IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation: *Eisler v. Connor, Clark & Lunn Financial Group Ltd.*, 2021 BCSC 1280

Date: 20210630
Docket: S208952
Registry: Vancouver

Between:

David Eisler and Michael Martin

Petitioners

And

Connor, Clark & Lunn Financial Group Ltd.

Respondent

Before: The Honourable Mr. Justice N. Smith

Reasons for Judgment

In Chambers

Counsel for Petitioners:	H. Mickelson, Q.C. A. Doolittle N. John
Counsel for Respondent:	L. Herbst, Q.C. V. Luxford
Place and Date of Hearing:	Vancouver, B.C. April 21–23, 2021
Place and Date of Judgment:	Vancouver, B.C. June 30, 2021

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INTRODUCTION

[1] The petitioners, David Eisler and Michael Martin, apply for leave to appeal an arbitration award arising out of a dispute with their former employer.

[2] The petitioners were employed by the respondent Connor, Clark & Lunn Financial Group Ltd. ("CC&L") as investment consultants. Their job included identifying, implementing and managing private equity investments for CC&L and its clients. When their employment was terminated, they entered into settlement agreements with CC&L under which they continued to receive income from investments they had been responsible for.

[3] A dispute arose about which investments were subject to the settlement agreements and the parties agreed to submit the matter to arbitration. The arbitrator ultimately found that the petitioners' contractual entitlement to any continuing income had ended when CC&L reorganized the limited partnership holding the relevant investments. However, CC&L agreed to continue paying some of the income the petitioners were claiming and that agreement was included in the arbitration award.

[4] In order to obtain leave, the petitioners must show that the proposed appeal raises an extricable question of law, as opposed to a question of fact or mixed fact and law. They allege an error of law in the arbitrator's definition of the contractual duty of good faith. CC&L says the petitioners did not rely on that issue before the arbitrator. Even if they did, CC&L says the arbitrator did not define the duty of good faith in the way the petitioners allege and made no legal error.

THE PETITIONERS' EMPLOYMENT AND TERMINATION

[5] Mr. Eisler and Mr. Martin joined CC&L in 2000 and 2005, respectively. They joined as "operating partners" for Banyan Capital Partners, a brand name under which CC&L conducted its private equity business. That business initially consisted of large investments funds that acquired interests in a variety of companies. Investors—typically large institutions—bought limited partnership units in a fund managed by a general partner. The general partner received management fees

along with a share of the fund's profits. CC&L was the majority owner of the general partner, but the petitioners also held shares in it and income from those holdings formed part of their compensation from CC&L.

[6] In 2010, CC&L established a "new model" of private equity investment. Instead of large funds that might own a number of unrelated companies on a relatively short-term basis, CC&L began to create smaller "single purpose" funds. Each of those funds would make long-term investments in a specific, previously identified business or industry. The smaller capital required for those single purpose funds made it possible for wealthy individuals to participate along with institutional investors.

[7] With the creation of the new model, the petitioners entered into a new employment agreement (the "2010 agreement"). Instead of owning shares in the general partner, the petitioners would acquire a "vested" right to an annual share of "Total Net Investment Income" ("TNII") on private equity investments. The details of the formula under which TNII was calculated are not relevant to this application.

[8] The 2010 agreement also provided that if CC&L terminated the petitioners' employment without cause, 50% of the total TNII "in respect of investments closed during the time of their employment by CC&L will vest immediately".

[9] In or about 2012, the petitioners identified and secured an investment in two related Alberta-based companies: Oakcreek Golf and Turf ("OCGT") and Golf Lease Inc. ("GLI"). The two companies, sometimes referred to collectively as the "Oakcreek Platform Investment", were the exclusive Western Canada distributors of Toro brand commercial turf care equipment and irrigation systems, as well as certain other products. A limited partnership called "Banyan Capital Partners Fund IV LP" ("Fund IV"), was established to acquire an 88% interest in the two companies.

[10] The arbitrator found that the purchase of OCGT and GLI was the very kind of "platform investment" anticipated by the 2010 agreement. While OCGT/GLI's business distributing Toro commercial equipment in Western Canada was expected

to be “low-growth,” it was anticipated there could be future opportunities for expansion by acquiring the business of Toro distributors in other regions.

[11] In 2014, CC&L terminated the petitioners’ employment without cause and the petitioners negotiated settlement agreements on substantially the same terms. The key passage of those agreements, for the purposes of these proceedings, reads:

> In accordance with the terms of the [2010 Agreement], 50% of the Total Net Investment Income generated in respect of investments closed during the Consultant’s employment with CC&L…has vested…

[12] The effect of that provision was to give the petitioners an ongoing right to receive income from the investments in which they had been involved. The only relevant investment at the time of their termination was Fund IV, which held the Oakcreek Platform Investment. The petitioners received income from that source, with no dispute about the amount, for the years 2014 through 2016.

THE SUBSEQUENT INVESTMENT AND RE-ORGANIZATION

[13] In 2017, an opportunity arose for OCGT and/or CC&L to acquire an Arizona-based company called Simpson Norton, which was also in the business of selling and servicing turf equipment, including Toro products. Instead of acquiring Simpson Norton as an addition to Fund IV’s existing investment in that industry, CC&L decided to first re-organize the Oakcreek Platform investment.

[14] Through a series of transactions, the existing investment in OCGT/GLI was transferred from Fund IV to a new limited partnership (“New Fund”) which then acquired Simpson Norton. Investors in Fund IV were given the option of selling their units for cash or exchanging them for units in New Fund. In the result, Fund IV was left with no assets and was dissolved.

[15] In addition to their entitlement under the settlement agreements, the petitioners each owned a personal corporation that held limited partnership units in Fund IV. In that capacity, they consented to the reorganization, while purporting to reserve their rights under the 2010 agreement and the settlement agreements.

[16] For the years 2017 and 2018, CC&L made payments to the petitioners calculated on the basis of revenues from OCGT/GLI, but not including revenues from Simpson Norton. The Petitioners asserted that the acquisition of Simpson Norton was an extension of the initial investment in OCGT/GLI, which had been made with a view to such expansion within the industry. They said they were therefore entitled to share in income generated by the entire enterprise. This was the issue the parties agreed to submit to arbitration.

THE ARBITRATION AWARD

[17] The primary issue before the arbitrator, and the subject of the most lengthy analysis in the arbitration award (comprising 72 of the 97 paragraphs under the heading "Analysis"), was the meaning of the phrase "investments closed" in the settlement agreements.

[18] CC&L argued that "investment" referred to a particular business acquired by the fund during the petitioners' employment. That meant the petitioners could not benefit from additions to a fund's holdings made after their termination. For that reason, CC&L said, the petitioners could only share in income generated by OCGT/GLI and not in the additional income coming from Simpson Norton.

[19] The petitioners argued that "investment" referred to a fund established during their employment (Fund IV), rather than to the individual companies in which the fund invested. Because the fund was created with a view to acquiring further related investments, they said they were entitled to share in the fund's income from all sources.

[20] On that issue of contractual interpretation, the arbitrator found for the petitioners. He held that, in the 2010 agreement, the parties had anticipated that the value of an initial investment made by a fund could be increased by further acquisitions within the same industry:

> [147]… In the context of a plan to engage in long-term platform investments that might grow through incremental acquisitions in the same industry sector, an agreement that the Claimants would acquire a vested interest not only in revenue from the initial platform investment but also in revenue resulting from

> later acquisitions, makes commercial sense. This is so because, even if the Claimants had no direct involvement in the later acquisition (due to employment termination without cause), incremental revenues from post-closing acquisitions by a Fund in the same industry segment by levering off of the initial platform investment, are also manifestations of the value of the initial investment.

[21] The arbitrator found that the same interpretation governed the 2014 settlement agreements, which meant the petitioners could benefit from expansion of a fund's holdings that occurred after their termination:

> [179] As a result, I find that the phrase "Total Net Investment Income generated in respect of investments closed during the Consultant's employment with CC&L" as used in Section 2 of the 2014 Settlement Agreements refers to the TNII in respect of any New Model Fund established during the Claimants' employment, including not only TNII attributable directly to the initial platform investment but also TNII attributable to Add-On Investments by that Fund, whether the Add On Investments were made before or after the termination of the Claimants' employment.

[22] Although that finding favoured the petitioners, the arbitrator then turned to an alternative argument advanced by CC&L. If "investments closed" refers to a fund, CC&L argued, the relevant holdings were now in a fund created after the petitioners' termination (New Fund) and the fund established during their employment (Fund IV) no longer existed.

[23] The logical result of that position would be that the petitioners were not entitled to income from either OCGT/GLI or Simpson Norton, but CC&L did not ask the arbitrator to go that far. The arbitrator said:

> [101] If its alternative argument is accepted, however, CC&L "has not asked the Arbitrator to find that the Claimants have no entitlement to income in respect of OCGT and GLI." CC&L explains that it takes this position in part because they would consider it to be unfair given the work done by the Claimants in sourcing and closing the acquisition of OCGT/GLI.
>
> [102] As a consequence if the alternative argument is accepted, it would not preclude CC&L from sharing in TNII in respect of New Fund's Investment in OCGT/GLI but would bar the Claimants' claim to TNII in respect of any other New Fund investments, including Simpson Norton.

[24] The arbitrator noted, while dealing with the first contractual interpretation issue, that the 2010 agreements contained no mechanism to allocate revenues and

expenses between different investments held by a single fund. The 2014 settlement agreements include what the arbitrator described as a "general" provision for disputes concerning "calculation" of TNII to be referred to a major accounting firm for binding determination, but that provision does not expressly deal with allocation between different investments.

[25] The petitioners objected on procedural grounds to the alternative argument being considered, but the arbitrator dismissed that objection, finding that it was open on the pleadings. He then found that, on the basis of the contractual interpretation the petitioners had advocated and that he had accepted, the petitioners had no claim to income from New Fund:

> [199] If Simpson Norton had been acquired by Fund IV, then the TNII of Fund IV would have included TNII generated by Simpson Norton, and the Claimants would have had their share of that TNII. But Simpson Norton was acquired by New Fund. Whether there is a contractual entitlement to a share of TNII generated by Simpson Norton is not determined by whether it is or is not an Add-On Investment. It is determined by whether Simpson Norton is acquired and held by Fund IV. As described above, the Claimants do not allege any impropriety in CC&L's decision to have New Fund, rather than Fund IV, acquire Simpson Norton.
>
> [200] In summary, for the reasons I have stated I find that the Claimants have no contractual entitlement under the 2010 Agreement or 2014 Agreements to TNII in respect of New Fund. Their entitlement under those agreements was limited to TNII in respect of Fund IV.

[26] The arbitrator also referred to the fact that the petitioners, in their separate capacity as principles of individual corporate unit holders, had consented to the reorganization while reserving their rights under the 2010 agreement and the settlement agreements. He found that reservation of rights did not create any new contractual rights in respect of New Fund.

[27] The resulting award (described as a partial final award because the arbitrator had not yet dealt with costs) is as follows:

> a. I declare that CC&L has agreed that the Claimants are entitled to TNII generated in respect of OCGT and GLI, but not to TNII generated by Simpson Norton or any other investment of New Fund; and
>
> b. The Claimants' request for an award declaring that the Claimants are entitled to a calculation of TNII based on all distributions and Management

> Fees, as evidenced by the audited financial statements, by New Fund or any other structure holding the Oakcreek platform investment is dismissed.

[28] The net result of the arbitrator's reasoning and decision is:

- CC&L could have acquired Simpson Norton as part of Fund IV in accordance with the intention to expand through "synergistic" acquisition of similar or related businesses. If it had done so, the petitioners would have been entitled to share in TNII generated by both OCGT/GLI and Simpson Norton, as well as any further acquisitions by Fund IV.

- Alternatively, CC&L could have left OCGT/GLI in Fund IV while acquiring and holding Simpson Norton in a separate fund, although that may not have been consistent with the idea of expanding the initial investment through related acquisitions. In that case, the petitioners would have no claim to income from Simpson Norton, but would have been entitled to continue receiving income from OCGT/GLI.

- In fact, CC&L acquired Simpson Norton in the separate New Fund, but retained the benefits of "synergistic" acquisition of related businesses by also transferring OCGT/GLI into New Fund. The logical and legal effect of this would deprive the petitioners of any continued income, although CC&L agreed, as a matter of "fairness," to not seek that result and to continue paying income derived from OCGT/GLI.

THE ALLEGED LEGAL ERROR

[29] The petitioners argue that CC&L, by its unilateral action in reorganizing the funds, deprived the petitioners of the benefit of the settlement agreements and thereby breached its contractual duty of good faith. On that issue, the arbitrator stated:

> [192] In their post-hearing submission and oral argument, the Claimants finally confirmed that they do not allege a breach of a duty of honesty or a duty of good faith. The Claimants made clear that they do not contend that

> CC&L exercised its business judgment dishonestly or in bad faith by structuring the acquisition of Simpson Norton through a New Fund.

[30] The petitioners say the error of law on which they seek to base their appeal is contained in that paragraph. Although they conceded there had been no dishonesty on the part of CC&L, they say a finding of dishonesty is not necessary to establish a breach of the duty of good faith and they did not abandon reliance on that duty.

[31] The petition states the question of law on which the petitioners seek leave to appeal as:

> Did the Arbitrator err in failing to apply the correct legal test for breach of the duty of good faith where one party has eviscerated the benefit of the contract for the other?

[32] In argument, counsel for the petitioners rephrased the question as:

> Did the Arbitrator err in failing to apply the correct legal test for breach of the duty of good faith by requiring, as a prerequisite, dishonesty or *mala fides*?

[33] The rephrasing of the proposed question is intended to more closely reflect the law of good faith as characterized by the Supreme Court of Canada in *Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage District*, 2021 SCC 7 [*Wastech*], which was released after the arbitration award and after the petition was filed.

THE COURT'S JURISDICTION

[34] This arbitration was commenced under the former *Arbitration Act,* R.S.B.C. 1996, c. 55 [*Act*]. That statute still governs this case, although it has since been repealed and replaced by a new *Arbitration Act*, S.B.C. 2020, c. 2. Section 31 of the *Act* provides:

> **Appeal to the court**
>
> (1) A party to an arbitration … may appeal to the court on any question of law arising out of the award if
>
> (a) all of the parties to the arbitration consent, or
>
> (b) the court grants leave to appeal.

> (2) In an application for leave under subsection (1)(b), the court may grant leave if it determines that
>
> (a) the importance of the result of the arbitration to the parties justifies the intervention of the court and the determination of the point of law may prevent a miscarriage of justice,
>
> (b) the point of law is of importance to some class or body of persons of which the applicant is a member, or
>
> (c) the point of law is of general or public importance.

[35] The law setting out the court's limited jurisdiction pursuant to s. 31 of the *Act* and the basis on which it can be exercised was concisely summarized by Justice Douglas in *Allard v. The University of British Columbia,* 2021 BCSC 60 at paras. 13–21:

> [13] Three distinct requirements must be satisfied before leave to appeal can be granted under the *Arbitration Act*:
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> i. The appeal must be based on a question of law arising from the Award (s. 31(1));
>
> ii. It must relate to a matter of importance (s. 31(2)); and
>
> iii. The leave judge must be prepared to exercise the court's residual discretion to grant leave (*MSI Methylation Sciences, Inc. v. Quark Venture Inc.*, 2019 BCCA 448 at para. 54 [*MSI*]).
>
> [14] The test for leave to appeal an arbitration award is not easily met: *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53 at paras. 38–40 [*Sattva*]. Courts must show due respect for the parties' decision to arbitrate and the commercial arbitral process: *TELUS Communications Inc. v. Wellman*, 2019 SCC 19 at paras. 54–56 [*TELUS*]. The modern "hands off" view is that arbitration is an autonomous, self-contained, and self-sufficient process where parties agree to have their disputes resolved by an arbitrator, not the courts: *TELUS*, at para. 56.
>
> [15] The limited jurisdiction of courts to hear arbitral appeals promotes efficiency and finality, the central aims of commercial arbitration: *Teal Cedar Products Ltd. v. British Columbia*, 2017 SCC 32 at para. 1 [*Teal Cedar*]. As noted by our Court of Appeal in *Boxer Capital Corporation v. JEL Investments Ltd.*, 2015 BCCA 24 at para. 3 [*Boxer*], commercial arbitration is intended to provide a speedy and, in the vast majority of cases, final determination of the parties' dispute.
>
> [16] Identifying a question of law for appellate review is a threshold requirement for granting leave: *Arbitration Act*, s. 31(1); *Teal Cedar*, at para. 1. This Court has no jurisdiction to review questions of either fact or mixed fact and law. Delineating a question of law is particularly important in the context of an arbitral review in BC "because it goes beyond the question of standard of review to the very jurisdiction of the court to embark on the review process": *MSI*, at para. 62. A court must grant leave only when

> questions of law can be clearly perceived and delineated: *Elk Valley Coal Partnership v. Westshore Terminals Ltd.*, 2008 BCCA 154 at para. 17; *Teal Cedar*, at para. 45; *Sattva*, at para. 54. Finding that the questions on appeal are not questions of law wholly disposes of this Court's jurisdiction to review them: *Teal Cedar*, at para. 42.
>
> [17] Legal questions are questions "about what the correct legal test is". Factual questions are "about what took place between the parties". Questions of mixed fact and law are about whether the facts satisfy the legal test" (i.e., the application of a legal standard to a set of facts): *Teal Cedar*, at para. 43; *Sattva*, at para. 49; *Canada (Director of Investigation and Research) v. Southam Inc.*, [1997] 1 S.C.R. 748 at para. 35 [*Southam*]; *Housen v. Nikolaisen*, 2002 SCC 33 at paras. 26–27.
>
> [18] Because contractual interpretation involves an application of the principles of contractual interpretation to the words of a contract in light of the surrounding factual matrix, it almost always involves questions of mixed fact and law: *Sattva*, at para. 50; *Teal Cedar*, at para. 47. Leave will rarely be granted to appeal an arbitral award on a question of contractual interpretation: *Boxer*, at para. 9; *Sattva*, at para. 55.
>
> [19] Extricable legal errors made in the course of contractual interpretation include "the application of an incorrect principle, the failure to consider a required element of a legal test, or the failure to consider a relevant factor": *Sattva*, at para. 53. A fundamental principle of contractual interpretation is that a contract must be construed as a whole: *Sattva*, at para. 64. If an arbitrator ignores a specific and relevant provision in construing a contract, that is a question of law that would be extricable from a finding of mixed fact and law: *Sattva*, at para. 64.
>
> [20] In the arbitration context, courts must be cautious when extricating questions of law from questions of mixed fact and law. In seeking leave to appeal, aggrieved parties will often frame alleged errors as questions of law, thereby circumventing the finality of the arbitral award: *Sattva*, at para. 54. As Justice Gascon cautioned in *Teal Cedar*, at para. 45, "[c]ourts must be vigilant in distinguishing between a party alleging that a legal test may have been altered in the course of its application (an extricable question of law [citations omitted]), and a party alleging that a legal test, which was unaltered, should have, when applied, resulted in a different outcome (a mixed question)".
>
> [21] Where the legal principle is not readily extricable, the matter remains one of "mixed fact and law": *Sattva*, at paras. 54–55. The leave judge must ultimately ensure that the proposed ground of appeal has been properly characterised. Only questions of law or extricable questions of law will meet the statutory threshold under s. 31(1) of the *Act*.

THE LAW OF GOOD FAITH

[36] In *Bhasin v. Hyrnew,* 2014 SCC 71, the Supreme Court of Canada discussed the general "organizing principle" of good faith, which may underlie and apply to a variety of contractual relationships and situations:

> [63] The first step is to recognize that there is an organizing principle of good faith that underlies and manifests itself in various more specific doctrines governing contractual performance. That organizing principle is simply that parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily.
>
> [64] As the Court has recognized, an organizing principle states in general terms a requirement of justice from which more specific legal doctrines may be derived. An organizing principle therefore is not a free-standing rule, but rather a standard that underpins and is manifested in more specific legal doctrines and may be given different weight in different situations: see, e.g., *R. v. Jones*, [1994] 2 S.C.R. 229, at p. 249; *R. v. Hart*, 2014 SCC 52, [2014] 2 S.C.R. 544, at para. 124; R. M. Dworkin, "Is Law a System of Rules?", in R. M. Dworkin, ed., *The Philosophy of Law* (1977), 38, at p. 47. It is a standard that helps to understand and develop the law in a coherent and principled way.
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> [65] The organizing principle of good faith exemplifies the notion that, in carrying out his or her own performance of the contract, a contracting party should have appropriate regard to the legitimate contractual interests of the contracting partner. While "appropriate regard" for the other party's interests will vary depending on the context of the contractual relationship, it does not require acting to serve those interests in all cases. It merely requires that a party not seek to undermine those interests in bad faith. This general principle has strong conceptual differences from the much higher obligations of a fiduciary. Unlike fiduciary duties, good faith performance does not engage duties of loyalty to the other contracting party or a duty to put the interests of the other contracting party first.
>
> [66] This organizing principle of good faith manifests itself through the existing doctrines about the types of situations and relationships in which the law requires, in certain respects, honest, candid, forthright or reasonable contractual performance. Generally, claims of good faith will not succeed if they do not fall within these existing doctrines. But we should also recognize that this list is not closed. The application of the organizing principle of good faith to particular situations should be developed where the existing law is found to be wanting and where the development may occur incrementally in a way that is consistent with the structure of the common law of contract and gives due weight to the importance of private ordering and certainty in commercial affairs.

[37] The Court said that general organizing principle gives rise to a specific duty of honesty in contractual performance:

> [73] ... I would hold that there is a general duty of honesty in contractual performance. This means simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract. This does not impose a duty of loyalty or of disclosure or require a party to forego advantages flowing from the contract; it is a simple requirement not to lie or mislead the other party about one's contractual performance. Recognizing a duty of honest performance flowing

> directly from the common law organizing principle of good faith is a modest, incremental step. The requirement to act honestly is one of the most widely recognized aspects of the organizing principle of good faith.

[38] *Bhasin* therefore has two branches—a specific duty of honesty and a more general principle of good faith that may govern contractual performance in a broader range of circumstances. That was confirmed by the Supreme Court of Canada in *Wastech*, which will be discussed below.

[39] Even before *Bhasin*, there was a line of authority that a party cannot exercise discretion under a contract to “nullify” or “eviscerate” the benefits the other party reasonably expected to obtain. Before the arbitrator, the petitioners referred to *Mesa Operating Limited Partnership v. Amoco Canada Resources Ltd.,* 1994 ABCA 94, where the court said at para. 22:

> [22] The rule that governs here can, therefore, be expressed much more narrowly than to speak of good faith, although I suspect it is in reality the sort of thing some judges have in mind when they speak of good faith. As the trial judge said, a party cannot exercise a power granted in a contract in a way that "substantially nullifies the contractual objectives or causes significant harm to the other contrary to the original purposes or expectations of the parties."

[40] Similarly, in *Transamerica Life Canada Inc. v. ING Canada Inc*. (2003), 234 D.L.R. (4th) 367 (O.N.C.A.) at para. 53 , the Ontario Court of Appeal said:

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

[41] In *Wastech*, the Supreme Court of Canada rejected “evisceration” as a determinative test for bad faith, although it may be relevant. The *Wastech* case, as decided at different stages, is critical to this matter and needs to be addressed in some detail.

[42] As it happens, *Wastech* arose out of a decision by the same arbitrator who decided this case. It involved a contract under which Wastech Services transported municipal waste to three disposal facilities. Wastech Services was paid according to rates that varied with the travel distance to each site. The district (referred to as "Metro") reallocated waste distribution in a way that reduced Wastech Services' opportunity to earn the higher "long haul" rates. That affected a "target operating ratio" referred to in the contract and reduced Wastech Services' profit. The arbitrator found that Metro had exercised its discretion under the contract in way that breached the duty of good faith.

[43] Metro sought leave to appeal under s. 31 of the *Act* and Justice Fitzpatrick, in reasons indexed at 2016 BCSC 68, found that there was a pure question of law concerning the scope of the good faith doctrine. She said at para. 59:

> [59] The issue that does arise is whether the Arbitrator's decision that the duty of good faith applied in these circumstances and that Metro breached this duty can now be appealed by Metro. It is true that the Arbitrator's decision was based on his findings of fact and interpretation of the [contract]. However, his characterization of the duty of good faith is a question of law that satisfies the requirements of s. 31(1) of the *Act*.

[44] The decision to grant leave was upheld by the Court of Appeal in reasons indexed at 2016 BCCA 393.

[45] Metro's appeal was subsequently allowed on the merits (indexed at 2018 BCSC 605) and that decision was upheld by the Court of Appeal in reasons indexed at 2019 BCCA 66. At the time of the award in this case, the Court of Appeal's decision in *Wastech* was the leading authority binding on the arbitrator on the concept of good faith in the exercise of contractual discretion. The court found that the arbitrator had made four errors, two of which are particularly relevant here:

> [74] For the foregoing reasons, I conclude that the questions posed for the Court must be answered in the affirmative and that more particularly, the arbitrator erred in law in:
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> …
>
> (3) effectively concluding that the duty of good faith is breached whenever a contracting party fails to have "appropriate regard" for the other, in circumstances where the

> agreement has not been found to have been "nullified" or "eviscerated"; and
>
> (4) finding "dishonesty" and thus a breach of the duty of good faith on Metro's part without any subjective element of dishonesty, improper motive (under which I would include "seeking to undermine" the interests of the other party), or bad faith as understood in existing law.

[46] On the specific question of the relationship between good faith and honesty, Justice Newbury said at para. 71:

> [71] This brings me to what I see as another error of law that is implicit in both questions of law that were posed for the Court. I refer to the arbitrator's conclusion that:
>
> > … the good faith doctrine characterizes the exercise of even an acknowledged, bargained-for contractual right as "dishonest" where it is wholly at odds with the legitimate contractual expectations of the other party. No additional form of dishonesty is required to be shown. [At para. 90; emphasis added.]
>
> Again with due respect to the contrary view, I read *Bhasin* as concerned substantially with conduct that has at least a subjective element of improper motive or dishonesty. I note that in [*Gateway Realty Ltd. v. Arton Holdings Ltd. (No. 3)* (1991), 106 N.S.R. (2d) 180 (S.C.T.D.)], for example, Kelly J. stated that "good faith conduct" is breached "when a party acts in 'bad faith' – a conduct that is contrary to community standards of honesty, reasonableness or fairness." (At 197.) In other areas of the law, both "bad faith" and "dishonesty" connote malice, untruthfulness, ulterior motive or, in the words of Mr. Justice Bastarache (as he then was) in *Crawford v. New Brunswick (Agricultural Development Board)* (1997) 192 N.B.R. (2d) 68 (C.A.), other "intentional conduct equivalent to fraud." Bad faith is also made out where the conduct in question is so reckless that "absence of good faith can be deduced and bad faith presumed. The act, in terms of how it is performed, is then inexplicable and incomprehensible, to the point that it can be regarded as an actual abuse of power, having regard to the purposes for which it is meant to be exercised": *Finney v. Barreau du Québec* 2004 SCC 36 at 39 *per* LeBel J.

[47] The Supreme Court of Canada dismissed Wastech Services' appeal. The Court confirmed that a breach of the duty of good faith can be found in the absence of actual dishonesty, but such a finding must depend on the purpose for which a party was given discretion under the contract:

> [69] Thus, beyond the requirement of honest performance, to determine whether a party failed in its duty to exercise discretionary power in good faith, one must ask the following question: was the exercise of contractual discretion unconnected to the purpose for which the contract granted

> discretion? If so, the party has not exercised the contractual power in good faith.

[48] In determining whether such a breach has occurred, the fact that the benefit of the contract has been "nullified" or "eviscerated" is not determinative, although it may be important evidence:

> [88] In sum, then, the duty to exercise discretion in good faith will be breached where the exercise of discretion is unreasonable, in the sense that it is unconnected to the purposes for which the discretion was granted. This will notably be the case where the exercise of discretion is capricious or arbitrary in light of those purposes because that exercise has fallen outside the range of behaviour contemplated by the parties. The fact that the exercise substantially nullifies or eviscerates the fundamental contractual benefit may be relevant but is not a necessary pre-requisite to establishing a breach.

[49] The combined effect of *Bhasin* and *Wastech* is therefore to confirm the existence to two separate duties in contractual performance, both underpinned by the organizing principle of good faith. One is the duty of honesty. The other is a duty to exercise discretion under a contract in a manner connected to the purpose for which the discretion was given.

WAS GOOD FAITH AN ISSUE BEFORE THE ARBITRATOR?

[50] In considering whether the petitioners have raised an issue of law on which leave to appeal can be granted, the first question is whether the duty of good faith issue was actually before the arbitrator.

[51] It appears from the written arguments made by the parties and from the arbitrator's reasons that the principle focus of the arbitration was on whether proper interpretation of the settlement agreements gave the petitioners a claim to income derived from Simpson Norton. CC&L conceded that the petitioners were entitled to continued income generated by OCGT/GLI.

[52] The alternative argument—that there was no longer a fund contemplated by the settlement agreements—was clearly treated as a secondary issue. However, the petitioners' written submissions to the arbitrator included the following:

> [254] CC&L was, at a minimum, under a contractual duty of good faith not to rely on its ability, fully at its own discretionary control, to use a non-arms' length reorganization in a way that extinguishes or limits TNII. Any such reliance has the effect of depriving the [Petitioners] of the benefit they bargained for – i.e. <u>all</u> growth of the Fund by way of add-on acquisition to the Oakcreek Platform Investment held by Fund IV. As CC&L's alternative argument relies on the Reorganization for that purpose and so is premised on a breach of CC&L's duty of good faith, it must be rejected.

[53] That paragraph cited *Mesa*, basing the argument on the "nullification" or "evisceration" approach that the Court of Appeal had, at the time of the arbitration, recognized in *Wastech*. While CC&L points out that this was only one paragraph of a 268-paragraph submission, in my view nothing turns on this given the secondary nature of CC&L's alternative argument, in addition to the good faith issue itself being a secondary defence to the alternative argument.

[54] CC&L relies in part on a statement made by the arbitrator during oral argument in an exchange with counsel for CC&L. The arbitrator said:

> THE ARBITRATOR: I'd just like to say in this area I do not understand Mr. Mickelson [counsel for the petitioners] to be arguing, or I understand him to be saying now that CC&L's discretion about whether to use a new fund or an old fund or some sort of combination thereof is not fettered by any contractual obligation or good faith obligation owed to your clients, and that the expectation was that rational business judgement and self-interest would prevail, and the submission is that's what happened in this case.

[55] Counsel for CC&L argues that if the arbitrator's understanding of the petitioners' position was incorrect, their counsel was obliged to intervene at that point or, at least deal with matter in reply, but failed to do so. I agree that would have been preferable, but I do not find that counsel's silence alone can be taken as an abandonment of the issue in the face of the clear statement of it contained in the written argument.

[56] I therefore find that the issue of good faith was before the arbitrator and I am not persuaded that the petitioners abandoned it.

<u>QUESTION OF LAW ARISING FROM AWARD: s. 31(1)</u>

[57] I return to the passage in the arbitration award that the petitioners focus on:

> [192] In their post-hearing submission and oral argument, the Claimants finally confirmed that they do not allege a breach of a duty of honesty or a duty of good faith. The Claimants made clear that they do not contend that CC&L exercised its business judgment dishonestly or in bad faith by structuring the acquisition of Simpson Norton through a New Fund.

[58] A few paragraphs later, the arbitrator said:

> [199] … As described above, the Claimants do not allege any impropriety in CC&L's decision to have New Fund, rather than Fund IV, acquire Simpson Norton.

[59] CC&L says the arbitrator's reference to "a breach of a duty of honesty or a duty of good faith" should be read as a reference to both branches of the *Bhasin/Wastech* analysis. I find this interpretation fails to consider the discrete paragraph of the arbitrator's reasons in context and in relation to the legal landscape at the time. The arbitrator's brief statement must be considered in light of what Court of Appeal had, at the time, said in *Wastech*. That decision placed a particular emphasis on "a subjective element of improper motive or dishonesty" in considering the duty of good faith.

[60] CC&L also argues that the arbitrator's two sentences in para. 192 of the award are not necessarily connected; it argues that because the arbitrator did not expressly say something to the effect of "because the petitioners did not claim dishonesty, they did not claim breach of a duty of good faith", the arbitrator did not engage in that reasoning. I again disagree with this interpretation and reject the idea that the legal question identified by the petitioners does not "arise out of the award": *Act*, s. 31(1). It is clear in my reading of the specific paragraph and the award as a whole that the arbitrator connected the petitioners' admission that there was no allegation of dishonesty with the petitioners' argument on the duty of good faith. If the arbitrator was considering the duty of good faith beyond a question of dishonesty I am not convinced that he would have simply rejected it without some reasoning and analysis on that point.

[61] When the arbitrator's statement is placed in proper context, I find for the purposes of this leave application that he failed to distinguish the duty of honest

performance from the broader doctrine of good faith and therefore concluded the issue of good faith was not before him because the claimants conceded there had been no subjective dishonesty. I conclude that raises a question of law—whether the correct legal test was applied—and that the question of law arises out of the award. A question of law need not be explicit in the award to meet the requirements of s. 31(1): *MSI Methylation Sciences, Inc. v. Quark Venture Inc.,* 2019 BCCA 448 at para. 72(b).

[62] The arbitrator did not have the benefit of the Supreme Court of Canada's decision in *Wastech*, but that would not necessarily preclude it being considered on an appeal. When a decision of the Supreme Court of Canada restates the common law, an appellate court may be bound to apply its approach although it did not exist at the time of the decision under appeal: *The Owners, Strata Plan NW 2575 v. Booth,* 2020 BCCA 153 at paras. 17–19.

[63] The legal test arising from *Wastech* is that an exercise of contractual discretion unconnected to the purpose for which the discretion was granted will be a breach of the duty to exercise discretion in good faith.

[64] On the facts of this case, an arbitrator or court would have to ask a series of questions in order to apply that legal test to the facts at hand:

- Was CC&L's decision to put both Simpson Norton and OCGT/GLI into New Fund an exercise of discretion arising out of or connected to its contract with the petitioners?
- If so, what was the purpose for which that discretion was granted?
- Was CC&L's action unconnected to that purpose?

[65] These are questions of fact or mixed fact and law on which it is not necessary to express an opinion at this stage. The point is that any decision on those factual or mixed questions must be based on an accurate statement of the legal test, which was not present here.

[66] Like Fitzpatrick J on the leave application in *Wastech*, I find that the definition or characterization of the duty of good faith and the legal test for a breach of this duty is a question of law that satisfies the requirements of s. 31(1) of the *Act.*

IMPORTANCE AND ARGUABLE MERIT: s. 31(2)

[67] Section 31(2)(a) of the *Act* requires that the arbitration result be important to the parties and that the court's intervention is necessary to prevent a miscarriage of justice.

[68] In my view, it can not be seriously doubted that the parties have significant financial interests at stake. In a separate proceeding, the petitioners are seeking payment of a little more than $1.5 million representing TNII based solely on OCGT/GLI for the years 2017-2019. CC&L's response to that claim does not take issue with the amount, but argues that for various reasons it is not yet due. Addition of income from Simpson Norton would presumably increase that amount in future years, depending on the long-term success of that investment.

[69] Whether intervention is necessary to prevent a miscarriage of justice depends on whether the alleged error relates to a material issue that, if decided differently, would affect the result in the case: *Sattva Capital Corp. v. Creston Moly Corp.,* 2014 SCC 53 at para. 71. This is assessed on the basis of "arguable merit," which the Court in *Sattva* defined as follows at para. 74:

> 74 … In my view, the common thread among the various expressions used to describe arguable merit is that the issue raised by the applicant cannot be dismissed through a preliminary examination of the question of law. In order to decide whether the award should be set aside, a more thorough examination is necessary and that examination is appropriately conducted by the court hearing the appeal once leave is granted.

[70] I find that test is met here. The arbitrator found that the settlement agreements gave the petitioners a right to receive ongoing income not only from the investment that existed at the time of termination but also from new investments added to the same investment fund. This conclusion was based on a detailed contractual interpretation of the settlement agreements and the parties' intentions. However, he

found that CC&L could extinguish that right simply by creating a new fund to hold both the existing and new investments. If that is ultimately found to have been a breach of the duty of good faith, it is arguable there would be a change in the final result of the case.

[71] CC&L argued that nothing would flow from the petitioners' establishing a breach of the duty of good faith, seemingly on the basis that a breach of this duty could only result in an action for damages, not for payment of TNII (among other arguments). These arguments are not for me to deal with in any detail at this stage, but suffice to say I disagree with CC&L's submissions on this point to the extent I find the question of law could be material to the final result in this case.

RESIDUAL DISCRETION TO GRANT LEAVE

[72] I do not accept the respondent's argument that the petitioners' conduct, both during the arbitration hearing and afterwards, leads to the conclusion that I should not grant leave. The petitioners were not obliged to apply to the arbitrator for an additional award pursuant to s.27(6) of the *Act* before using the appeal provisions (and I'm not convinced that s. 27(6) is even applicable here).

[73] The appeal process in the *Act* exists to allow parties to appeal extricable questions of law arising out of an arbitration award that are material to the final result, if the appeal has arguable merit. The petitioners utilized the appeal process as it is meant to be used, the petition was not filed out-of-time, I have found such a question of law exists here, and I have found arguable merit to the appeal. I do not agree with the respondent's suggestion that the petitioners' conduct was improper.

CONCLUSION

[74] Accordingly, I grant the petitioners leave to appeal on the question:

> Did the Arbitrator err in failing to apply the correct legal test for breach of the duty of good faith by requiring, as a prerequisite, dishonesty or *mala fides*?

[75] In view of that result, I do not need to address the petitioners' alternate application to set aside the award on the basis of arbitral error under s. 30 of the *Act*.

I agree with counsel for the petitioners that that issue is more appropriately addressed, if at all, at the same time as the appeal: *Arbutus Software Inc. v. ACL Services Ltd.,* 2012 BCSC 107 at para. 31.

[76] Costs of this application may be addressed as costs in the appeal.

"N. Smith, J"