

Good Faith in Real Property Law in Canada: Recent Developments

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A. INTRODUCTION

The duty of good faith is generally understood as the obligation of a party to a contract not to act in a manner that is unfair or unreasonable in some sense. The concept of good faith is said to have been part of the Anglo-Canadian law of contracts for over two centuries,¹ but its more recent development in Canada is generally taken to have begun in *LeMesurier v. Andrus*,² in which the Ontario Court of Appeal held that a purchaser of real property could not terminate the transaction by invoking a standard annulment clause in the agreement of purchase and sale based upon a minor discrepancy between the property as described in the agreement and the actual property. In so holding, the court adopted the statement of the Supreme Court of Canada in *Mason v. Freedman* that "[a] vendor who seeks to take advantage of the [annulment] clause must exercise his right reasonably and in good faith and not in a capricious or arbitrary manner."³ The purpose of this paper is to explore how Canadian courts have applied the concept of good faith during the past decade in relation to contracts concerning real property.⁴ Our general conclusion is that the duty of good faith is well established in many aspects of real property contract law in Canada, although often the same results can and are achieved by means of other more

¹ See E.P. Belobaba, "Good Faith in Canadian Contract Law" in *Commercial Law: Recent Developments and Emerging Trends (Special Lectures of the Law Society of Upper Canada, 1985)* (Don Mills, ON: De Boo Publishers, 1985) 73 at 75.

² (1986), 25 D.L.R. (4th) 424 (Ont. C.A.), leave to appeal to S.C.C. refused, [1986] 2 S.C.R. v (note) [hereinafter *LeMesurier*].

³ *Mason v. Freedman*, [1958] S.C.R. 483 at 487. The quote is found in *LeMesurier*, *ibid.* at 430.

⁴ Many papers and annotations have been written on the duty of good faith from varying perspectives. These include Belobaba, *supra* note 1; S.K. O'Byrne, "Good Faith in Contractual Performance: Recent Developments" (1995) 74 Can. Bar Rev. 70; J.D. McCamus, "The Duty of Good Faith Contractual Performance at Common Law" (Superior Court of Justice Fall Education Seminar, National Judicial Institute, 2000) [unpublished]; P.M. Perell, Annotation of *Peel Condominium Corp. No. 505 v. Cam-Valley Homes Ltd.* (2001) 41 R.P.R. (3d) 234; S.F. Rosenhek, "Breach of Duty of Good Faith" (Paper presented at the Ontario Bar Association Seminar "Troublesome Business Torts," November 7, 2001) [unpublished]; W.G. Horton, "Good Faith in Contract Performance: Revolution or Redundancy" (Paper presented at the Osgoode Hall Law School Continuing Legal Education Seminar "Emerging Issues in Corporate Litigation," April 14, 2000) [unpublished]; D. Stack, "The Two Standards of Good Faith in Canadian Contract Law" (1999) 62 Sask. L. Rev. 201; and M. Romanin and J. Horton, "Gateway and the Good Faith Continuum" [unpublished].

traditional contract doctrines, and in general Canadian appellate courts have been less likely than Canadian trial courts to base their decisions on the duty of good faith.

Before examining real property contract cases which address the duty of good faith, we consider in section B the more general issue of the distinction between the negotiation and performance stages of contracts in determining the applicability of the duty of good faith. The focus of the section is on two recent decisions, *Martel Building Ltd. v. R.*⁵ and *Peel Condominium Corp. No. 505 v. Cam-Valley Homes Ltd.*⁶ Section C reviews the manner in which the duty of good faith has been applied in various situations involving the performance of real property contracts. Section D concludes the paper with a brief commentary on the role and status of the duty of good faith, in particular, the issue of whether good faith is an independent doctrine giving rise to an independent cause of action.

B. GOOD FAITH AND THE NEGOTIATION OF CONTRACTS

In this section, the proposition that the duty of good faith does not arise in the pre-contractual negotiation stage is addressed. Considered by many to be generally valid,⁷ the proposition was largely reaffirmed in the two cases discussed below.

a. Martel Building Ltd. v. R.

In *Martel Building*,⁸ the Supreme Court of Canada held that there was no duty of care associated with the negotiation of contracts. Although the Court stated that the case was about the law of negligence and did not decide whether a duty to bargain in good faith should be recognized in Canada, in our view, for the reasons

⁵ (2000), 36 R.P.R. (3d) 175 (S.C.C.) [hereinafter *Martel Building*].

⁶ (2001), 41 R.P.R. (3d) 231 (Ont. C.A.) [hereinafter *Peel Condominium*].

⁷ See, e.g., R.E. Hawkins, "LAC and the Emerging Obligation to Bargain in Good Faith" (1990) 15 Queen's L. J. 65. In England, the proposition was explicitly endorsed by the House of Lords in *Walford v. Miles*, [1992] 2 A.C. 128, in which Lord Ackner stated that a duty to negotiate in good faith was "as unworkable in practice as it is inherently inconsistent with the position of a negotiating party" (at 138).

⁸ *Supra* note 5.

discussed below, the decision is still an authority for the proposition that there is no duty of good faith arising in the negotiation of contracts.

Martel Building concerned a ten-year lease with an option to renew between the plaintiff Martel as the landlord and the federal government as the tenant. Before the lease expired, the parties began discussions about whether the government would renew the lease, but these discussions were followed by long periods during which no action was taken by the government. Eventually, the government decided not to exercise its renewal option and called for tenders instead. Martel submitted a bid, but was not awarded the lease. Martel commenced an action against the government. The action was unsuccessful at trial in the Federal Court, but the trial decision was reversed on appeal by the Federal Court of Appeal. Although one of the claims made by Martel was that the government breached a duty to negotiate in good faith, the courts at both levels declined to consider liability based upon this ground. On further appeal, the Supreme Court restored the trial judgment and dismissed Martel's action.

One of the issues before the Supreme Court was whether the government owed a duty of care to Martel during the negotiation stage preceding the call for tenders. Delivering the judgment of the Court, Iacobucci and Major JJ. held that there existed no duty of care with respect to negotiations. The Court analyzed Martel's claim as being one for compensation for contractual relational economic loss, which was subject to the presumptive rule against recovery. While there were exceptions to this rule and the categories of such exceptions were not closed, in the Court's view, Martel's claim did not fall into any of the established exceptions. Therefore, the Court reasoned, in order to succeed, Martel's claim had to satisfy the two-part test established by *Anns v. Merton London Borough Council*,⁹ namely, (1) there was a sufficiently close relationship between Martel and the government, and (2) there was no policy consideration that would negate or limit the scope of the duty of care, the class of persons to whom it is owed, or the damages from a breach of

duty. Iacobucci and Major JJ. held that, although Martel's claim satisfied the first part of the test, it failed the second part because there were policy considerations operating against the finding that negligence extended to pre-contractual negotiations.

The policy considerations cited by the Court were the following: (1) the very object of negotiation works against recovery, as the primary goal of any economically rational actor engaged in commercial negotiation is to achieve the most advantageous financial bargain; (2) it would defeat the essence of negotiation and hobble the marketplace to extend a duty of care to pre-contractual commercial negotiations, and to label a party's failure to disclose its bottom line, its motives, or its final position as negligent; such a conclusion would of necessity force the disclosure of privately acquired information and the dissipation of any competitive advantage derived from it, all of which is incompatible with the activity of negotiating and bargaining; (3) to impose a duty in the circumstances of the case could interject tort law as after-the-fact insurance against failures to act with due diligence or to hedge the risk of failed negotiations through the pursuit of alternative strategies or opportunities; (4) to extend the tort of negligence into the conduct of commercial negotiations would involve the courts in a significant regulatory function, scrutinizing the minutiae of pre-contractual conduct; it is undesirable to place further scrutiny upon commercial parties when other causes of action already provide remedies for many forms of conduct; (5) to extend negligence into the conduct of negotiations could encourage needless litigation.¹⁰

Iacobucci and Major JJ. concluded that "as a general proposition, no duty of care arises in conducting negotiations."¹¹ The Court went on to note as follows:

As a final note, we recognize that Martel's claim resembles the assertion of a duty to bargain in good faith. The breach of such a

⁹ [1978] A.C. 728 (H.L.).

¹⁰ *Supra* note 5 at 207-209. These policy considerations resemble the bases for the holding of the House of Lords in *Walford v. Miles*, *supra* note 7.

¹¹ *Supra* note 5 at 209.

duty was alleged in the Federal Court, but not before this Court. As noted by the courts below, a duty to bargain in good faith has not been recognized to date in Canadian law. These reasons are restricted to whether or not the tort of negligence should be extended to include negotiation. Whether or not negotiations are to be governed by a duty of good faith is a question for another time.¹²

The Court expressly declined to decide whether a duty to bargain in good faith should be recognized in Canada.¹³ Nonetheless, there are at least two reasons for believing that *Martel Building* supports the conclusion that there is at present no duty to negotiate in good faith in Canada. First, it is not at all clear whether a duty of care in negotiations based upon the law of negligence differs in substance from the duty to bargain in good faith. Second, the policy considerations referred to by the Court as militating against extending negligence to pre-contractual negotiations would likely apply with equal force with respect to the issue as to a duty to bargain in good faith. *Martel Building* can therefore be seen as providing a basis for concluding that there is no duty to bargain in good faith in Canadian law. This was also the interpretation of *Martel Building* adopted by the majority of the Ontario Court of Appeal in *Peel Condominium*,¹⁴ as will be discussed below.

b. Peel Condominium Corp. No. 505 v. Cam-Valley Homes Ltd.

In *Peel Condominium*, the defendant Cam-Valley was a developer of a large condominium project which was divided into phases. The project included a plan to build condominiums around a wooded outdoor recreation area. The first phase, consisting of developing a high-rise residential tower, was completed in 1991 and a later phase, a townhouse development, was completed in 1995. By the time the townhouse development was finished, the real estate market had undergone changes, and Cam-Valley decided to use the lands reserved for outdoor recreation facilities for another townhouse development. When Cam-Valley proceeded to remove the trees on these lands, PCC 505, the condominium corporation created for the townhouse development, applied for a declaration that the lands were held in trust for the

¹² *Ibid.*

¹³ For a discussion of the decision, see annotation by P.M. Perell at 36 R.P.R. (3d) 188.

condominium unit owners represented by PCC 505 and for an interim injunction prohibiting further alteration of the lands. PCC 505 was successful at first instance. Epstein J. held that the developer owed the purchaser of a condominium unit a duty of good faith and fair dealing, and that such duty gave rise to the obligation on the developer to take the purchaser's reasonable expectations into account in developing the lands in question. Epstein J. also appeared to suggest that the developer in the case owed a fiduciary duty to the purchasers of units, and that this was another reason why the developer was obligated to take into account the unit purchasers' reasonable expectations. Thus, according to Epstein J., although PCC 505 did not own the lands, Cam-Valley was nonetheless not at liberty to build townhouses on the lands, since the condominium unit owners represented by the applicant had the reasonable expectation arising from the circumstances of the case that, if recreational facilities were not built on the lands, then the lands would remain in their natural woodland state. In the result, Epstein J. granted a permanent injunction prohibiting Cam-Valley from developing the lands, even though this remedy was not requested by the applicant.

The decision of Epstein J. was reversed by the Court of Appeal, which was unanimous with respect to the result but split in terms of the reasons. The decision of the majority was written by Finlayson J.A., with Labrosse J.A. concurring, and the decision of the minority was written by Weiler J.A. Finlayson J.A. held that Epstein J. erred in finding that the developer was obligated to take into account the reasonable expectations of the purchaser of a condominium unit in developing the lands in issue. Finlayson J.A. attributed this error to the failure of Epstein J. to distinguish between the negotiation and performance stages of the contract, and to apply the rule that only the latter attracted the duty of good faith. Weiler J.A., on the other hand, agreed with Epstein J. on the issue of the duty owed by the developer to the condominium unit owners. Nonetheless, Weiler J.A. appeared to be in agreement with the majority in endorsing the principle that the duty of good faith arose with

¹⁴ *Supra* note 6.

respect to the performance, but not the negotiation, of contracts. The reasons of the majority and minority are reviewed in more detail below.

Finlayson J.A. found as a preliminary matter that, under the condominium documents, Cam-Valley remained the owner of the lands in question until the outdoor recreational facilities were built, and further, that Cam-Valley had no obligation to build such facilities. Since the facilities were never built, it followed that Cam-Valley remained the owner of the lands and was free to deal with them as it chose. Finlayson J.A. held that there was no fiduciary relationship between the developer and the unit owner, stating: "I think that the weakness of the trial judge's analysis is that she fails to draw a bright line between the status of the respective developer and purchaser prior to executing a binding agreement of purchase and sale and the obligation of the contracting parties to complete the closing of the sale in good faith."¹⁵ With respect to the duty of good faith, Finalyson J.A. stated as follows:

[The concern in *LeMesurier*,¹⁶ which was relied on by Epstein J.] was with the parties' conduct in performing an executory contract: one already made. The trial judge appears to have taken this authority a step further by applying the principles in *LeMesurier* to the pre-contractual phase of the parties' relationship and, in particular, to the time that the agreements were being prepared by the developer. This notion that the developer has an obligation to incorporate all the purchasers' "reasonable expectations" into the disclosure documents is unrealistic and unsupported by authority. *LeMesurier* does not decide that arm's length parties owe each other a duty of good faith during the bargaining phase of their relationship. In fact, there is supporting case law that there is no duty to bargain or negotiate in good faith: *Mannpar Enterprises Ltd. v. Canada* (1999), 173 D.L.R. (4th) 243 (B.C.C.A.), at 265-267 and *Weiss v. Schad* (November 17, 1999), Doc. 92-CQ-15488 (Ont. S.C.J.), at para. 123. As Iacobucci and Major JJ. stated for the court in *Martel Building* . . .

As a final note, we recognize that Martel's claim resembles the assertion of a duty to bargain in good faith. The breach of such a duty was alleged in the Federal Court, but not before this Court. As noted by the courts below, a duty to bargain in good faith has not been recognized to date in Canadian law.¹⁷

¹⁵ *Ibid.* at 250.

¹⁶ *Supra* note 2.

¹⁷ *Supra* note 6 at 250-251.

Weiler J.A., on the other hand, was of the opinion that Cam-Valley did owe a duty of good faith to PCC 505 condominium owners in developing the lands in question. According to her interpretation of the condominium contract documents, Cam-Valley did not reserve the right to build on the subject lands, but even if it did, Cam-Valley was not free to deal with the lands as it chose because it owed a duty not to act solely in accordance with its own interests and to *exercise its contractual right* in a manner that took into account the reasonable expectations of the condominium owners. This was because the relationship between the parties in the case was unlike that in *Martel Building*, which involved two sophisticated commercial parties, but was like that between an employer and employee, which is marked by an imbalance of bargaining power and the lack of information on the part of one of the parties. Thus, Weiler J.A. concluded, "[w]hile the developer has the right to change the development, just as an employer has a right to terminate an employee, *that right must be exercised* with candour and reasonableness, taking into consideration the interests of the condominium owners."¹⁸ (However, in terms of the result, Weiler J.A. agreed with the majority that the remedy granted by Epstein J. should be set aside because damages would be a more appropriate remedy.)

Interestingly, the reasoning of Weiler J.A. clearly frames the issue in the case in terms of the exercise of a contractual right rather than pre-contractual negotiations. That is, Weiler J.A.'s holding was not that Cam-Valley should have incorporated into the condominium documents the prospective purchasers' reasonable expectations (including the expectation that, if no recreational facilities were built, the lands would be left in its natural state), but that Cam-Valley should have exercised its contractual right to change the development in a manner consistent with such expectations. It is unclear whether there is any practical distinction between these two positions, as the result of applying Weiler J.A.'s rule would be equivalent to turning the reasonable expectations of one of the parties to the contract into contractual terms. It is therefore possible to regard Weiler J.A.'s reasons as in effect

¹⁸ *Ibid.* at 268 [emphasis added].

negating the rule that no duty of good faith attaches to contract negotiations. On the other hand, the fact that Weiler J.A. cast her judgment in terms of the application of good faith to the performance of a contract may indicate that she was not prepared to jettison that rule.¹⁹

That this conclusion may be correct is indicated by *978011 Ontario Ltd. v. Cornell Engineering Co.*,²⁰ in which the Ontario Court of appeal had another occasion to comment on the relationship between parties negotiating a contract. In *Cornell Engineering*, which was released a month and a half after *Peel Condominium* and which dealt with a contract to provide services, Weiler J.A. stated on behalf of the Court that Canada has a judicial system that emphasizes individual responsibility and self-reliance in which parties negotiating a contract expect that each will act entirely in the party's own interests, and that, therefore,

Absent a special relationship, the common law in Canada has yet to recognize that in the negotiation of a contract, there is a duty to have regard to the other person's interests, namely, to act in good faith.²¹

c. Conclusion regarding Good Faith and Negotiations

Given the above cases, it seems fair to conclude that there is currently no duty in Canadian law to negotiate contracts in good faith. However, this conclusion must be tempered with the caution that the courts may not continue to take this view in all cases. The possibility that a court might, at least in some circumstances, impose a duty of good faith in relation to the bargaining phase of a contract is suggested by a frequently-cited comment made by La Forest J. in *International Corona Resources Ltd. v. LAC Mineral Ltd.*²² *LAC Minerals* concerned the use made of information regarding certain property which the defendant obtained

¹⁹ For commentary on *Peel Condominium*, see P. M. Perell's annotation at 41 R.P.R. (3d) 234.

²⁰ (2001), 198 D.L.R. (4th) 615 (Ont. C.A.), leave to appeal to S.C.C. refused (2001), 55 O.R. (3d) i (note) (S.C.C.) [hereinafter *Cornell Engineering*].

²¹ *Ibid.* at 625.

²² [1989] 2 S.C.R. 574, 6 R.P.R. (2d) 1 (S.C.C.) [hereinafter *LAC Minerals* and cited to R.P.R.].

from the plaintiff while the two parties were negotiating a joint mining venture. The negotiations did not lead to a contract, but the defendant used the information to prevent the plaintiff from acquiring the property, acquired the property itself, and developed a mine on it. The five-member panel of the Supreme Court was unanimous in holding in favour of the plaintiff on the basis of breach of confidence by the defendant. But La Forest J. (Wilson J. concurring) went further, and held that the defendant also breached a fiduciary duty it owed to the plaintiff. Then, in the context of discussing the proper remedy, La Forest J. stated: "The institution of bargaining in good faith is one that is worthy of legal protection in those circumstances where that protection accords with the expectations of the parties."²³

It is unclear how much significance should be attached to this statement, given the context in which it was made, and also given the fact that La Forest J.'s decision was based upon a finding that the defendant had breached a fiduciary duty (as well as a duty of confidence). Nonetheless, the statement has received much attention from both the courts and commentators as signifying a step towards the recognition of a duty to bargain in good faith.²⁴ Thus, despite the pronouncements of the court in *Peel Condominium* and *Martel Buildings, LAC Minerals*, coupled with the statement of the Court in *Martel Buildings* that it was not deciding whether there should be a duty to bargain in good faith, continues to make it impossible to conclude definitively that no Canadian court will recognize such a duty in any circumstance. That is, while, as has been noted by the Court in *Martel Buildings*, no Canadian common-law court has yet recognized a duty to bargain in

²³ *Ibid.* at 40.

²⁴ See, e.g., *Granitile Inc. v. R.* (1998), 41 C.L.R. (2d) 115 (Ont. Gen. Div.), at 182; *Crawford v. New Brunswick (Agricultural Development Board)* (1997), 13 R.P.R. (3d) 215 (N.B.C.A.), at 219 (in the context of the exercise of a contractual power of sale); *Opron Construction Co. v. Alberta* (1994), 14 C.L.R. (2d) 97 (Alta. Q.B.), at 222; J. Cassels, "Good Faith in Contract Bargaining: General Principles and Recent Developments" (1993) 15 *Advocates' Quarterly* 56 at 70-73; Hawkins, *supra* note 7. Professor Cassels concludes that the judgment of La Forest J. reflects a "strong strand of judicial thinking regarding good faith, and crystallizes the connection between good faith, reasonable expectations and commercial morality" (*ibid.* at 73), and Professor Hawkins that, after *LAC Minerals*, "it will be impossible to say that the doctrine of good faith bargaining forms no part of Canadian law" (*ibid.* at 88).

good faith,²⁵ it seems still possible that a Canadian court might, based upon *LAC Minerals*, recognize such a duty in a particular case.

d. *Good Faith and the Performance of Contractual Obligations*

By contrast, it is established that the duty of good faith exists in relation to the performance of contractual obligations. Thus, in *Crawford v. New Brunswick (Agricultural Development Board)*, Bastarache J. A. (as he then was) stated that the "requirement to act in good faith when performing duties owed under a contract is well established."²⁶ Neither *Martel Buildings* nor *Peel Condominium* affects the validity of this statement; in fact, as was noted, the reasoning of both the majority and minority in *Peel Condominium* confirms its correctness. Thus, while the precise meaning of the duty of good faith in the performance of contracts or the degree of its generality may be less than clear, it is clear that a duty of good faith will attach to the performance of contractual obligations at least in some circumstances.

C. GOOD FAITH IN REAL PROPERTY CONTEXTS

a. *Real Property Leases*

(i) Options to Renew

Given the discussion in the preceding section, it might be expected that, with respect to a clause in a lease providing for an option to renew, the preliminary decision regarding whether the option clause constitutes an enforceable contract or not will be determinative of whether the duty of good faith is applicable in respect of the clause — i.e., that, if the option is an enforceable contract, the duty of good faith will attach to the performance of the option, but no duty of good faith could arise with

²⁵ Many other courts and commentators have noted the same point. See, e.g., *Cornell Engineering*, *supra* note 20; and J.W. Lem and A. White, Annotation of *EdperBrascan Corp. v. 117373 Canada Ltd.*(2000), 37 R.P.R. (3d)188 at 189 (Canadian law never has, and still does not, recognize any duty to negotiate in good faith during the contract formation stage of commercial contracts).

²⁶ *Supra* note 24. See also *EdperBrascan Corp. v. 117373 Canada Ltd.*(2000) 37 R.P.R. (3d) 188 (Ont. S.C.J.), at 208 [hereinafter *EdperBrascan*].

respect to the option if it does not constitute an enforceable contract. However, the case law does not entirely bear out this expectation.

In *Empress Towers Ltd. v. Bank of Nova Scotia*,²⁷ a clause in a lease granted the tenant a right of renewal for a period of five years, exercisable by three-months' written notice at a rent which "shall be market rental prevailing at the commencement of that renewal term as mutually agreed between the Landlord and the Tenant." The clause further provided that, if the landlord and the tenant did not agree upon the rental rate within two months following the exercise of the option, the agreement would be terminated at the option of either party. The lease was due to expire on August 31, 1989. In May 1989, the tenant bank exercised its option to renew and proposed the rental rate of \$5,400 a month. The landlord, Empress, did not reply in writing. On July 26, 1989, the bank wrote to Empress again, stating that the proposed rent was a rate that the bank had been advised as being appropriate by independent appraisers, and also that the bank was willing to negotiate. On August 31, i.e., the date of expiry of the lease, Empress responded, stating that it would allow the Bank to remain on a month-to-month basis if the Bank would pay \$15,000 before September 15, 1989, and the rent proposed by the Bank thereafter, the tenancy being terminable on 90 days' notice. The Bank did not do so, and Empress filed a petition seeking to obtain a writ of possession on October 3, 1989. The petition was dismissed at trial.

On appeal, the British Columbia Court of Appeal dismissed the appeal. Lambert J.A., on behalf of the majority of the court, stated that the principal question in the case was whether the renewal clause was void for uncertainty, i.e., for being a mere agreement to agree, and held that the clause was not void for uncertainty as it provided a formula, namely, market rental, for determining the rent. Lambert J.A. went on to remark as follows:

In my opinion, the effect of the requirement for mutual agreement must be that the landlord cannot be compelled to enter into a renewal

²⁷ (1990), 73 D.L.R. (4th) 400 (B.C.C.A.) [hereinafter *Empress Towers*].

tenancy at a rent which it has not accepted as the market rental. But, in my opinion, that is not the only effect of the requirement of mutual agreement. It also carried with it, first, an implied term that the landlord will negotiate in good faith with the tenant with the objective of reaching an agreement on the market rental rate and, secondly, that agreement on a market rental will not be unreasonably withheld.²⁸

Lambert J.A. also stated that the court did not have to decide in the case "whether a bare right of renewal at a rental to be agreed carries with it an obligation to negotiate in good faith or not to withhold agreement unreasonably."²⁹ In further support of the judgment, Lambert J.A. drew a parallel between the case at hand and *Griffin v. Martens*,³⁰ in which it was held that a clause providing that the agreement was subject to the purchaser being able to arrange satisfactory financing carried with it an implied obligation on the purchaser to use his best efforts to obtain satisfactory financing. Lambert J.A. stated that the implied requirements to negotiate in good faith and not to withhold agreement unreasonably carries the "same degree of diligence as 'best efforts.'"³¹

Note that, under the reasoning of Lambert J.A., the renewal clause, though not a mere agreement to agree, was also not a concluded contract that could be enforced by the court against the landlord without the landlord agreeing to a rental rate. The renewal clause was thus a kind of hybrid, semi-contract the essence of which was to obligate the parties to negotiate an agreement on the market rental rate in good faith and not to withhold such agreement unreasonably. In the event that the parties were unable to reach an agreement after negotiating in good faith, there would be no breach of the option but there would also be no renewal.

It seems doubtful that the court in *Empress Towers* would have reached the result it did if the option clause was not contained in a subsisting lease. At the

²⁸ *Ibid.* at 404.

²⁹ *Ibid.* at 405.

³⁰ [1988] B.C.J. No. 828, 27 B.C.L.R. (2d) 152 (C.A.).

³¹ *Supra* note 27 at 405.

same time, as was observed by a later court,³² the decision clearly does not stand for the proposition that a court will imply a duty to negotiate in good faith with respect to an option clause so long as the clause is part of an existing contract. As Lambert J.A. stressed, the key to implying the terms in question was that the parties agreed that there should be a right of renewal at the prevailing market rental.³³ The preliminary finding that the renewal clause was in some sense enforceable was thus necessary for the court to find that there was a duty to negotiate in good faith.

However, not all courts have interpreted *Empress Towers* in this manner, as illustrated by *Hirex Holdings Ltd. v. Chrysler Canada Ltd.*³⁴ In *Hirex*, a clause in a lease provided for a renewal "at a rental to be agreed upon by the Lessor and the Lessee, as being the fair market rental for the demised premises." Meredith J. held this clause to be void for uncertainty, but also held that, under *Empress Towers*, the clause carried with it an implied term that the landlord would negotiate in good faith. (Meredith J. also held that the landlord in the case discharged the good faith obligation.) Meredith J. thus appeared to suggest that a renewal clause necessarily implied a duty to negotiate in good faith regardless of whether it was void for uncertainty or not.

Although this suggestion does not seem consistent with the reasoning of the court in *Empress Towers*, the approach of the court in *Hirex* is similar to that taken by at least one Ontario Court. In *Canada Trustco Mortgage Co. v. 1098748 Ontario Ltd. (c.o.b. Canyyz Properties Limited Partnership)*,³⁵ an option clause provided for "such renewal to be on terms, conditions and at a Minimum Rent to be as is mutually agreed upon between the Landlord and tenant . . . such Minimum Rent not to be less than the rent payable under this Lease [and] such Minimum Rent to be fair market rent for premises of comparable age, location and construction." Cumming J.,

³² *EdperBrascan Corp. v. 117373 Canada Ltd.*, *supra* note 26 at 207 (*Empress Towers* is not an authority for a general proposition that the duty to bargain in good faith exists whenever a negotiation takes place within an existing contract).

³³ *Supra* note 23 at 404.

³⁴ (1991), 16 R.P.R. (2d) 154 (B.C.S.C.) [hereinafter *Hirex*].

without referring to *Empress Towers*, held that this clause is at most an agreement to agree and unenforceable. Nonetheless, Cumming J. also held that the clause implied a duty on both parties to make a good faith attempt to negotiate renewal terms. While acknowledging that implying such a term with respect to the negotiation stage of a contract was problematic, Cumming J. appeared to be of the view that a duty to negotiate in good faith may still exist where such negotiation would take place in the context of an existing contract:

The lease in question, however, contemplates a potential further agreement that is based in part on the previous and continuing *contractual relationship* of the parties. The inclusion of a term to negotiate following the exercise of the parties' option to renew must give rise to something. This approach is consistent with the values of commercial efficacy and certainty that I outlined above. It is appropriate to interpret the provision in question here as demonstrating the intention of the parties to preserve the goodwill of their former contractual relationship. A previous relationship and an agreement to negotiate on renewal terms and conditions may not allow the court to infer what those terms and conditions would be, but the context imparts a duty of the parties to negotiate in good faith for renewal terms and conditions following exercise of the renewal option. By "duty of good faith" I mean nothing more than a requirement that the parties not negotiate in bad faith.³⁶

Cumming J. went on to find that there was no evidence indicating any bad faith conduct on the part of the respondent landlord in the case, and that the fact that the applicant tenant would not accept the landlord's offers did not amount to bad faith.

³⁵ (1999), 23 R.P.R. (3d) 82 (Ont. Gen. Div.) [hereinafter *Canada Trustco*].

³⁶ *Ibid.* at 89 [emphasis original]. A similar analysis of a clause providing that the parties agree to negotiate in good faith with a view to renew the agreement is found in *Northland Fleet Services Ltd. v. Quintette Operating Corp.*, [2001] B.C.J. No. 1296 (S.C.), which concerned a contract to provide vehicle maintenance and repair services. The court stated that there is, as yet, no absolute rule or principle of law that automatically precludes the enforceability of an agreement to negotiate with a view to reaching an agreement, and that even a bare obligation to negotiate might have some commercial value deserving of judicial protection (at para. 42). The court accordingly found that the agreement to negotiate in the case at hand was enforceable and that the defendant was in breach of it by declining to negotiate, as a result of which the plaintiff suffered a loss of a chance to obtain a contract. (However, the court did not award any damages on this basis, stating that in the circumstances, the prospect of the plaintiff obtaining a profitable contract had been negligible: see para. 48). The judgment, released on June 14, 2001, does not refer to either *Martel Building* or *Peel Condominium*.

An option to renew was also considered in *Sheppard v. Czechoslovak (Toronto) Credit Union Ltd.*³⁷ The case is ambiguous in terms of when a duty to negotiate in good faith would arise. The option clause in the case provided that the tenants were to have the option of renewing the lease at a rental to be agreed upon by the parties prior to a certain date. Conant D.C.J. found the clause to be void for being a mere agreement to agree and stated that the remaining issue was whether the landlord was nonetheless in breach of a duty to negotiate in good faith by refusing to enter into negotiations with the applicants. On that issue, Conant D.C.J. stated that there was "no basis in law for inferring the existence of such an obligation independent of the terms of the contract," and that, since the terms of the lease set out the date by which an agreement for renewal, if any, had to be made, and since the tenant did not give notice to exercise the option by that date, the landlord was under no obligation to negotiate with the tenant after that date. However, Conant D.C.J. also stated that "[i]f the tenants had in fact given notice of their intention to renew and entered into negotiations with the landlord prior to this date, the landlord may have been under a duty to negotiate in good faith which a Court, depending on the circumstances, might or might not have found it to have breached."³⁸

In contrast with *Hirex, Canada Trustco*, and *Sheppard*, two recent cases, though not relating to real property leases, have held that the key to the result in *Empress Towers* was the existence of the objective standard (i.e., the market rental rate) set out in the option clause. In *Mannpar Enterprises Ltd. v. Canada*,³⁹ which concerned renewal of a permit to remove sand and gravel issued by the Crown, Hall J.A. (for the court) held that there was no implied term obligating the Crown to negotiate a renewal in good faith. In doing so, Hall J.A. distinguished *Empress Towers*, stating that, unless, as in *Empress Towers*, there was a "benchmark" or a standard by which to measure good faith, "the negotiation concept is unworkable."⁴⁰

³⁷ (1988), 1 R.P.R. (2d) 290 (Ont. Dist. Ct.) [hereinafter *Sheppard*].

³⁸ *Ibid.* at 293.

³⁹ (1999), 67 B.C.L.R. (3d) 64 (B.C.C.A.) [hereinafter *Mannpar*].

⁴⁰ *Ibid.* at 85.

Since there was no such benchmark in the contract in the case, there could be no duty to negotiate in good faith.

The second case is *EdperBrascan Corp. v. 117373 Canada Ltd.*,⁴¹ which concerned an agreement to sell shares, but in which the court had an occasion to discuss *Empress Towers*. Lane J. noted that *Empress Towers* was "problematic" in its reliance on an analogy between option cases and an implied obligation to use best efforts where a contract is subject to, e.g., financing, since such analogy was rejected as being invalid by the House of Lord in *Walford v. Miles*.⁴² Lane J. was therefore of the view that *Empress Towers* should perhaps be regarded as "confined to its very narrow set of facts, and not as an authority for a general proposition that the duty to bargain in good faith exists whenever a negotiation takes place within an existing contract."⁴³ Lane J. further remarked that, even confined to its facts, *Empress Towers* seemed out of step with the authorities holding that a duty to bargain in good faith is not a workable concept from the point of view of enforcement through the courts.⁴⁴

There are, then, three possible positions that can be taken with respect to an option to renew which does not set out all fundamental terms: (1) an obligation to negotiate in good faith arises in all cases where the option is contained in a subsisting lease (*Hirex*, *Canada Trustco*, and perhaps *Sheppard*); (2) such obligation arises only if the option provides a "benchmark" (*Mannpar* and *Empress Towers* as interpreted in *Mannpar*); and (3) no obligation of good faith arises unless the option constitutes an enforceable contract in itself, with the possible exception of cases factually paralleling *Empress Towers* (*EdperBrascan*). While only the last of these possibilities is truly consistent with the proposition that there is no duty of good faith associated with pre-contractual negotiations, given the widespread acceptance of

⁴¹ *Supra* note 26. See also the helpful annotation of the case by J.W. Lem and A. White, *supra* note 25.

⁴² *Supra* note 7. The court in *EdperBrascan*, *ibid.* at 207, quoted a passage from *Walford v. Miles* in which the House of Lords stated that an agreement to negotiate in good faith is unenforceable since it, like an agreement to agree, lacks the necessary certainty, which was not true of an agreement to use best endeavours.

⁴³ *EdperBrascan*, *ibid.* at 207.

Empress Towers as a leading authority on option clauses, and the existence of cases such as *Canada Trustco*, the possibility of any given court adopting the other positions cannot be ruled out.

(ii) Clauses Granting a Discretion

Good faith has also been held to attach to the exercise of a discretion granted under a contract. The leading case in this area in real property law is *Gateway Realty Ltd. v. Arton Holdings Ltd.*,⁴⁵ a Nova Scotia decision considered by many to be the high-watermark in the imposition of the duty of good faith. *Gateway* was a dispute between the plaintiff, Gateway, which owned a mall where Zellers was the anchor tenant, and the defendant, Arton, the owner of a competing mall to which Zellers had relocated. After moving to Arton's mall, Zellers assigned to Arton the seventeen years remaining in its lease with Gateway. Gateway and Arton subsequently entered into an agreement which provided that Arton was to use its "best efforts" to sublease the space that had been occupied by Zellers. However, the space remained unoccupied, and Gateway commenced an action against Arton, claiming, *inter alia*, that it was entitled to terminate the lease for breach of the "best efforts" obligation or, alternatively, breach of a duty of good faith. Gateway succeeded at trial and the trial judgment was affirmed on appeal.

At trial, Kelly J. found for Gateway on both grounds. In dealing with the good-faith ground, Kelly J. reviewed the law of good faith in detail, noting that the duty of good faith governed the manner in which parties to a contract should pursue their contractual objectives, and that the duty would be breached when a party engaged in "a conduct that is contrary to community standards of honesty, reasonableness or fairness."⁴⁶ Kelly J. further noted that, "[i]n essence, the courts are more and more requiring both parties to a lease not to act in an 'unreasonable' manner

⁴⁴ *Ibid.* at 208.

⁴⁵ (1991), 288 A.P.R. 180 (N.S.S.C.T.D.), affirmed (1992), 307 A.P.R. 180 (C.A.) [hereinafter *Gateway*].

⁴⁶ *Ibid.* at 192.

in the performance of a contract unless the lease explicitly provides the party can act in such a manner."⁴⁷ Kelly J. then stated:

What will constitute bad faith or breach of the conduct described above will depend on the terms of contract and the circumstances of each case. In most cases, bad faith can be said to occur when one party, without reasonable justification, acts in relation to the contracts [sic] in a manner where the result would be to substantially nullify the bargained objective or benefit contracted for by the other, or to cause significant harm to the other, contrary to the original purpose and expectation of the parties.⁴⁸

Kelly J. found that Arton and Zellers, both of which had a right under the lease to sublease or assign the premises, were under an obligation not to exercise this and other discretionary rights under the lease arbitrarily or unreasonably and to exercise them in a good faith manner, and that Arton was in breach of this obligation since it almost wholly failed to act in furtherance of finding a tenant to fill the space previously occupied by Zellers with a view to maintaining the viability of the Gateway mall.

The decision of Kelly J. was affirmed on appeal, but on the basis that Kelly J. was correct in holding that Arton failed to exercise best efforts to find a suitable replacement tenant in accordance with its agreement with Gateway. In its fairly brief judgment, the Appeal Division did not address the applicability of a duty to perform contractual rights in good faith. The judgment highlights the obvious fact that the good-faith ground was not necessary to the trial court's decision. Nevertheless, *Gateway* has been widely cited and relied upon as a leading case on the duty of good faith.⁴⁹

The manner in which a discretion given under a contract must be exercised was addressed by the Ontario Court of Appeal in *Canadian National*

⁴⁷ *Ibid.* at 196.

⁴⁸ *Ibid.* at 197.

⁴⁹ See, e.g., O'Byrne and McCamus, *supra* note 4. In his annotation of *MDS Health Group Ltd. v. King Street Medical Arts Centre Ltd.* in (1994), 12 B.L.R. (2d) 211 at 212, R.B. Potter asserts that *Gateway* was a case about what constitutes "best efforts," and not about good faith in contract.

Railway v. Inglis Ltd.,⁵⁰ which concerned a clause in a lease providing that the rent during a renewal period may be fixed by the lessor "at an amount which in the opinion of the lessor is fair and equitable." Although the court did not refer to the concept of good faith expressly, its analysis of the effect of this clause is still useful in the present context. The landlord in *CN Railway* asserted that, as an "opinion" was a subjective matter, its decision in fixing the rent was not open to challenge so long as it did not consider patently irrelevant matters. Robins J.A., on behalf of the Court, rejected this assertion. Robins J.A. stated that, under the authority of *Greenberg v. Meffert*,⁵¹ provisions in agreements making performance subject to "the opinion" or "the discretion" of a party to the agreement may, depending on the nature of the agreement and the subject matter of the opinion or the discretion, be controlled by either subjective or objective standards. Robins J.A. quoted the following passage from *Greenberg v. Meffert*:

In contracts in which the matter to be decided or approved is not readily susceptible of objective measurement — matters involving taste, sensibility, personal compatibility or judgment of the party for whose benefit the authority was given — such provisions are more likely construed as imposing only a subjective standard. On the other hand, in contracts relating to such matters as operative fitness, structural completion, mechanical utility or marketability, these provisions are generally construed as imposing an objective standard of reasonableness ...⁵²

In the view of Robins J.A., the clause in issue clearly called for an objective standard of reasonableness, as "it cannot properly be construed as empowering CN unilaterally to fix the rent, as it would have it, on a subjective basis at whatever rate it might honestly believe is appropriate."⁵³

⁵⁰ (1997), 15 R.P.R. (3d) 1 (Ont. C.A.) [hereinafter *CN Railway*].

⁵¹ (1985), 50 O.R. (2d) 755 (Ont. C.A.). This case concerned an employment contract under which commissions were payable to an employee by an employer "at sole discretion of employer." The court held that the words meant that the employer must act reasonably, honestly, and in good faith in exercising its discretion.

⁵² *CN Railway*, *supra* note 50 at 9.

⁵³ *Ibid.*

Although, as noted, the court in *CN Railway* did not refer to good faith, its holding that the exercise of a contractual discretion is subject to certain standards is similar in its effect and spirit to the holding in *Gateway* regarding good faith.

Note that a contractual provision may be interpreted as granting a discretion in an implicit manner. Thus, for example, a clause in an agreement of purchase and sale of land providing that the agreement is conditional upon the purchaser obtaining rezoning that is "suitable to the purchaser" can be seen as granting a discretion to the purchaser. This was the analysis adopted by the court in *737985 Ontario Ltd. v. Essex Sanitary Plumbing & Heating Co.*,⁵⁴ in which Hockin J. stated that the words "suitable to the purchaser" introduced to the agreement a discretion in favour of the purchaser, providing the purchaser the opportunity to define a development which agreed with the dictates of its economic self-interest. Concerning the nature of this discretion, Hockin J. stated: "This was not an unbridled discretion; the exercise of the discretion was subject to the requirement of honesty and good faith, and its exercise must be said to be reasonable when viewed objectively against the background of the circumstances of the case. A discretion could not be exercised capriciously or arbitrarily."⁵⁵ (In support of these statements, Hockin J. cited *Greenberg v. Meffert*,⁵⁶ but not *Gateway*.)

Situations like that in *Empress Towers* may also be said to involve an element of discretion. As may be recalled, Lambert J.A. stated in that case that the option clause carried with it not only an implied term that the landlord will negotiate in good faith with the tenant with the objective of reaching an agreement on the market rental rate, but also a term that agreement on a market rental will not be unreasonably withheld.⁵⁷ That is, the clause grants the landlord a discretion to agree

⁵⁴ (1993), 31 R.P.R. (2d) 217 (Ont. Gen. Div.), at 224.

⁵⁵ *Ibid.*

⁵⁶ *Supra* note 51.

⁵⁷ See *supra* note 27 at 405. Although Lambert J.A. referred to the landlord as the party having the duty of good faith, it would seem that the duty would be imposed on both parties to the contract.

to any particular rental rate or not, but, under *Empress Towers*, this discretion must be exercised in a reasonable manner.

(iii) Compliance with a Restrictive Covenant

The duty of good faith has also been referred to in relation to a restrictive covenant. In *MDS Health Group Ltd. v. King Street Medical Arts Centre Ltd.*,⁵⁸ the applicant, MDS, was a medical laboratory services company and a tenant in a medical office building owned by King Street, which was one of the respondents. All of the shares of King Street were owned by the tenants in the building, and the relationship among the shareholders was governed by a shareholders' agreement. The shareholders' agreement and the lease between MDS and King Street contained a restrictive covenant providing that King Street would not lease premises in the building to a competitive medical laboratory service. This restrictive covenant contained a specific exemption to permit doctors in the building to take laboratory specimens from their own patients in the ordinary course of conducting their medical practice. After the building came to be in a financial difficulty, MDS refused to pay a substantially increased rent. King Street then leased certain space in the building to a group of doctors practising in the building (also respondents in the case) who began to operate a "Physicians' Lab," staffed by "nurses" who took specimens, which were picked up and taken to an off-premises medical laboratory, a competitor of MDS, for analysis, the results of which were reported back to the ordering physician. MDS commenced an action for, *inter alia*, a declaration that the respondents were in breach of the restrictive covenant.

Haley J. found for MDS, stating that the magnitude of the respondent doctors' operation "destroys the whole premise upon which MDS's original participation in the building was based: i.e., that they would have a group captured by location and convenience for which they could provide a service with a view to

⁵⁸ (1994), 12 B.L.R. (2d) 209 (Ont. Gen. Div.) [hereinafter *MDS Health Group*].

making it a profitable undertaking."⁵⁹ King Street and the doctors were therefore in breach of the restrictive covenant. And Haley J. went further and held that the respondents' conduct amounted to a breach of the good faith required of the parties to a contract. As can be seen, the judgment is reminiscent of *Gateway* (which Haley J. relied on) in terms of both its conception of good faith and the fact that the finding regarding good faith was not necessary to the result of the case.

(iv) Landlord's Work

The application of the duty of good faith arising in connection with the tenant's choice of remedies when a landlord is in breach of its obligations to build the premises under a lease is illustrated by *1072154 Ontario Ltd. v. Cara Operations Ltd.*⁶⁰ *Cara Operations* involved a shopping-centre lease between the plaintiff developer and the defendant tenant, Cara. The lease required the plaintiff to build the premises to be occupied by Cara in accordance with the specifications set by Cara, and provided: "In the event that the Landlord fails to complete the Landlord's Work by the above-mentioned dates then Cara shall be entitled to terminate the Agreement by written notice to the Landlord, or at Cara's option, Cara may complete such Landlord's Work and bill the Landlord therefor or deduct such amount from rent."⁶¹ When the plaintiff's work was nearing completion, Cara sent a letter to the plaintiff, complaining of a number of alleged deficiencies in the work. Cara also insisted on incorporating the Second Cup Coffee facility into the project, although this was inconsistent with the lease and in conflict with an existing agreement between the plaintiff and another store. Cara subsequently purported to exercise its contractual right to terminate the agreement on the basis of the alleged deficiencies. The plaintiff commenced an action against Cara for, *inter alia*, damages for breach of the lease.

Hoilett J. found in favour of the plaintiff. One of the assertions made by the plaintiff at trial was that, although a few of the deficiencies alleged by Cara did

⁵⁹ *Ibid.* at 222-223.

⁶⁰ [2001] O.J. No. 3344 (S.C.J.) [hereinafter *Cara Operations*].

⁶¹ *Ibid.* at para. 2.

in fact require correction, they were easily remediable, and that, as such, under the terms of the lease, Cara was obliged, in good faith, to exercise its best efforts to achieve the business objectives of the agreement. Hoilett J. agreed. In the opinion of Hoilett J., the conclusion was inescapable that, while some of Cara's complaints were legitimate, they were not sufficiently major to go to the root of the contract. Hoilett J. noted that the lease contained a clause which expressly provided that the parties must proceed in good faith and use their best efforts to fulfil the conditions under the agreement, and that the termination clause on which Cara relied made three alternative remedies available to Cara in the event that the landlord failed to complete its work in accordance with the agreement: (1) terminate the agreement by written notice; (2) complete the work and bill the landlord; (3) complete the work and deduct the cost of completion from rent. Hoilett J. reasoned that Cara failed to discharge its obligation to "proceed in good faith and use best efforts," as the evidence indicated that either of remedies two or three would have been a reasonable route for Cara to follow. Therefore, at the very least, Cara was required to canvass the reasonableness of pursuing either of the two other remedies available to it. With respect to the express obligation to "proceed in good faith" specifically, Hoilett J. had the following to say:

Concerning the defendant's obligation to "proceed in good faith," I am also of the view that the defendant failed in that respect. The most flagrant conduct in that regard, in my opinion, was the attempt by the defendant to, in effect, unilaterally amend the agreement to include Second Cup Coffee products and the implied, if not explicit, threat that the agreement was at risk if the plaintiff did not accept the defendants' interpretation of the agreement. The "Second Cup Coffee" name is too high-profile a brand name to suggest that it could be obliquely and innocuously added to an otherwise comprehensive menu. The posture assumed by the defendant in relation to the Second Cup Coffee product was, in my opinion, a transparent attempt to change the agreement.

[Other circumstances also reflecting on the bad faith of the defendant include] the admitted exaggerations on the part of the defendant in condemning the plaintiff's work. Were one to read, without further illumination, the letter purporting to terminate the agreement, one may well have concluded that the overall quality of

workmanship was shoddy and evidenced little, if any, pride of workmanship. The evidence fell far short of warranting such a conclusion; [this finding] is fortified by the fact that the defendant was, without even taking much of a breath, quite willing to resurrect the project on terms which, in my view, were more favourable to it; [this circumstance] lends some credit to the claim that the defendant sought to use the deficiencies, in part admitted, as a pretext for getting out of an agreement it thought it could improve upon.⁶²

Cara Operations differs from the other cases discussed in this paper in that the obligation to proceed in good faith was expressly provided for in the agreement between the parties. Still, in *Cara Operations*, as in cases such as *Gateway* and *MDS Health Group* in which the duty of good faith was implied, the concept of good faith was used by the court in attaching legal disapproval to conduct that was perceived as being unreasonable and driven by a collateral motive.⁶³

(v) Rights of First Refusal

The issue of good faith was rejected by the Ontario Court of Appeal as being irrelevant in determining whether a right of first refusal contained in a lease was triggered in *Downtown King West Development Corp. v. Massey Ferguson Industries Ltd.*⁶⁴ The defendant in that case, Massey Ferguson, owned a large piece of property which could be severed into thirty separate building parcels. The plaintiff, Downtown, held a lease on a part of the property. The lease was intended to contain a clause granting the plaintiff a right of first refusal to purchase part of the leased parcels (block 4), which right would be triggered by Massey Ferguson being prepared to sell block 4 alone or as part of a bulk sale. However, the agreement as ultimately executed by the parties contained a different right of first refusal. Downtown became aware of this discrepancy, and when Massey Ferguson refused to rectify the lease, Downtown registered a certificate of pending litigation on block 4. Subsequently, Massey Ferguson agreed to sell all of the property to a third party, and, when it was

⁶² *Ibid.* at paras. 50-51.

⁶³ This point is addressed in a more detailed and generalized way in Horton, *supra* note 4.

⁶⁴ (1993), 33 R.P.R. (2d) (Ont. Gen. Div.), reversed (1996), 1 R.P.R. (3d) 1 (Ont. C.A.), leave to appeal to S.C.C. refused (1996), 138 D.L.R. (4th) vii (note) [hereinafter *Downtown King West*].

unable to have the certificate of pending litigation removed, negotiated with the third party the deletion of block 4 from the bulk sale. Downtown offered to buy block 4, but Massey Ferguson was determined not to sell any of the property to Downtown and refused the offer. In the action, Downtown continued its claim for rectification, and also sought damages.

At trial, one of the issues before the court was, assuming that rectification was granted, whether Massey Ferguson could avoid the right of first refusal by intentionally deleting block 4 from the land being sold, when both the vendor and the purchaser had intended to include it in the agreement. Rosenberg J. answered this question in the negative, stating as follows:

[Downtown] had an obligation to act in good faith towards their tenant, who had a first right of refusal. They cannot say, in effect: "Even though we have received an offer for all of the parcels which we are willing to accept, we do not wish to trigger the first right of refusal and therefore we will delete the subject parcel from the offer by renegotiations with the purchaser."⁶⁵

Rosenberg J. went on to hold that Massey Ferguson's efforts to avoid the right of first refusal held by Downtown was in breach of good faith, and that Downtown was entitled to damages for the differences between the losses they suffered and the profits they would have realized had their right of refusal been recognized.⁶⁶

Thus, the trial court's decision was essentially that Downtown's right of first refusal was triggered when Massey Ferguson received the initial offer from the third party to purchase the whole of the property because the deletion of block 4, which was designed to enable Massey Ferguson to avoid triggering Downtown's right

⁶⁵ The trial judgment, *ibid.* at 39.

⁶⁶ Rosenberg J. relied on *Landymore v. Hardy* (1991), 21 R.P.R. (2d) 174 (N.S.S.C.T.D.), which concerned a right of first refusal entered into by parties to an agreement for purchase and sale of land. The court in *Landymore v. Hardy* held that the grantor of a right of first refusal was not entitled to frustrate it by conveying the property in such a way as to avoid having to give the right in the first place, and that relationships between the giver and holder of a right of first refusal must be characterized by good faith and reasonableness. Accordingly, the giver of the right in the case was not allowed to arrange a sham transaction whereby a non-arm's-length third party made an offer to buy the

of first refusal, could not be allowed to achieve that effect as it connoted bad faith. It would appear that, under this analysis of the right of first refusal, a right of first refusal would in effect create an implied term stating that, when the giver of the right has an opportunity to trigger the right, it must choose to do so.

The decision of the trial court was reversed by the Court of Appeal. On the issue of good faith, Robins J.A. (for the court) stated as follows:

Much has been made of the finding that Massey acted in breach of good faith by deleting the leased property from the final documentation so as to avoid the right of first refusal. In my opinion, this finding is without legal foundation. The right of first refusal is clear and unambiguous. Under its terms, Massey has not obligated itself to sell the leased property either separately or by way of an *en bloc* sale. Had Massey received an offer to purchase its total holdings capable of acceptance, it would have been entitled to delete the leased property therefrom by negotiations with the proposed purchaser. *The fact that it may choose to do so because it did not wish to trigger a lessee's right of first refusal is of no moment. In the absence of any covenant to the contrary, it may reject any offer it receives for whatever reason it wishes.*

This is not a matter of good faith but, rather, a matter of the rights and obligations created by the first refusal agreement. The lessee held no option and had no right *per se* to buy the property. The right it held became operative only if, as and when the lessor received a *bona fide* offer that it was willing to accept. *The reason for its unwillingness to accept any particular offer is immaterial.* It did not covenant to sell the property and cannot be said to have acted in bad faith if, because of a breakdown in its relationship with the lessee or for any other reason, it chose to remain the owner of the property rather than trigger the right of first refusal.⁶⁷

In the view of the Court of Appeal, then, Downtown's right of first refusal was not triggered merely because Massey Ferguson received an offer which, if accepted, would have triggered it, and Massey Ferguson was entitled to accept or reject the offer for any reason, including for the purpose of preventing the right of

subject property at an inflated price. Note that the case, it would seem, could simply have been decided on the ground that the offer had not been a *bona fide* offer.

⁶⁷ The judgment of the Court of Appeal, *supra* note 64 at 15 [emphasis added].

first refusal from being triggered. Under this view, Massey Ferguson's motive in rejecting the initial offer was irrelevant and did not merit the court's inquiry.⁶⁸

b. Agreements of Purchase and Sale

It has been held in many cases that the right to terminate a contract must be exercised in good faith. In this section, we canvass the good faith requirement as it relates to three grounds for terminating an agreement of purchase and sale of land: (i) deficiencies in the property, (ii) clauses providing that time is of the essence, and (iii) unfulfilled conditions.

(i) Deficiencies, Requisitions, and Annulment Clauses

It has been held in a line of cases of high authority that a party exercising its right to terminate an agreement in reliance on an annulment clause on the basis of a deficiency in the subject property must do so in good faith. This is illustrated by the leading case of *LeMesurier v. Andrus*.⁶⁹ In *LeMesurier*, the respondent purchaser terminated the agreement when she learned that the driveway as described in the agreement was partly on the neighbouring property. The encroachment was between one-third and three-quarters of a foot. In order to remedy the deficiency, the vendors obtained a quitclaim for part of the encroachment and moved the curb along the edge of the driveway so that all of the driveway was within the lot line of the subject property. The result of these measures was that part of the driveway was somewhat narrower and the property was .16% smaller than was described in the agreement. But these measures did not satisfy the purchaser, who terminated the transaction in reliance on the standard annulment clause. The vendors initially brought an action for specific performance, but, upon selling the property

⁶⁸ Note that the judgment of the Court of Appeal can be reconciled with *Landymore v. Hardy*, *supra* note 66, on the basis that the offer in issue in *Downtown King West*, unlike that in *Landymore v. Hardy*, was a *bona fide* offer made by an arm's-length party.

⁶⁹ *Supra* note 2.

subsequently, proceeded with the action as one for damages. The action was dismissed at trial and the vendors appealed.

The appeal was allowed by the Ontario Court of Appeal. Grange J.A. (for the court) held, relying on the earlier cases of *Mason v. Freedman*⁷⁰ and *Hurley v. Roy*,⁷¹ that "a vendor who seeks to take advantage of the clause must exercise his right reasonably and in good faith and not in a capricious or arbitrary manner."⁷² Grange J.A. stated:

I think the purchaser's reliance upon this clause can be described as "capricious or arbitrary" where the vendors had removed the curb and replaced it within the lot line so that it did not encroach on the adjacent lot, and I cannot find her action to be "reasonable and in good faith." If we were to give the clause the meaning and force ascribed to it by the trial judge, there would be very few contracts for the sale of urban land that could survive. It would be a rare case where a careful survey would not disclose some minor discrepancy. Vendors and purchasers owe a duty to each other honestly to perform a contract honestly made.⁷³

Grange J.A. went on to note that this approach may be "merely an example of the development of an independent doctrine of good faith in contract law at least in the performance of contracts ... "

A similar case was *Garrett v. Ayr Ventures Inc.*,⁷⁴ in which the transaction failed to close when an improperly registered lien was discovered. It was known to the purchaser that the lien was not more than \$16,920 and possibly only \$1,692. Although closing was at first extended by one day, on the extended closing date, the purchaser instructed his solicitor not to close the sale until the lien was removed. The vendor's solicitor was unable to remove the lien, but offered a personal undertaking to register a release of the lien. The purchaser refused to close and sued for a return of the deposit. The vendor counter-claimed for forfeiture of the deposit.

⁷⁰ *Supra* note 3.

⁷¹ (1921), 50 O.L.R. 281 (C.A.).

⁷² *Supra* note 2 at 430.

⁷³ *Ibid.*

⁷⁴ (1995), 44 R.P.R. (2d) 215 (Ont. Gen. Div.).

The purchaser's action was dismissed and the vendor's counter-claim was allowed. Sills J., relying on *LeMesurier* and other cases, and citing the evidence showing that the purchaser was purchasing the property as a speculative endeavour and that the downturn in the real estate market had an adverse impact on the purchaser's scheme, held that the purchaser had been unreasonable, capricious, and arbitrary in refusing to co-operate with the vendor.

In *Meunier Estate v. Cassels, Brock & Blackwell*,⁷⁵ the purchaser sought and obtained an extension of closing, but, on the day before the extended closing date, raised an objection regarding an assignment of rents to the existing mortgagee and also regarding certain instruments registered on title. The vendor's solicitor made attempts to resolve these problems, but they were not resolved entirely, and the purchaser refused to close on the closing date. The vendors brought an action, seeking, *inter alia*, damages for breach of contract. The action was allowed by Spence J., who stated that the purchaser could not rely on the deficiencies because its conduct amounted to "lying in the weeds."⁷⁶ Spence J. noted that, if the purchaser wished to proceed with the transaction, it could easily have raised its concerns sooner, instead of doing so at the last minute. Spence J. stated: "I think it is reasonable to infer that [the purchaser] wanted to be able not to complete, and for that reason delayed its response . . . right up to the eve of closing, when the vendors would most likely not be able to do anything to rectify the situation."⁷⁷ In the result, the purchaser was not allowed to rely on its objections as a basis for not completing the transaction.⁷⁸

⁷⁵ (1994), 41 R.P.R. (2d) 126 (Ont. Gen. Div.).

⁷⁶ *Ibid.* at 143. The court attributed this expression to *Rice v. Rawluk* (1992), 8 O.R. (3d) 696 (Gen. Div.), at 709-711, in which purchasers were not allowed to avoid the transaction because the deficiency on the basis of which the purchasers purported to terminate the agreement could have been easily removed if they had raised it when they first learned of it.

⁷⁷ *Ibid.*

⁷⁸ See also *Henderson v. Turner*, [1994] O.J. No. 2708 (Gen. Div.), in which it was held that a purchaser had acted capriciously or arbitrarily and in bad faith in refusing to close the transaction on the basis of the vendor's failure to deliver a clear certificate of execution where such failure was of technical nature.

Good faith has also been referred to in relation to a deficiency in a tender, as exemplified by *Victorian Homes (Ontario) Inc. v. DeFreitas*,⁷⁹ where it was held that purchasers could not rely on a minor deficiency in the tender to terminate an agreement, where the deficiency could have been corrected, had the purchaser acted in good faith and disclosed the reason for alleging that the tender was insufficient.

Note that, in each of the above cases, the court's finding could simply have been based upon the principle of *de minimis non curat lex* (the law does not take note of trifling matters) or on the basis that a party cannot rely on a minor deficiency in invoking its right to terminate the agreement as such reliance would be inconsistent with the intention of the parties underlying the annulment clause. That is, good faith was, once again, not crucial to these decisions. But, perhaps because minor deficiencies are almost always relied upon by a party looking for a way not to carry out an agreement, such cases provide opportunities for the courts to base their decisions in part on good faith.⁸⁰

In any event, whether a decision regarding a party's entitlement to terminate an agreement is based upon the doctrine of good faith or that of *de minimis non curat lex*, the question remains precisely why a court would (or should) rely on either doctrine. That is, why does the lack of good faith or the trifling nature of the deficiency matter? A case that helps answer this question is *Stefanovska v. Kok*,⁸¹ in which the court discussed the role of the motive of the purchaser in determinations regarding whether a requisition constituted a valid objection to title. Moldaver J. stated that the test to be applied in making such a determination was whether the vendor could convey substantially what the purchaser contracted to acquire. In Moldaver J.'s view, although this test was basically an objective one, its application required taking into account all of the circumstances of the case, and the subjective

⁷⁹ (1991), 16 R.P.R. (2d) 55 (Ont. Gen. Div.).

⁸⁰ For an analysis of good faith as an "excluder of opportunistic conduct," see Stack, *supra* note 4.

⁸¹ (1990), 12 R.P.R. (2d) 80 (Ont. H.C.).

views and motives of the purchaser could sometimes be relevant. Moldaver J. explained this view in the following terms:

The materiality of the deficiency is to be determined essentially on an objective basis. However, this is not to say that the subjective views of the purchaser are to be ignored; far from it. There may be instances where a certain purchaser has agreed to buy a piece of property for a specific, legitimate and bona fide purpose, only to discover that some deficiency in title will render this use impossible. Here, the purchasers' refusal to close is neither arbitrary, capricious nor without real consequence. In this type of case, the Court would still be required to look at all of the circumstances but would be entitled, in its overall assessment, to place greater emphasis on the *legitimate* but frustrated needs of the purchaser.

In other cases, the Court, in carrying out its objective assessment, will give less weight to the subjective views of the purchaser if the needs alleged are more or less commonplace, not out of the ordinary and of little or no consequential effect to the use or enjoyment of the property as a whole.

At the other extreme, the Court will give no weight to the subjective views of the purchaser if it is felt that the so-called needs are capricious or arbitrary and contrived to avoid contractual obligations [the court cited *LeMesurier* and other cases].⁸²

Moldaver J. further stated that evidence of motive, "[w]hile not in and of itself determinative, . . . may cast doubt upon the legitimacy of the reasons advanced, by one side or the other, for the failure to complete the contract."⁸³

Under Moldaver J.'s approach, the purchaser's motive would be relevant in determining the weight to be assigned to the subjective views of the purchaser regarding the purchaser's needs, which weight is a factor in assessing the materiality of the requisition; that is, good faith is merely one of the factors helping a court to determine the real issue, namely, whether the objection raised by a party is valid and material. Viewed in this light, the *LeMesurier* line of cases discussed above can be analyzed as follows: the lack of good faith on the part of the party purporting to terminate the agreement pointed to the conclusion that the party's objection to the

⁸² *Ibid.* at 90-91.

⁸³ *Ibid.* at 91.

deficiency in issue was not legitimate because the deficiency was not material; it was this conclusion, rather than the lack of good faith *per se*, that led to the results in those cases.

All of the cases reviewed above concern the *quality* of requisitions. Good faith issues have arisen in relation to the *quantity* of requisitions as well. In *Caruana v. Duca Community Credit Union Ltd.*,⁸⁴ the appellant purchaser (Caruana) had made a large number of requisitions, many of which were found by the motions court judge to have been without merit. However, Caruana's appeal was based upon only one of the unsatisfied requisitions, which concerned an access deficiency that the Court of Appeal found to have been a reasonable ground for Caruana's refusal to complete. Laskin J.A., speaking for the Court, rejected the contention of the vendor that the "numerous unmeritorious requisitions"⁸⁵ made by Caruana evidenced bad faith, and that Caruana should be denied relief for that reason. Noting that the motions court judge had not made a finding of bad faith and that the record did not support such a finding, Laskin J.A. stated that the "position Caruana eventually took in connection with the [access deficiency at issue in the appeal] was reasonable," and that "it was reasonable for a purchaser in Caruana's position not to close."⁸⁶ The *Caruana* case therefore supports the idea that, while submitting a large number of unmeritorious requisitions may or may not constitute bad-faith conduct, it will not detract from the purchaser's legal right to refuse to close if at least one of the requisitions is valid, material, and remains unsatisfied.

Another case of interest in this regard is *Bank of America Canada v. Mutual Trust Co.*,⁸⁷ in which the trial court expressed the view that the conduct of the defendant (MT) in making a large number of unmeritorious requisitions for the purpose of gaining tactical advantages was a breach of the duty of good faith, such

⁸⁴ (1994), 20 O.R. (3d) 563, additional reasons (1995), 21 O.R. (3d) 287 (C.A.) [hereinafter *Caruana*].

⁸⁵ *Ibid.* at 572.

⁸⁶ *Ibid.* at 573.

⁸⁷ (1998), 18 R.P.R. (3d) 213 (Ont. Gen. Div.), varied (2000), 30 O.A.C. 149 (C.A.), appeal to S.C.C. on another ground inscribed for hearing, [2000] S.C.C.A. No. 218 [hereinafter *Bank of America*].

breach leading to the conclusion that MT was not entitled to terminate the agreement on the ground that the plaintiff's answers to the requisitions were not satisfactory. This view was stated by Farley J. as follows:

... I find that MT was being given substantially what it had contracted for (although substantially less than it appears that it wished it had bargained for) ... an analysis of the requisitions in the subject case disclosed that they were over and above the "throw in everything" variety but rather they dealt with anything whether or not extraneous to the deal. In my view the requisitions discussed above were truly extraneous to the deal as it stood between MT [the defendant] and the Banks — and it was improper for MT to attempt to introduce such matters, including those elements of side deals with Reemark to which the Banks were not privy or of deals which on reflection MT wished it had not made. It seems to me that the requisitions as made, were made not for the purpose of completing the deal so that the result was substantially what was bargained for, but rather the requisitions were made with the primary and overwhelming purpose of MT attempting to avoid its obligations to fund. That runs completely contrary to the views of the Court of Appeal in *LeMesurier* ...⁸⁸

The Court of Appeal affirmed the result on the issue of whether MT was entitled to terminate the agreement, stating that, as the agreement did not entitle MT to submit the requisitions in issue, MT had "no right to advance [them]" and therefore "no lawful basis to terminate its contractual obligations" in reliance on the fact that the requisitions were not satisfied.⁸⁹ The court also stated that, given this conclusion, it was not "necessary to address the finding by the trial judge that these requisitions were advanced in bad faith and that this provides another reason for concluding that MT cannot rely on the requisitions and the answers to them as a basis for refusing to meet its [contractual obligations]."⁹⁰

⁸⁸ Trial judgment in *Bank of America*, *ibid.* at 268. Farley J. also remarked with respect to the *Caruana* case, *supra* note 84, that, had there been a finding of bad faith supported by the record in that case, then valid requisitions may not have been a basis for the purchaser refusing to complete the transaction (at 270). As noted earlier, the reasoning of Laskin J.A. in *Caruana* appears at least equally consistent with the opposite conclusion.

⁸⁹ Judgment of the Court of Appeal, *supra* note 87 at para. 36.

⁹⁰ *Ibid.* at para. 37.

Based upon *Caruana* and *Bank of America*, there is some chance of a party being found to be in breach of a duty of good faith by submitting a large number of requisitions that are without merit in order to gain strategic advantages, but such a finding may not affect the party's entitlement to terminate an agreement on the basis of at least one valid and material unsatisfied requisition submitted along with invalid ones. The cases also show that, the Ontario Court of Appeal, like other appellate courts in the cases discussed in this paper, appears to prefer to decide cases on bases other than good faith.

(ii) Clauses Stating That Time is of the Essence

Another group of cases in which good faith or a similar concept has been invoked are those where a party purports to rely on the "time is of the essence" clause to terminate a transaction. The Canadian courts that have held that parties were not entitled to rely on such a clause to avoid a transaction tend to focus on the conduct and motive of the party relying on the clause. As will be seen, other courts — the Privy Council and at least one Canadian appellate court — have taken a contrasting approach, which focuses on the contractual rights and obligations of the parties to the contract.

In *Leung v. Leung*,⁹¹ the agreement provided that a second mortgage was to be given back by the vendor and that the mortgage was to be prepared in a registrable form by the purchaser. The agreement also provided that time was of the essence. On the date set for closing, the parties attended at the registry office at 3:30 p.m., but the second mortgage was rejected by the registry office as being not in registrable form. The purchaser's solicitor advised the vendors' solicitor that the problem could be corrected in a few hours, and proposed that the transaction be closed in escrow. The vendors rejected this proposal and terminated the agreement. The second mortgage was in registrable form by 6:00 p.m. the same day. The purchaser sued for specific performance and Yates J. found for the purchaser.

⁹¹ (1990), 75 O.R. (2d) 786 (Gen. Div.) [hereinafter *Leung*].

The grounds for the judgment were, first, that the evidence established that, according to the custom of the real estate practice in Ontario, the word "day" did not mean only the hours during which the registry office was open; and, second, that, in any event, even if the purchaser breached the agreement by failing to tender the mortgage in registrable form by the closing time of the registry office, the vendors were not entitled to rely on the "time of the essence" clause to terminate the contract, as the vendors were under a duty to act in good faith. The duty of good faith meant that the exercise of the power of rescission by a party to a land-sale agreement must not be arbitrary, capricious, or unreasonable, and, further, that, where a party acted contrary to good faith in the performance of the contract, the law precludes the party from relying on the "time of the essence" provision to terminate the contract.⁹² Yates J. reasoned that the vendors and their solicitors in the case acted in bad faith in terminating the contract, as evidenced by a number of actions they took, including the termination on the basis of a minor and technical defect which the purchaser knew could be readily corrected within a short period of time. Yates J. also pointed to the evidence indicating that the vendors were aware of the fact that the real estate market was rising around the time set for closing, stating that it was a reasonable inference from the facts that this was a compelling reason why the vendors refused to close the transaction. Since the vendors were not entitled to rely on the "time of the essence" clause, they were in breach of the agreement. In the result, the purchaser was entitled to specific performance.

A case similar in spirit, though not invoking the concept of good faith expressly, is *Salama Enterprises (1988) Inc. v. Grewal*.⁹³ In *Salama Enterprises*, the parties to the agreement, which provided that the time was of the essence, knew that the purchaser intended to subdivide the land being purchased. At the purchaser's request, the vendors agreed to postpone the completion date. The purchaser was unable to obtain the documents regarding the property which were necessary for

⁹² For these propositions, the court relied on, *inter alia*, *Dynamic Transport Ltd. v. O.K. Detailing Ltd.* (1978), 85 D.L.R. (3d) 19 (S.C.C.).

⁹³ (1992), 90 D.L.R. (4th) 146 (B.C.C.A.) [hereinafter *Salama Enterprises*].

subdivision, and subsequently requested another extension. The vendors refused to grant the second extension request and the transaction did not close. The purchaser brought an action for specific performance. The action was dismissed at trial, but, on appeal, the British Columbia Court of Appeal allowed the appeal. Goldie J.A., on behalf of a three-member majority, reasoned as follows: although normally time remains of the essence even after an extension of the closing date is granted, a court may not give effect to the "time of the essence" clause when giving effect to the clause would lead to unjust or inequitable results; the facts of the case indicated that the contract of sale should be construed as reflecting a common intention to subdivide the land and that the purchaser was to undertake this on behalf of both parties; when the vendors invoked the "time of the essence" clause, they made it impossible for the purchaser to do all that it had agreed it should do in the common interest of the parties; evidence showed that the purchaser had been diligent in its attempt to obtain the necessary documentation; in these circumstances, the court ought not to allow the "time of the essence" clause to stand in the way of the purchaser's performance. Goldie J.A. remarked that "[t]his is the sort of circumstance which makes it unjust or inequitable for a party to insist that time is of the essence ..."⁹⁴

Salama Enterprises was distinguished in *Khangura v. Triple R. Construction Ltd.*⁹⁵ The agreement in that case stated that time was of the essence. The subject property being intended to be subdivided, the parties entered into an addendum to the agreement of purchase and sale. The addendum provided that the purchaser recognized that the building permits might not be available by the proposed closing date, and that the vendor would be entitled to a certain number of extensions of the completion date. The vendor was not able to meet the last extended completion date provided for in the addendum, and the parties agreed to postpone completion by another month. Due to delays caused by the municipality, the building permits were not obtained until two days after the postponed completion date. The purchaser's

⁹⁴ *Ibid.* at 161.

⁹⁵ (1996), 4 R.P.R. (3d) 267 (B.C.S.C.), affirmed (1998), 20 R.P.R. (3d) 60 (C.A.) [hereinafter *Khangura*].

action for a return of the deposit was allowed. Finding that time continued to be of the essence, Davies J. of the British Columbia Supreme Court stated that, in *Salama Enterprises*, it would have been unjust to allow reliance on the essentiality of time because there was a common intention to subdivide the defendant's property, and that that was not the situation in the case at hand. Davies J. further stated: "The defendant anticipated that there may well be delays attributable to the Municipality and protected itself from such delays by the extension period clause in the Addendum to the Contract of Purchase and Sale. Unfortunately, the contractual protection was not as extensive as it should have been ... The plaintiff cannot be faulted for insisting upon his legal rights."⁹⁶

The absence of any reference to good faith in *Salama Enterprises* and *Khangura* underscores the fact that most judgments referring to good faith could have been rendered without reliance on that notion. A useful case to review in this context is a recent decision of the Privy Council in *Union Eagle Ltd. v. Golden Achievement Ltd.*,⁹⁷ which provides an interesting contrast with the approach taken by the Canadian courts. In *Union Eagle*, an agreement of purchase and sale of a flat set out the date, time, and place of completion, as well as providing that time was to be of the essence in every respect of the agreement and that, if the purchaser failed to comply with any of the terms and conditions of the agreement, the deposit would be forfeited as liquidated damages and the vendor would be entitled to rescind the agreement. On

⁹⁶ *Ibid.* at 274. In his annotation of the case in 4 R.P.R. (3d) 268 at 269, J.W. Lem contrasts this case with Ontario cases in which a party was not allowed to rely on their strict contractual rights, and noted that, despite any factual differences between *Khangura* and the Ontario cases, "we may well be witnessing the birth of yet another east vs. west doctrinal debate," as *Khangura* indicates that, unlike in Ontario, "words sometimes mean what they say" in British Columbia. Other cases concerning the "time of the essence" clause include *Vandervliet v. 639708 Ontario Corp.* (1994), 40 R.P.R. (2d) 119 (Ont. Gen. Div.) (the purchaser failed to act in good faith in refusing to close in escrow until the necessary consent of the municipality was obtained); *Morgan v. Lucky Dog Ltd.* (1987), 45 R.P.R. 263 (Ont. H.C.), at 288 ff. (a party causing delays cannot rely on the "time of the essence" clause); and *Watchfield Developments Inc. v. Oxford Elgin Developments Ltd.* (1992), 25 R.P.R. (2d) 236 (Ont. Gen. Div.) (where the closing documents contained minor deficiencies, the purchaser, who would not agree to a short extension of closing or agree to close in escrow, cannot be said to have acted in good faith or taken all reasonable steps to complete the contract, and, therefore, cannot rely on the essentiality of time). Stack, *supra* note 4, comments that the "time of the essence" clause was rendered useless in *Watchfield Developments*.

the closing date, the conveyancing clerk at the vendor's solicitors' office telephoned the purchaser's solicitors and warned that, unless the balance of the purchase price was paid by the time set out in the agreement (5 p.m.), her client would exercise his right to rescind the agreement. The clerk with the purchaser's solicitors telephoned back and confirmed that her client would complete in accordance with the contract. But this had not taken place by 5 p.m., and the vendor's conveyancing clerk telephoned the purchaser's solicitors' office at 5:01 p.m. to say that the money had not arrived and that the vendor reserved the right to rescind and forfeit the deposit. The purchaser's conveyancing clerk replied that a messenger was on his way. As found by the trial judge, the purchaser's messenger arrived at 5:10 p.m. and tendered. The vendor rescinded the agreement and forfeited the deposit. The purchaser brought an action, claiming, *inter alia*, specific performance. The action was dismissed by the High Court of Hong Kong, and the appeal from that decision was dismissed by a majority of the Court of Appeal of Hong Kong. On further appeal, the Privy Council dismissed the appeal.

Lord Hoffmann (noting that the purchaser "refused to accept that so venial a lapse should result in the loss of the contract"⁹⁸) stated that the main point in the appeal was whether the circumstances of the case justified the application of the equitable jurisdiction of the Board to relieve against contractual penalties and forfeitures. Lord Hoffman held that they did not, as "the facts lie well beyond the reach of the doctrine," and stated as follows:

The principle that equity will restrain the enforcement of legal rights when it would be unconscionable to insist upon them has an attractive breadth. But the reasons why the courts have rejected such generalisations are founded not merely upon authority [citation omitted] but also upon practical considerations of business. These are, in summary, that in many forms of transaction it is of great importance that if something happens for which the contract has made express provision, the parties should know with certainty that the terms of the contract will be enforced. The existence of an undefined discretion to refuse to enforce the contract on the ground that this

⁹⁷ [1997] 2 W.L.R. 341 (P.C.) [hereinafter *Union Eagle*].

⁹⁸ *Ibid.* at 343.

would be "unconscionable" is sufficient to create uncertainty. Even if it is most unlikely that a discretion to grant relief will be exercised, its mere existence enables litigation to be employed as a negotiating tactic. The realities of commercial life are that this may cause injustice which cannot be fully compensated by the ultimate decision in the case.⁹⁹

Lord Hoffmann also noted that, for these reasons, the courts in England, although ready to grant restitutionary relief against penalties, have been unwilling to grant relief by way of specific performance against breach of an essential condition as to time, quoting from *Steedman v. Drinkle* the statement of Viscount Haldane that the Courts of Equity "never exercise this jurisdiction where the parties have expressly intimated in their agreement that it is not to apply by providing that time is to be of the essence of their bargain."¹⁰⁰ Lord Hoffman concluded as follows:

The present case seems to their Lordships to be one to which the full force of the general rule applies. The fact is that the purchaser was late. Any suggestion that relief can be obtained on the ground that he was only slightly late is bound to lead to arguments over how late is too late, which can be resolved only by litigation. For five years the vendor has not known whether he is entitled to resell the flat or not. It has been sterilised by a caution pending a final decision in this case. In his dissenting judgment, Godfrey J.A. said that the case "cries out for the intervention of equity." Their Lordships think that, on the contrary, it shows the need for a firm restatement of the principle that in cases of rescission of an ordinary contract of sale of land for failure to comply with an essential condition as to time, equity will not intervene.¹⁰¹

Union Eagle is of note in at least two respects. First, the case was approached as being one about whether equity should intervene to grant relief from the exercise of admitted contractual rights, and not at all about whether the conduct or motive of the non-breaching party should be scrutinized. The judgment contains no reference to good faith or any other duty on the part of the vendor, or possible motives on the part of the vendor in refusing to accept the purchaser's tender. (Although this may have been because the vendor's refusal had no collateral purpose,

⁹⁹ *Ibid.* at 344-345.

¹⁰⁰ *Steedman v. Drinkle*, [1916] 1 A.C. 275 at 279, quoted in *Union Eagle*, *ibid.* at 346.

¹⁰¹ *Union Eagle*, *ibid.* at 348.

or because the vendor's motive was not made an issue in the case, the former seems unlikely and the latter would in itself indicate a major difference in approaches to good faith between Canada and the United Kingdom.) In this respect, *Union Eagle* resembles *Salama Enterprises* and *Khangura*. The second notable aspect of the case is the emphasis placed by Lord Hoffmann on the need for certainty regarding essential contractual rights, which many Canadian courts appear willing to compromise for the sake of making relief based upon good faith available.

Union Eagle thus points to a way of characterizing the Canadian decisions concerning good faith: the courts in those cases in effect determine whether to exercise their equitable jurisdiction and refuse to allow a party to invoke its strict rights under the contract. Many Canadian courts differ from the Privy Council in *Union Eagle* in being willing to exercise such jurisdiction when they deem the conduct of a party to be unreasonable in some way. Thus, the Canadian cases and *Union Eagle* illustrate different approaches to the traditional debate regarding how to balance the need to achieve justice and equity between the litigating parties, on the one hand, and the need to promote certainty of law, on the other.

At least one Canadian appellate court has adopted an approach similar to that of the Privy Council in *Union Eagle* in determining whether a party should be allowed to terminate an agreement in reliance on the "time of the essence" clause. In *Bowlen v. Digger Excavating (1983) Ltd.*,¹⁰² an agreement of purchase and sale of land provided that "[a]ll time periods, deadlines and dates in this Contract will be strictly followed and enforced." The closing date was postponed twice by agreement. (The first postponement was accompanied by the express statement that time remained of the essence, but not the second.) On the second postponed closing date, the real estate agent for both parties spoke with a paralegal at the solicitor's office, seeking a further one-day extension on the purchaser's behalf, but the paralegal had no instructions from the vendors regarding a further extension. The purchaser had not fully performed its obligations under the agreement by the second postponed closing

date. The next day, the vendors' solicitor advised the purchaser's solicitor that no further extension would be permitted, and that the contract was terminated. Later the same day, the purchaser's solicitors advised that the purchaser was prepared to proceed with closing notwithstanding the purported termination of the contract. The transaction did not close, and the purchaser sought an order for specific performance under the contract.

At first instance, specific performance was granted on the ground that it would be inequitable for the vendors to rely on the position that time was of the essence, since, *inter alia*, there had been two prior extensions of time, the purchaser kept the vendors informed of the steps they were taking to conclude the transaction, and the requested extension was for only one day. This decision was reversed by the Alberta Court of Appeal. The Court of Appeal stated that, generally speaking, the party seeking specific performance must be in a position to show that it was ready, willing, and able to perform the agreement, and that, where the parties have stipulated that time is of the essence, the courts will generally not assist the party which has failed to perform on time. The court noted that recent case law requires the party seeking to rely on a time of the essence clause to be acting in good faith, but did not make any further reference to good faith. The court stated that there were two issues on appeal: whether the vendors had by conduct waived the "time of the essence" clause; and whether for some other reason their conduct made it inequitable or unjust for them to rely on that clause.

Finding that time remained of the essence after both extensions, and that the vendors had not waived the "time of the essence" clause, the court stated as follows:

Assuming, without deciding, that the Court has equitable jurisdiction to relieve against a breach of a time clause, beyond the waiver issue, we are of the view that the court should only exercise such discretionary jurisdiction where the evidence establishes that the other parties had conducted themselves in an unfair and unjust

¹⁰² [2001] A.J. No. 1125 [hereinafter *Bowlen*].

manner. While we do not wish to set out any general guidelines at this stage, at the least the party seeking relief must be in a position to show that the conduct of the other party misled him or caused him to act in a manner which resulted in an inability to perform the obligations that he would otherwise have been in a position to perform. Considering all of the circumstances, does the evidence disclose any misconduct on the part of the Bowlens [the vendors] to provide a foundation for the exercise of the jurisdiction?¹⁰³

The court went on to state that the delay had been entirely the fault of the purchaser since the purchaser failed to arrange its affairs so that it would be ready, willing, and able to complete by the date set for closing. With respect to factors relied on by the lower court for its decision (referred to above), the Court of Appeal had the following to say:

The other factors, being the short period of the requested extension and the fact that the purchaser's solicitor kept the vendor informed of their progress, are not relevant considerations. The Chambers Judge considered it significant that the Bowlens had sought and obtained a one-month extension and that Digger had sought and obtained a two-day extension. He noted that Digger then asked for "an additional day, I may say only an additional day" and kept the Bowlens informed of what steps it was taking to conclude the transaction. The fact is, however, that Digger was in essential breach of the Contract, the breach was fundamental, and Digger was not ready, willing and able to complete on the closing date. As noted above, time remained of the essence and a delay of even one day constituted a breach, which gave the Bowlens the option of terminating the agreement.

The party which has fully performed its obligations under a contract is entitled to insist on performance by the other party. Certainty in contracts, especially terms relating to the closing date of contracts for the sale of land is of great commercial importance, and the Court cannot insert itself into the contracting process by extending time for performance absent evidence of relevant misconduct by the innocent party or waiver.¹⁰⁴

Thus, the court's decision was based entirely on whether any conduct of the vendors rendered it unjust for them to rely on the clause. That question, in the court's view, could be answered in the affirmative only if the vendors' conduct misled

¹⁰³ *Ibid.* at para. 24.

¹⁰⁴ *Ibid.* at paras. 27-28 [emphasis added].

the purchaser or caused its inability to perform the obligations that it would otherwise have been in a position to perform. Therefore, the fact that the requested extension was of short duration was irrelevant in determining whether the vendors were entitled to terminate the contract.

The reasoning of the Alberta Court of Appeal in *Bowlen* resembles that in *Union Eagle* in that it frames the issue in terms of the contractual rights and obligations of the parties set out in the agreement rather than in terms of the good faith (or some other analogous) duty on the part of the party exercising its rights under the contract. The *Bowlen* decision thus represents an alternative Canadian approach to that illustrated by cases such as *Leung*.

(iii) Conditional Agreements

It has been held in many cases that an agreement contingent upon the fulfilment of a condition should be interpreted as including a term that the parties will co-operate and use their best efforts to bring about the fulfilment of the condition.¹⁰⁵ While, for the most part, these cases do not refer to good faith expressly, the duty to use best efforts is similar in nature to the duty of good faith.

A recent example of a case concerning a conditional agreement is *Marleau v. Savage*.¹⁰⁶ The agreement of purchase and sale of land in that case was subject to the approval of the Ministry of Health pursuant to nursing home legislation, though the agreement was silent as to which party was responsible for obtaining the approval. The Ministry advised that the review process necessary for the issuance of approval would be postponed indefinitely, and the vendor brought a motion for summary judgment for damages for breach of the agreement. The purchaser brought

¹⁰⁵ Earlier cases setting out this rule include *Dynamic Transport Ltd. v. O.K. Detailing Ltd.*, *supra* note 92 at 28, in which Dickson J. stated that the vendor, who was responsible for obtaining the required subdivision approval, was under a duty to act in good faith and take all reasonable steps to complete the sale; *100 Main Street Ltd. v. W.B. Sullivan Construction Ltd.* (1978), 88 D.L.R. (3d) 1 (Ont. C.A.), at 7 (where an agreement is conditional upon the consent of the mortgagee being obtained, there was an implicit obligation on the purchaser to render reasonable co-operation and comply with the mortgagee's request to disclose financial statements); and *Griffin v. Martens*, *supra* note 30.

a counter-motion for summary judgment for return of the deposit. Aitken J. dismissed both motions, holding that a trial was necessary. Aitken J. stated that the law was clear that, where a condition was inserted in an agreement for the benefit of one party, the party could not take advantage of the condition unless it satisfied the court that it took all reasonable steps or used its best efforts to fulfil the condition. A trial was necessary to assess the credibility of the parties and make findings of fact as to the reasonableness of their actions and positions in all of the circumstances of the case.¹⁰⁷

In *Leibel v. Glenway Land Corp.*,¹⁰⁸ the agreement entered into between the plaintiff builder (the purchaser) and the defendant land developer (the vendor) was conditional on the issuance of building permits from municipal planning authorities. The municipality refused to issue the permits because of certain problems with the development's water system. These problems had to do with a water flow problem with one fire hydrant, and the problem was quickly fixed. The purchaser demanded return of the deposit and failed to pay any further taxes on the property. The solicitors for the defendant vendor notified the plaintiff purchaser that the agreement was terminated because of the purchasers' refusal to pay the taxes. The purchaser brought an action for, *inter alia*, return of the purchase price deposits, and the vendor counter-claimed for the balance owing under the agreement. Both claims were dismissed.

With respect to the purchaser's claim, McRae J. stated that the primary issue was whether the vendor was in breach of the agreement because the municipality refused to grant building permits. McRae J. answered this question in the negative, stating as follows:

To permit the plaintiff to repudiate the contract because of a partially closed valve in one fire hydrant would be unfair to the

¹⁰⁶ (1998), 22 R.P.R. (3d) 70 (Ont. Gen. Div.).

¹⁰⁷ For a similar case, see *Cougs Investments (Pickering) Ltd. v. Forbes*, [1996] O.J. No. 1459 (Gen. Div.).

¹⁰⁸ (1996), 1 R.P.R. (3d) 276 (Ont. Gen. Div.).

defendants and contrary to the spirit of the agreement. The defendants had complied with the servicing requirements as contracted. To release the plaintiff from liability because of the "anomaly" in one fire hydrant, the cause of which is unexplained, and cannot be said to have been caused by the defendant, would make such agreements commercially unviable. The reality is that the plaintiff was desperate to be relieved from an agreement to purchase these lots at a price in excess of their value after the dramatic drop in real estate prices which occurred in late 1989 and early 1990.¹⁰⁹

Therefore, the plaintiff purchaser breached the agreement when it failed to pay the taxes, and the vendors were entitled to terminate the agreement and exercise their rights under the agreement. (However, McRae J. went on the hold that the vendors were not entitled to the balance of the purchase price because their exercise of the option to cancel the agreement and repossess the property extinguished all other claims, including those for damages.)

A different result was reached in *Barg v. Boyd*.¹¹⁰ The agreement in that case was conditional upon the purchaser selling his house. The real estate market declined, and the completion date was postponed twice. The purchaser received an offer on his house at a fair market value, but refused to accept it on the ground that the offer price would not be sufficient to enable him to pay for the new house. The purchaser brought an action, seeking return of the deposit. The purchaser's claim was allowed. McWilliam J. stated that the fundamental issue was whether an obligation can be imposed on the purchaser to accept fair market value when the contract did not require it. McWilliam J. held that it could not be. This was because the obligation of the plaintiff was to make his best efforts to complete the transaction, and to act in good faith in his efforts to fulfil the condition. This meant that the purchaser's budget and expenses could not be ignored; that is, the test was not "totally objective."¹¹¹

¹⁰⁹ *Ibid.* at 283.

¹¹⁰ (1992), 26 R.P.R. (2d) 157 (Ont. Gen. Div.).

¹¹¹ *Ibid.* at 162. See also *737985 Ontario Ltd. v. Essex Sanitary Plumbing & Heating Co.*, *supra* note 54 (an agreement was conditional upon the purchaser obtaining rezoning suitable to the purchaser; the purchaser used its best efforts and proceeded with due diligence to secure rezoning but was unable to do so; the purchaser was entitled to return of the deposit). For discussions on the issue of whether good faith is a subjective or objective notion, see *McCamus*, *supra* note 4 at section 5(b); and *O'Byrne*, *supra* note 4 at 78. In *Griffin v. Martens*, *supra* note 30, Lambert J.A. held that the words

References, if any, in these cases to the duty to act in good faith appear incidental to the analysis based upon the duty to make best efforts. Nevertheless, the commonality between the duty to act in good faith and the duty to make best efforts is obvious, and both duties potentially operate to prevent a party from relying on a conditional clause to terminate the agreement.

D. CONCLUSION: THE STATUS OF THE DUTY OF GOOD FAITH

At the outset of this paper, it was stated that the duty of good faith is generally understood as the obligation of a party to a contract not to act in a manner that is unfair or unreasonable in some sense. The cases reviewed in this paper show that it is not really possible to synthesize them into a more specific and satisfying definition of good faith than this initial statement. The duty of good faith is well established in many specific areas of real property law in Canada, and it is more likely to apply where the conduct of a party to a contract will have consequences contrary to the purpose and operation of the contract as reasonably understood and expected by the parties, especially where such conduct is driven by a motive outside of the contract. Beyond that, the duty of good faith remains a fragmentary concept that can only be assessed in reference to specific types of situations.

Further, the cases indicate that the duty of good faith is currently not a general and independent principle of contractual performance that can in itself form a basis for a cause of action.¹¹² Despite the remark (referred to earlier) in *LeMesurier* that the approach to good faith adopted in that case may be an example of the development of an "independent doctrine of good faith,"¹¹³ many courts have stated that there is no such independent doctrine. Examples include *Crawford v. New*

"satisfactory financing" should be interpreted to mean "satisfactory to a reasonable person with all the subjective but reasonable standards of the particular purchaser."

¹¹² See the discussion on this point in a commentary on *Wallace v. United Grain Growers Ltd.* (1997), 152 D.L.R. (4th) 1 (S.C.C.) by McCamus, *supra* note 4. Professor McCamus concludes that no general obligation to perform contracts in good faith was recognized in *United Grain Growers*, which was a wrongful-dismissal action.

Brunswick, in which Bastarache J.A. stated that "[i]n most cases ... the courts have been reluctant to recognize a distinct cause of action for breach of good faith based on the law of contract";¹¹⁴ and *Mesa Operating Ltd. Partnership v. Amoco Canada Resources Ltd.*, in which the Alberta Court of Appeal stated that "[a] general obligation expressed in terms of good faith is not an obvious part of contract law in England and Canada, although Professor E.P. Belobaba advocates otherwise."¹¹⁵ These statements are consistent with the authorities reviewed in this paper.¹¹⁶

Moreover, as has been noted with respect to many of the cases discussed in this article, often, where the courts relied on the duty of good faith, such reliance was not necessary to the result of the case. This state of the law was aptly described by the court in *NewsWest Corp. v. Glendar Holdings Ltd.*:

Without reviewing the cases or the debate, a fair summary might be that trial courts have been more willing to apply the concept of good faith than have courts of appeal, who for the most part have found other reasons to uphold the trial decisions without a specific reference to the good faith obligation. I agree with the observation of Dr. Fridman in *The Law of Contract* [4th ed.], where at p. 556, he states:

Consideration and comparison of such decisions suggests that, at the present time, it is too soon to conclude that Canadian courts have recognised as a general principle that contracts must be performed in good faith.¹¹⁷

¹¹³ *LeMesurier*, *supra* note 2 at 430. For the previous reference to the remark, see the text following the excerpt accompanying footnote 73.

¹¹⁴ *Supra* note 24 at 219.

¹¹⁵ (1994), 13 B.L.R. (2d) 310 at 319. See also *Schluessel v. Maier* (2001), 85 B.C.L.R. (3d) 239 (S.C.), at 271 (it is not possible to endorse the view that a general duty of good faith exists in law); and *TNL Paving Ltd. v. British Columbia (Ministry of Transportation & Highways)* (1999), 46 C.L.R. (2d) 165 (S.C.), at 257 (there is no general duty to act in good faith necessarily implied in every contract in British Columbia). But see *530888 Ontario Ltd. v. Sobeys Inc.*, [2001] O.J. No. 318 (S.C.J.), at para. 6 in which Lax J. declined to strike the cause of action based upon breach of the duty of good faith, stating that, as it is controversial whether there is (or should be) explicit judicial recognition of an independent good faith doctrine in contract law, it would be wrong to conclude that the claim could not possibly succeed.

¹¹⁶ One exception is the trial judgment in *Gateway*, *supra* note 45. See also *M.A. Hanna Co. v. Sydney Steel Corp.* (1995), 18 B.L.R. (2d) 264 (N.S.S.C.), which concerned a dispute arising in the sale of goods context. The court stated that "[t]he conduct in question also qualifies as a breach of the duty under the contract to conduct affairs in good faith" (at 285), suggesting that the breach gave rise to an independent cause of action.

¹¹⁷ [2001] S.J. No. 419 (Q.B.), at para. 31.

As was observed earlier in the discussion of the *Union Eagle* case,¹¹⁸ the cases show that the duty of good faith has generally been used by the courts in refusing to allow a party to rely on its contractual rights where allowing such reliance appears unfair in some equitable sense. That is, good faith functions as a convenient label in articulating the reasons for such refusal, and, in most cases, such reasons could have been articulated without resorting to the notion of good faith. (For example, the court in *LeMesurier* could have held that the discrepancy in issue was too trivial to come within the purpose of the title and annulment clauses.) It would therefore seem that, at present, not only is good faith not an independent principle, it is also, for the most part, not a necessary concept.¹¹⁹

Still, good faith appears to be an expanding concept, with more and more courts (no doubt pressed by the parties) addressing it in some manner, and it is quite possible that the reach of the duty of good faith will grow wider and more general.

¹¹⁸ *Supra* note 97.

¹¹⁹ A related issue is whether the implied duty of good faith has its basis in the intention of the parties to contracts or a rule of law. Helpful discussions on this point are found in McCamus, *supra* note 4 at section 5; O'Byrne, *supra* note 4 at 77ff.; and Stack, *supra* note 4. Professor McCamus concludes that "it may be realistic to assume that implied duties of good faith are likely, on occasion at least, to slide into the category of legal incidents rather than mere presumed intentions" (at section 5(c)), and Professor O'Byrne that "until the matter is litigated from a common law perspective before Canada's highest court, it is simply uncertain whether the good faith doctrine will be imposed by operation of law or by virtue of contractual interpretation only" (at 84).