136}

For example, it might be that a contract provides a rule that is applicable to a large set of possible future contingencies, but that rule proves highly inefficient in a large subset of cases. A rule exists that governs the case (no contractual gap), but the contract is incomplete as it does not provide an efficient rule. Contracts are incomplete owing to the various transaction and information costs associated with the process of specifying contractual terms in advance.\textsuperscript{137} Incompleteness may be caused by exogenous factors, such as the complexity of a transaction, the uncertainty of future states that are not observable or not verifiable, or the irrepressible ambiguities or vagueness of language. Incompleteness may also be endogenous – that is, it may result from parties’ deliberate choice to withhold information in the pursuit of their strategic bargaining interests.\textsuperscript{138} Identifying the cause of incompleteness is important, because the judicial ability to enforce an incomplete contract by supplying efficient solutions is largely a function of why a contract is incomplete.\textsuperscript{139}

Since the specification of contractual terms is costly, parties may choose not to specify in advance contractual terms aimed at preventing opportunistic strategies. This leaves room for opportunistic behaviour. If a contract is silent on a specific state of affairs (or is insufficiently state contingent), once the unspecified state of affairs occurs, one party may


\textsuperscript{138} On strategic ambiguity, see Ayres & Gertner, ‘Strategic,’ supra note 136; B Douglas Bernheim & Michael D Whinston, ‘Incomplete Contracts and Strategic Ambiguity’ (1998) 88 Am Econ Rev 902.

\textsuperscript{139} Schwartz, ‘Relational Contracts,’ supra note 137.
take advantage of the lack of contractual specification of rights and duties to appropriate part of the cooperative surplus.140

This action implies that parties negotiating an agreement must choose the optimal level of *ex ante* precision of contractual terms (or, to state it differently, the optimal level of contractual incompleteness). For each possible future contingency, they are confronted with a choice between bearing the actual costs of specifying in advance the contractual terms regulating the future contingency (that is, *ex ante* specification through negotiation) or saving the actual costs of *ex ante* specification and letting a judge determine the contractual rules after the contingency materializes (that is, *ex post* specification through adjudication).141 Law and economics theory suggests that they choose to negotiate narrow, specific rules if the actual cost of higher *ex ante* precision is outweighed by a reduction in the expected cost of opportunistic behaviour.142 Conversely, they opt for more general clauses, such as good faith performance, if the actual benefit of lower *ex ante* precision outweighs the expected cost of increased opportunistic behaviour.143 This important point will be expanded on later.

140 Form a law and economics perspective, completeness is not necessarily associated with a contractual gap (i.e., a lack of a contractual provision); a contract is incomplete when it does not provide an efficient rule for future contingencies. It might be, e.g., that a contract provides a rule that is applicable to a large set of possible future contingencies, but that rule proves highly inefficient in a large subset of cases. In this case, there is not a contractual gap (as a rule exists that governs the case), but from an economic perspective the contract is incomplete as it does not provide an efficient rule.

141 A more comprehensive discussion should include in the set of choices other sources of law, such as, e.g., the statutory provision of duties of good faith performance. This analysis is left to future research.


Before examining more closely the efficiency conditions of good faith, it is worth emphasizing that good faith is not the only doctrine grounded in contractual incompleteness. In applying the doctrine of vagueness/uncertainty of terms, courts address incomplete contracts and interpret indefinite, unspecified contractual terms similarly to what they do under the doctrine of good faith. This does not mean, however, that the doctrine of vagueness/uncertainty fulfills the same function as the doctrine of good faith. There is a clear, functional distinction between the two doctrines that should be clarified.

Under the traditional doctrine of vagueness/uncertainty, an agreement will not be enforced as a contract if the parties have not reached an agreement on all of its essential terms. A contract, therefore, must be sufficiently complete such that ‘a court can fairly be asked to give it effect.’ Similarly, courts can deny enforcement if a particular term of a contract is so vague that a court cannot give it meaning. If a material term suffers from incurable uncertainty, courts may decline to enforce the entire agreement on grounds of uncertainty. Stripped to its essence, the doctrine of vagueness/uncertainty enables courts to decline to specify terms that the parties have left unspecified, thereby not enforcing an incomplete agreement.

As Robert Scott has demonstrated, this doctrine ensures that the formal mechanisms of legal enforcement are not triggered when parties consider that more efficient and effective methods of enforcement are


144 From an economic standpoint, incompleteness is a necessary (though not sufficient) condition for any active role of courts in the process of interpreting contracts. On this point, see George M Cohen, ‘Implied Terms and Interpretation in Contract Law’ in Gerrit De Geest, ed, Encyclopedia of Law and Economics, vol 7: Contract Law and Economics (Cheltenham, UK: Edward Elgar, 2011) 125 at 127.


146 See e.g. Hillas & Co Ltd v Aros Ltd, [1932] 43 LJ L Rep 359; Canada Square Corp v Versaford Services Ltd, 34 OR (2d) 250, 15 BLR 89, 130 DLR (3d) 205, 1981 Carswell Ont 124 (Ont CA).

147 Swan, Canadian Contract, supra note 145 at 287.

148 See e.g. Scammell & Nephew v Onston, [1941] AC 251; Courtney & Fairbairn Ltd v Tolaini Brothers (Hotels) Ltd and Another, [1975] 1 WLR 297 CA; LCDH Audio Visual Ltd v ISTS Verbatim Ltd (1988), 40 BLR 128 (Ont HCJ).
Scott brings evidence that parties frequently write contracts that are deliberately incomplete and intentionally fail to specify verifiable measures of performance. They do so not because they rely on the absence of legal enforcement per se but, rather, because they rely on alternative efficient forms of self-enforcing mechanisms based on reciprocal fairness. The doctrine of vagueness/uncertainty limits legal enforceability to protect parties’ preference for these self-enforcing mechanisms. From this perspective, courts must discern cases in which incompleteness is the product of parties’ inadvertence or carelessness in writing the agreement from those in which parties deliberately write indefinite agreements as they rely on self-enforcing mechanisms. As Scott explains, the doctrine of vagueness/uncertainty performs the function of ‘narrowing the domain of legal liability,’ thereby preserving ‘space for parties to exploit opportunities to reciprocate.’

In contrast, the doctrine of good faith performance enables parties that have made an enforceable agreement to defer to courts the task of specifying terms that they have left unspecified. The distinctive feature of the doctrine of good faith performance is that it directs the judge to specify contractual terms so as to minimize contractual opportunism. Therefore, while the doctrine of vagueness/uncertainty attains the choice of whether courts should enforce an incomplete agreement, the doctrine of good faith attains the choice of how courts should enforce an incomplete agreement so as to minimize contractual opportunism.

In conclusion, economic analysis suggests that the doctrine of good faith provides an institutional response to the problem of contractual opportunism rooted in contractual incompleteness. It enables parties to save on ex ante specification costs while deferring to courts the task of specifying the contractual rules after a contingency materializes. This explains why good faith is widely recognized as a legal principle across many common and civil law jurisdictions. From an institutional perspective, good faith allows for efficiently allocating law-making power to judges when the private bargaining process proves inadequate or inefficient in dealing with contractual opportunism through ex ante specification of contractual terms.

150 Ibid at 1645.
THE EFFICIENCY CONDITIONS OF GOOD FAITH

1 The conventional economic framework

A sensible strategy for defining the outer boundaries of good faith is to examine the adjudication process’s institutional limitations and relative advantages over alternative law-making mechanisms (that is, private bargaining, adjudication, or legislation). A duty of good faith should not arise in those situations in which judges do not have the institutional capacity to deal efficiently with the problem of contractual opportunism. Conversely, good faith should arise when judicial *ex post* specification of contractual terms proves advantageous compared with alternative sources of law. From this perspective, the outer boundaries of good faith are determined by the efficiency conditions of good faith. A comprehensive analysis of this complex issue is beyond the scope of this article. The intent of this subsection is only to provide the reader with a sense of how economic analysis could help define the scope of application of the general organizing principle of good faith and thereby address a crucial issue that *Bhasin* has left unanswered.

The goal of contract law is to minimize the sum of the following two cost items \( C = S + O \), where \( S \) denotes the costs of specifying the contractual terms (specification costs), and \( O \) represents the cost of the opportunistic behaviour arising from incomplete contracts (opportunism costs). For simplicity, let us focus on the choice between only two of the alternatives: (a) *ex ante* specification by private parties (that is, private bargaining) or (b) *ex post* specification through adjudication (that is, the good faith regime). Under this assumption, the good faith regime is efficient if private bargaining does not work better in minimizing \( C \).

Law and economics scholars have traditionally assumed that the efficiency of good faith depends on the magnitude of the *ex ante* specification costs and the likelihood a contingency will materialize. On this view, *ex ante* specification by private parties is efficient when specification costs are low and the likelihood a contingency will materialize is high; conversely, *ex post* specification through adjudication is efficient when *ex ante* specification costs are high and the likelihood a contingency will materialize is low. That is, conventional legal–economic scholars have traditionally focused on the economizing effect on specification costs. Good faith reduces specification costs by shifting them from the *ex ante* to the *ex post* dimension.

From this perspective, when the actual *ex ante* specification costs exceed the expected costs of contractual opportunism, parties have an incentive to defer the solution to the *ex post* stage. The more unlikely it is...
that opportunistic behaviour will occur, the lower the expected cost of contractual opportunism will be and, therefore, the lower the private parties’ willingness to bear the costs of specifying ex ante the contractual terms. In brief, the use of good faith is efficient for those contingencies that are highly unlikely to occur. While this conventional economic framework provides a useful starting point for an economic understanding of good faith, it overlooks the institutional dimension of good faith, which is the subject of discussion of the remainder of this section.

2 The institutional dimension of good faith
A change in the timing of specification of contractual terms (ex ante versus ex post) involves a concomitant change in the technique of specification (private bargaining versus adjudication). That is, the choice that private parties are confronted with is twofold: (a) ex ante versus ex post determination and (b) a contractual, versus a judicial, decision-making process. For the sake of brevity, these two choice dimensions will be called, respectively, the ‘temporal’ and the ‘institutional’ change (or shift). In the remainder of this subsection, the impact of both shifts on specification and opportunism costs are considered. The limited purpose is to identify some of the variables that affect these costs and, thus, to illustrate the usefulness of economic analysis for defining the outer boundaries of good faith.

The conventional assumption that good faith allows parties to reduce specification costs certainly contains a kernel of truth. It is easily challenged, however, when one considers the impact of the institutional shift on specification costs. In fact, the shift to the adjudication process imposes high litigation costs for private parties that could be saved through ex ante private negotiation. Hence, the reduction in ex ante specification costs obtained by postponing these costs until the future is often offset by additional costs associated with costly litigation or costly judicial enforcement.152

In addition, the institutional shift associated with a good faith regime significantly affects the magnitude of opportunism costs because courts and private parties have different relative abilities to identify and enforce legal rules reducing the costs of opportunistic behaviour. Hence, the

152 Another way to save on ex ante specification costs is to make recourse to forms of self-enforcing mechanisms. First, as Scott has demonstrated, they allow parties to make credible promises even where contractual terms are indefinite (i.e., not fully specified ex ante). Second, they allow parties to save on the costs of litigation. Self-enforcing indefinite agreements are discussed later. For discussion, see Scott, ‘Self-Enforcing,’ supra note 149; Robert E Scott, ‘The Death of Contract Law’ (2004) 54 UTJ 4 at 369 [Scott, ‘Death of Contract Law’].
identification of situations in which a duty of good faith arises should rest on a careful assessment of the comparative advantages and disadvantages of courts for providing an efficient institutional response to the problem of contractual opportunism.\(^{153}\)

The law and economics literature has identified some significant limitations on courts’ institutional abilities to identify the efficient allocation of legal entitlements. Judicial ability to minimize contractual opportunism is largely a function of the causes of incompleteness. First, \(ex\ post\) judicial specification is impracticable when the relevant information is either unverifiable or unobservable.\(^{154}\) It has been demonstrated that courts tend to maintain a passive, non-interventionist approach when contracts are incomplete, as a consequence of asymmetrical information. This is because courts do not engage in the futile activity of supplying terms that hinge on unobservable information. In these cases, as Alan Schwartz observed, courts tend ‘to treat incomplete contracts as if those contracts were complete.’\(^{155}\) So, for example, ‘courts using the doctrine of good faith behave passively when the issue is the quantity of services a party is to supply under a contract that fails to specify quantity.’\(^{156}\) This suggests that the imposition of good faith duties is inefficient when the measure of performance is either unverifiable or unobservable.

Second, reliance on \(ex\ post\) judicial specification reduces predictability and transparency, thereby increasing the costs associated with contractual performance. In fact, contracting parties typically need guidance regarding their performance obligations. They need to predict with confidence what performance may require. From this perspective, good faith proves efficient when parties can accurately predict what behaviours a court will find sufficient to satisfy the requirements of good faith. Hence, the risk of recognizing good faith as a general organizing principle susceptible to \(ex\ post\) judicial concretization thorough new legal doctrines is that parties will be disabled from predicting with confidence the behavioural standards that courts will find sufficient to satisfy good faith.\(^{157}\) This might produce the unintended consequence of increasing

\(^{153}\) Cf Hadfield, ‘Judicial Competence,’ supra note 137; Schwartz, ‘Relational Contracts,’ supra note 137.

\(^{154}\) Schwartz, ‘Relational Contracts,’ supra note 137 at 282–3.

\(^{155}\) Ibid. See also Scott, ‘Self-Enforcing,’ supra note 149 at 1657.

\(^{156}\) Schwartz, ‘Relational Contracts,’ supra note 137 at 314. To be clear, although Schwartz’s analysis focuses on US system of contract law, this analysis proves useful for our purposes since US contract law is based on the recognition of good faith performance as a general principle (UCC § 1–203).

\(^{157}\) Scott, ‘Death of Contract Law,’ supra note 152 at 374–5 (discussing the negative impact of general, vague, standards on predictability).
the transaction costs associated with contractual performance and, con-
comitantly, generating inconclusive litigation. From this perspective,
good faith is efficient only if the increased uncertainty associated with
unpredictable interpretation is justified by a lack of specific contractual
clauses or more detailed \textit{ex ante} regulation that could better address the
relevant contracting problem. For example, the common problem of
keeping the contract price above the opportunity cost of performance is
usually best addressed through index clauses that are industry specific
and too costly for courts to determine.\textsuperscript{158}

Third, as a result of the increased vagueness in contractual regulation
associated with good faith, recourse to a good faith regime could pro-
duce the unintended consequence of increasing parties’ incentives to
engage in strategic behaviours. This would increase the costs associated
with moral hazard.\textsuperscript{159} The vaguer the legal standard, the broader the leev-
way left to parties to argue in favour of a contractual interpretation that
maximizes their private gain at the expense of joint-surplus maximiza-
tion. In short, if not properly articulated, the good faith regime might
amplify incentives for contractual opportunism, especially in those cases
where courts have exhibited a passive attitude in contractual adjudica-
tion. This reinforces the previous conclusion that good faith proves ineff-
cient when it conditions judicial enforcement on non-verifiable meas-
ures of performance.

Fourth, a good faith regime might undermine the incentives or propen-
sity towards efficient cooperative behaviour.\textsuperscript{160} Scott has convincingly
demonstrated that under some circumstances the self-enforcement of
indefinite agreements produces an outcome that is superior to the judicial
enforcement of incomplete contracts based on broad standards such as
good faith.\textsuperscript{161} Scott discusses experimental evidence according to which
‘once the exchange is subject to a legally enforceable claim . . . voluntary
reciprocity declines and the overall level of cooperation declines as
well.’\textsuperscript{162} In these cases, judicial enforcement acts as a rival of reciprocal

\textsuperscript{158} Schwartz, ‘Relational Contracts,’ supra note 137 at 284–5; Schwartz & Scott, ‘Contract
Theory,’ supra note 157 at 601.
\textsuperscript{159} Schwartz & Scott, ‘Contract Theory,’ supra note 157 at 603; Scott, ‘Self-Enforcing,’
 supra note 149 at 1687.
\textsuperscript{160} Scott, ‘Self-Enforcing,’ supra note 149 at 1645, 1687. However see, for a different per-
JL Econ & Org 2, 256 (explaining that \textit{ex post} judicial balancing tests might induce \textit{ex
post} efficient agreement).
\textsuperscript{161} Scott, ‘Self-Enforcing,’ supra note 149 at 1688.
\textsuperscript{162} Scott, ‘Death of Contract Law,’ supra note 152 at 388.
fairness. Since it is the informality of the norms of fairness that make them so effective, the attempt to formalize them through broad contractual terms (such as good faith) undermines the operation of a self-enforcing mechanism of reciprocal fairness. One possible explanation is that the perspective of judicial enforcement ‘may signal unwillingness to reciprocate.’\textsuperscript{163} That is, ‘[f]air types may regard the threat of legal enforcement as simply unfair.’\textsuperscript{164} Another possible explanation is that the prospect of legal enforcement can create a moral hazard risk that may deter parties from writing self-enforcing agreements.\textsuperscript{165} In both cases, legal liability may crowd out the parties’ self-enforcing mechanisms by undermining incentives for reciprocal fairness.

On the other hand, it must be recognized that \textit{ex post} judicial specification enjoys relative advantages. First, it allows for much more information to be considered in a particular case, thereby fostering outcome accuracy. However, this advantage should be weighed against the fact that, from an evolutionary standpoint, more information in each single case can create more variance in overall outcomes and, thus, more uncertainty.\textsuperscript{166} Second, \textit{ex post} judicial specification allows parties to reduce transaction costs and facilitates the conclusion of second-most efficient contracts where the complexity of the relationship increases the transaction costs associated with specifying the terms necessary to have the most efficient contract in advance.\textsuperscript{167} Third, \textit{ex-post} judicial specification might prove advantageous when there is a strong power imbalance between the parties (for example, employment agreement negotiations) and \textit{ex ante} mechanisms for redressing that power asymmetry (for example, \textit{ex ante} regulation or collective bargaining) are too costly or not available.

In conclusion, comparative institutional analysis proves useful to define the outer boundaries of good faith. In identifying situations in which new good faith duties arise, judges should take into account that \textit{ex post} judicial specification is likely to generate inefficiency when the value of a relevant economic parameter is not easily verifiable or observable. Conversely, good faith is more likely to prove efficient when transactional complexity imposes transaction costs that are too high or power imbalances that are not easily redressed through \textit{ex ante} strategies.

\textsuperscript{163} Ibid.
\textsuperscript{164} Ibid.
\textsuperscript{165} Scott, ‘Self-Enforcing,’ supra note 149 at 1687.
\textsuperscript{167} Scott, ‘Self-Enforcing,’ supra note 149 at 1657.
V Bhasin’s impact on contractual freedom and legal certainty

The omission in Bhasin of a clearer definition of the outer boundaries of good faith has raised the concern that the new general doctrine of good faith might negatively impact contractual freedom and legal certainty. We are now in the position to discuss more rigorously this fundamental concern. It should be emphasized at the outset that Bhasin’s reasoning does not provide a clear answer to this fundamental question. In a number of unclear and somewhat contradictory statements, Bhasin attempts to strike a balance between good faith and contractual freedom. First, Bhasin clearly states that the new doctrine flowing from the general principle of good faith operates ‘irrespective of the intentions of the parties.’ At the same time, the Supreme Court of Canada emphasizes that the good faith principle is not to be used ‘as a pretext for scrutinizing the motives of contracting parties.’ Second, as already noted, Bhasin emphasizes that claims based on good faith performance will generally not succeed if they do not fall within ‘existing doctrines.’ Concurrently, however, it establishes that the list of good faith doctrines is not ‘closed.’ These confusingly counterbalancing statements leave largely undetermined the boundary between judicial good faith law-making and the contractual autonomy of private parties. As Shannon O’Byrne and Ronnie Cohen have neatly observed, good faith as articulated in Bhasin is a strange hybrid of a contractual term and a judicial doctrine: ‘Like a term, the duty [of good faith] 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.’

This section contends that economic theory helps us to define the tools for undertaking a more rigorous inquiry into Bhasin’s impact on contractual freedom and legal certainty. It concludes that, while Bhasin’s impact on contractual freedom remains difficult to assess – mainly because of the challenges associated with the lack of definition of the precise ambit of application and working properties of the new general

168 Bhasin SCC, supra note 1 at para 74.
169 Ibid at para 63. However, the meaning of this statement remains vague and, therefore, is unable to effectively limit the expansion of judicial law-making through good faith. As O’Byrne observed, ‘[t]he scope of this statement is unclear but it is unlikely that it is offered as an invariable rule.’ In addition, ‘it would also seem inevitable that motive would be relevant at times. In short, motive can count as helping to prove actionable bad faith.’ See O’Byrne & Cohen, ‘The Contractual,’ supra note 3.
170 Bhasin SCC, supra note 1 at para 66.
171 Ibid at para 66.
organizing principle of good faith – there is reason to believe that Bhasin, especially in the first period of its application, will raise challenges with respect to the principle of legal certainty.

A CONTRACTUAL FREEDOM
Any assessment of Bhasin’s impact on contractual freedom must preliminarily provide a well-defined normative baseline against which Bhasin can be tested. Bhasin, as well as much supportive and critical commentary on it, has not satisfied this adequacy condition. By comparison, economic theory helps us to deal with the indeterminacy of the normative baseline required to assess Bhasin’s impact on contractual freedom. The discussion is organized in two steps. First, the prevailing economic justification for the principle of freedom of contract is summarized, thus enabling the identification of a normative baseline from which to assess Bhasin’s impact on contractual freedom. Second, whether good faith law-making enhances, or is incompatible with, the economic function of contractual freedom is considered; this question poses difficult issues for comparative institutional analysis. It is concluded that at this moment there are no elements supporting claims that Bhasin undermines contractual freedom. The next subsection will argue that, nonetheless, Bhasin raises legal certainty concerns.

1 Normative baseline: The Paretian framework
From an economic standpoint, the principle of freedom of contract is justified based on the assumption that it enhances economic efficiency.173 A contract, the argument goes, enables individual actors to engage in mutually advantageous exchanges of resources, thereby allocating them to highest-valued use. On this view, it is the consensual nature of contractual agreements that generates their allocative efficiency.174 The underlying assumption is that rational actors do not consent to contractual agreements that cause them economic losses; they consent only to exchanges that are advantageous to them. Hence, contractual freedom enables a process of private bargaining that increases the joint economic surplus of the parties involved. In short, contractual freedom generates Pareto superior allocations of resources.

173 For a useful discussion of alternative theories of freedom of contract and their use as a normative baseline to assess contractual doctrines, see Hamish Stewart, ‘A Formal Approach to Contractual Duress’ (2005) 47 UTLJ 175.
174 For discussion on this point, see the two following classic contributions: Jules Coleman, Markets, Morals and the Law (Cambridge: Cambridge University Press, 1988); Trebilcock, The Limits supra note 135.
It must be emphasized, however, that the economic justification of contractual freedom is based on the assumption of zero (or low) transaction and information costs. Nevertheless, it is generally recognized that many transactional contexts are characterized by the presence of high information or transaction costs that create incentives for opportunistic behaviour by strategic actors.\textsuperscript{175} This justifies the existence of institutional constraints on the principle of freedom of contract.\textsuperscript{176} In essence, there are sound economic reasons within the Paretian (efficiency) framework that justify the imposition of institutional constraints on the binding force to which the parties would freely agree (or have agreed). This suggests that – once the assumption of zero transaction costs is dropped – the two principles of economic efficiency and contractual freedom do not give us the same prescriptions.

In a variety of situations, there are limitations on contractual freedom that are welfare enhancing, whereas a rigid application of the same principle in other situations would generate welfare-reducing outcomes. Therefore, freedom of contract is not intended to be an absolute prescription; it should rather be weighed against the efficiency criterion. Far from calling for the absence of constraints on the \textit{pacta sunt servanda} principle, the principle of freedom contract calls for an efficient institutional framework – one that reduces transactional and informational costs, thereby allowing welfare-enhancing exchanges. In short, the freedom to contract is relative to the institutional framework within which individuals are allowed to engage in mutually advantageous exchanges. With the relative nature of the freedom of contract principle justified, the second step of considering whether \textit{Bhasin} enhances, or is incompatible with, the economic function of contractual freedom can be considered.

2 \textit{The institutional choice problem}

Depending on the type of opportunistic behaviour to be regulated, various sources of law exhibit different advantages and disadvantages in terms of their ability to minimize the sum of opportunism and specification costs. This raises a difficult issue of institutional choice. Owing to the institutional limitations of the adjudication process, not all forms of contractual opportunism call for a corrective intervention through the good faith regime; in some cases, as discussed above, other institutional arrangements provide better solutions. Once this logic is recognized, the question of the impact of \textit{Bhasin} on contractual freedom becomes whether the recognition of a general organizing principle of good faith

\textsuperscript{175} See the foundational contribution of Ronald Coase, ‘The Problem of Social Cost’ (1960) 3 JL & Econ 1.

\textsuperscript{176} For an economic analysis of contract law, see Trebilcock, \textit{The Limits}, supra note 135.
proves an efficient institutional response to the demand for welfare-enhancing institutional constraints. From this perspective, to claim that Bhasin undermines the principle of freedom of contract, one must prove that Bhasin authorizes judicial law-making through good faith in those (or at least some) cases in which alternative law-making mechanisms would prove better equipped to create anti-opportunistic legal rules. Conversely, to claim that Bhasin enhances the principle of freedom of contract, one must prove that Bhasin authorizes judicial law-making through good faith in those (or at least some) cases in which alternative law-making mechanisms would prove ill-equipped to create anti-opportunistic legal rules.

However, one of Bhasin’s limitations is its failure to define the objective scope of application of the general organizing principle of good faith. As repeatedly emphasized above, the definition of the outer boundaries of good faith is left to the incremental work of future courts. Absent a clear definition of the scope of good faith, any prediction of Bhasin’s impact on the degree of contractual freedom is unwarranted, unless supported by a serious, comparative analysis of the relative abilities of alternative law-making institutions to deal with the problem of contractual opportunism. It becomes possible to assess the impact of Bhasin on contractual freedom only for specifically defined types of new good faith duties. On the other hand, because of the inherent indeterminacy of substantive good faith and because it is impossible to predict how courts will exercise the law-making power that Bhasin confers on them, it is unwarranted to state that Bhasin will foster a more consistent and principled approach to contractual performance. Only the future application of Bhasin by lower courts will tell us whether it has enhanced the capacity of the evolutionary common law process to produce legal rules that increase social welfare.

More specific concerns arise with respect to the related principle of legal certainty. The remainder of this article discusses whether the general organizing principle of good faith will enhance commercial certainty and enable judges to better protect parties’ reasonable expectations.

B LEGAL CERTAINTY
Cromwell J discussed the principle of freedom of contract together with the related principle of legal certainty. The Supreme Court of Canada was cognizant of the potential impact of a comprehensive, overarching doctrine of good faith on legal certainty. Yet, lacking a solid explanation of the working properties and objective scope of good faith, the Court could do no more than provide some contradictory indications. On the one hand, as largely discussed in the first section of this article, Cromwell J
opened the doors to future innovative good faith law-making. On the other hand, in an attempt to mitigate the potential radical effects of the overarching doctrine of good faith, he provided several indications in favour of judicial incrementalism.\footnote{Bhasin SCC, supra note \textit{1} at para 66.} In particular, he emphasized that claims based on good faith performance will generally not succeed if they do not fall within existing doctrines. These counterbalancing statements introduce objective elements of legal uncertainty.

First, Cromwell J did not explain under which circumstances judges are enabled to go beyond the existing list of established good faith doctrines and introduce new contractual doctrines. The Supreme Court of Canada stated that future developments would be ‘context-specific.’\footnote{Ibid at para 69.} That is, they should be based on what honesty and reasonableness in performance require so as to give appropriate consideration to the interests of both contracting parties. However, this reference to context-specific decision making is not accompanied by a well-defined set of criteria for narrowing the evidentiary bases on which courts interpret agreements between private parties.\footnote{A commitment to contractual freedom is empty if not supported by a clear indication of the interpretation method of contractual agreements between private parties. See, in this respect, Schwartz & Scott, ‘Contract Theory,’ supra note \textit{157} at 569: ‘A commitment to party sovereignty regarding the contract’s substantive terms implies a further commitment to party sovereignty regarding the interpretive style an adjudicator should use to find the substantive terms.’}

Second, the impact of \textit{Bhasin} on legal certainty is likely to vary across different areas of law. To understand this point, the common assumption in economics that people are risk averse proves a valuable analytical tool. Generally, people are willing to sacrifice a certain amount of allocative efficiency in legal rules for the ability to easily predict the legal consequences of their behaviour. That is, individuals are willing to give up optimal allocations of legal entitlements in exchange for a stable, predictable set of legal rules. Hence, the question becomes whether \textit{Bhasin} provides a better trade-off between predictability and efficiency compared with other law-making methods in the area of contract law. Once this logic is recognized, in order to claim that \textit{Bhasin} fosters legal certainty one must prove that judicial law-making through good faith enjoys comparative advantages in attaining a better balance between allocative efficiency and legal predictability.

Here, the key variable to be taken into account is individual preference for \textit{ex ante} legal precision. Individuals who strive for legal precision prefer detailed rules (that is, rules that provide precise guidance in advance) to standards (that is, vague rules allowing a variety of judicial
interpretations). Hence, in those areas of law where economic actors have high incentives to know the precise content of the law, *Bhasin* is likely to frustrate the demand for legal precision and increase the transactional and informational costs associated with private contracting. As Peters has clarified, as a result of *Bhasin*, ‘communications between the parties on performance issues will take on heightened importance’;¹⁸⁰ clients and their lawyers will have ‘to keep in mind the . . . potential for assertion of a good faith performance duty . . . in any case where the relationship between contracting parties goes bad.’¹⁸¹ More specifically, the uncertain external boundaries of good faith are likely to increase transaction costs in those situations where opportunism costs are higher – for example, in the case of large asset-specific investments by one of the parties.

Third, *Bhasin* introduces a retroactive source of uncertainty. Establishing a new source of law in the area of contractual performance raises the problem of determining the extent to which previous decisions establishing *ad hoc* duties of good faith remain precedential. The indication of *Bhasin* in favour of judicial incrementalism suggests that decisions falling within established categories of good faith performance will remain precedential. Indeed, *Bhasin* makes explicit reference to the approach taken by the Supreme Court of Canada in *Peel*, in which the general organizing principle of unjust enrichment was recognized without displacing existing specific doctrines.¹⁸² As Neil Finklestein and colleagues observe, ‘[p]resumably, in contractual contexts where there is a judicially-recognized power imbalance between the contracting parties, such as in the insurance, employment, and landlord-tenant contexts, duties to act in good faith will be unshakeable.’¹⁸³ However, in the absence of a clear discussion on this point, the precedential effect of pre- *Bhasin* decisions is uncertain.

Finally, as emphasized by other commentators, *Bhasin* creates uncertainty by not clarifying which duties derived from the general principle of good faith can be relaxed through express contractual clauses. Once again, the Supreme Court of Canada provides contradictory hints. On the one hand, Cromwell J says that parties may through express terms ‘relax the requirements of the doctrine so long as they respect its

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¹⁸⁰ Peters, ‘Tell Me,’ supra note 3 at 6 [emphasis added].
¹⁸¹ Ibid [emphasis added]. See similarly McCanus, ‘The New General Principle,’ supra note 3 at 114: ‘[T]he *Bhasin* doctrine may complicate the task of advising clients with respect to communications relating to termination or renewal rights and perhaps other aspects of contractual performance such as the exercise of other types of options and contractual discretionary powers.’
¹⁸² *Peel (Regional Municipality) v Canada; Peel (Regional Municipality) v Ontario*, [1992] 3 SCR 762.

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minimum core’;\textsuperscript{184} on the other hand, he emphasizes that a ‘\textit{generically worded} entire agreement clause does not indicate any intention of the parties to depart from the basic tenets of honest performance.’\textsuperscript{185} In this manner, the Court alludes to a minimum degree of specificity required for private parties to block the judicial imposition of good faith performance duties. But, in the absence of well-defined criteria for determining the minimum degree of specificity, private parties will have to estimate how much detail they must negotiate to protect themselves from future judicial intervention.\textsuperscript{186} This will likely alter negotiating parties’ efficiency calculus. In determining the optimal level of specificity, private parties will have to consider not only the likelihood of a given contingency and the costs of opportunistic behaviour but also the likelihood of judicial intervention and its impact on opportunism costs. In this respect, it is likely that the impact of \textit{Bhasin} on transaction costs will be a function of the parties’ estimates of the judicial ability to deal efficiently with contractual opportunism. That is, transaction costs will increase in those areas of contract law in which parties anticipate courts’ lack of institutional ability to minimize the costs of bad faith behaviour.

\textbf{VI Conclusions}

This article’s primary purpose has been to provide an institutional understanding of the general organizing principle of good faith performance, enabling an assessment of the potential impact of the Supreme Court of Canada’s decision in \textit{Bhasin} on the evolution of the Canadian common law of contracts. The discussion rested on the methodological assumption that good faith is better understood as an institutional tool for allocating law-making powers from private parties to courts. More precisely, good faith is a general clause that enables judges to choose the evaluative criterion specifying its prescriptive content in a single case. Therefore, instead of focusing on a unified substantive definition of good faith, a more promising strategy is to inquire into the comparative advantages of allocating to judges the power to decide a case based on judges’ notions of fairness in commercial relationships. In this way, the focus of the discussion shifts from the first-order problem (that is, the allocation of legal entitlements) to the second-order problem (that is, the choice of the decision-making

\textsuperscript{184} \textit{Bhasin} SCC, supra note 1 at para 77.
\textsuperscript{185} Ibid at para 78 [emphasis added].
\textsuperscript{186} See Finkelstein et al, ‘The Duty,’ supra note 3 at 373 (emphasizing ‘the Court’s lack of specificity as to how exactly the duty of honest performance can be contractually relaxed’).
process that is best suited to decide the allocation of legal entitlements). Both the historical analysis of *bona fides* in Roman law and the economic inquiry into the function of good faith have corroborated the usefulness of the proposed institutional understanding of good faith performance.

In the second section of this article, it was emphasized that *Bhasin’s* most distinctive feature, compared with the most recent developments in the common law of good faith in England and Australia, is to shift the dogmatic source of good faith duties from implication of contractual terms to the idea of general organizing principle. This dogmatic shift has profound institutional implications concerning the allocation of law-making powers, the structure of legal reasoning, and the role of the doctrine of precedent. More specifically, it was argued that *Bhasin* critically affects the mechanism of judicial legal change in the area of contract law by introducing a new law-making mechanism (law-making through good faith) that fundamentally differs from the doctrine of precedent. With the help of the reason-based model of precedent, the difference between law-making through good faith and law-making through precedent was illustrated. In short, while a precedent applies if the elements of the factual matrix from which it was generated are present in an instant case, a general legal doctrine applies unless the factual matrix of a case contains elements that defeat the first-order reasons supporting the ratio embedded in the legal doctrine. Therefore, in developing new legal doctrines based on the general principle of good faith, courts act more as legislators than adjudicating bodies. They establish a ratio that pre-empts the decision on the entire set of future cases falling within its scope and provides a *prima facie* solution to those cases.187

In essence, *Bhasin* empowers courts to create the ratio that grounds the decision of the case even when first-order reasons covered by binding precedents do not support this decision. Despite Cromwell J’s repeated emphasis on the incremental nature of this innovative step, the conceptual framework developed in *Bhasin* unlatches courts from the constraints of the doctrine of precedent specifically with respect to the creation of new good faith contractual duties. From this perspective, it was argued that *Bhasin* introduces a conception of good faith in contractual performance that bears structural similarities to the civil law approach to good faith. At first glance, this might suggest reading *Bhasin* as a judicial transplant of the continental conception of good faith into the context of the Canadian common law of contract. However, a more correct reading of *Bhasin* emphasizes the desirability of a more cautious judicial cross-
fertilization between alternative legal traditions in the process of constructing the meaning of good faith performance.

In the third section of this article, it was contended that Bhasin introduces a mechanism resembling the *oportere ex fide bona* introduced by the *praetor peregrinus* in the second century BC. This analytical perspective helps to understand the institutional functioning of law-making through good faith and illuminates the characteristics of its evolutionary impact on the development of contract law. The introduction of the *ex fide bona* clause in the formula issued by the praetor determined a significant expansion of judicial powers that enabled the judge to apply equitable criteria independent of the law in force. In this manner, the praetor had the means to advance the development of substantive law, enrich the set of actionable claims, and thereby meet the demand for legal change arising from Rome’s commercial expansion. Despite the fact that the peregrine praetor lacked formal law-making powers, he was capable of creating a new body of rules separate from other legal sources and resting on different foundations.

To illustrate this point, the emergence of the *emptio venditio* in the context of the *bona fidei* contracts was examined. Crucially, it was contended that a similar evolutionary dynamic could occur in the Canadian common of law of contract as a result of the recognition of good faith as a general organizing principle. That is, similar to the expanded authority of the Roman praetor, an expansion of the judicial power in the area of contract law occurs in Bhasin, giving Canadian courts the power to recognize new situations in which duties of good faith arise. Just as the *oportere ex fide bona* enabled the Roman praetor to create new law independent of ordinary law, the new general organizing principle of good faith enables courts to develop new contractual doctrines independent of binding precedents. This could potentially trigger forms of judicial activism introducing new doctrinal constraints on contractual autonomy.

After having clarified the working properties of the general principle of good faith and its evolutionary implications, it was argued in the fourth section of this article that the economic perspective provides a useful framework for defining the scope of application of the general organizing principle of good faith. The identification of the efficiency conditions of good faith was argued to be a useful preliminary step in solving the problem of the outer boundaries of good faith. From this perspective, new duties of good faith arise only where the adjudication process better serves the functions of contract law compared with alternative sources of law. For example, good faith is likely to generate inefficiency when the measure of performance is either unverifiable or unobservable. Conversely, good faith is more likely to prove efficient when highly complex contractual relationships between parties increase the level of transaction costs.
associated with *ex ante* private negotiations or *ex ante* regulatory strategies to redress power imbalances are too costly.

Finally, in the fifth section of this article, it was contended that the economic–institutional approach allows for a more rigorous discussion of the relationship between good faith, freedom of contract, and legal certainty. On the one hand, it was emphasized that due to the presence of high transaction costs the principle of freedom of contract should be weighed against the principle of economic efficiency. From this perspective, absent a clear definition of the scope of good faith and given the lack of an agreed understanding of the working properties of good faith, any assessment of *Bhasin*’s impact on the degree of contractual freedom is unwarranted. Currently, there are insufficient elements to reach a conclusion on whether *Bhasin* will result in enhanced capacity for the evolutionary common law process to produce legal rules increasing social welfare. On the other hand, *Bhasin* introduces multiple sources of legal uncertainty. First, Cromwell J does not explain under which circumstances judges are enabled to go beyond established good faith doctrines by introducing new ones. Second, the lack of definition of the outer boundaries of good faith is likely to result in increased transaction costs in situations where opportunism costs are higher – for example, when there are large asset-specific investments by one of the parties. Third, *Bhasin* does not clarify the precedential effect of pre-*Bhasin* decisions, which introduces a retroactive source of uncertainty. Fourth, *Bhasin* does not identify which of the duties derived from the general principle of good faith can be relaxed through express contractual clauses. This will likely increase transaction costs in those areas of contract law in which parties anticipate courts’ lack of institutional ability to minimize the costs of bad faith behaviour.

This article has provided only the beginning of a line of inquiry into good faith performance using a comparative institutional analysis of alternative sources of law. The reader has been provided with arguments supporting the claim that this methodological approach is useful for better understanding the meaning and implications of *Bhasin*, rigorously defining the outer boundaries of good faith, and critically assessing the impact of future evolutions of the principle of good faith on contractual freedom and legal certainty.