IADC Annual Meeting
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"Contracts and 'Hardship' Issues"
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Canadian Perspective

The Quebec Court of Appeal rendered a decision in August 2016 regarding the duties of good faith and fairness in contracts. It reviewed the theory of unforeseeability (*imprévisibilité*) as applicable in Quebec which is the only civil law jurisdiction in Canada, in the matter of *Churchill Falls (Labrador) Corporation Limited* v. *Hydro-Québec*[1].

The proceedings had been instituted in 2010 further to a request presented by Churchill Falls to Hydro for a renegotiation of the pricing of a power contract signed in 1969 ending in 2041 ('Power Contract"). The Power Contract had been negotiated over the course of several years and did not contain a price adjustment clause. Such a clause had been discussed during the negotiations in the 1960s but ultimately, the parties deliberately chose not to add indexation clauses to the Power Contract.

Churchill Falls argued that given the fundamental changes in the energy market after the execution of the Power Contract, it was entitled to request a renegotiation of the pricing terms. The extent of the profits received by Hydro upon the resale of electricity was unforeseeable at the time that the risks and benefits were negotiated.

Both the Superior Court, which had dismissed the claim and the Court of Appeal which also dismissed Churchill Falls' request to renegotiate the Power Contract, reviewed the applicable provisions of the Civil Code of Québec namely:

> Art. 6. Every person is bound to exercise his civil rights in good faith.
> Art. 7. No right may be exercised with the intent of injuring another or in an excessive an unreasonable manner which is contrary to the requirements of good faith.
> …
> Art. 1375. The parties shall conduct themselves in good faith both at the time the obligation is created and at the time it is performed or extinguished.
> Art. 1434. A contract validly formed binds the parties who have entered into it not only as to what they have expressed in it but also as to what is incident to it according to its nature and in conformity with usage, equity or law.
> …
> Art. 1439. A contract may not be resolved, resiliated, modified or revoked except on grounds recognized by law or by agreement of the parties.

While both parties to the dispute acknowledged that the legislator did not incorporate the theory of unforeseeability (*imprévision*) in the Civil Code which was revised in 1994, Churchill Falls attempted to innovate and expand on the concepts of good faith and collaboration. This argument was made by referring to the codification of the obligation of good faith and the doctrine of abuse of rights as reflected in articles 6, 7, 1375 and 1434 C.C.Q. as a manifestation of the intention of the legislator to

[1] 2016 QCCA 1229, under appeal to the Supreme Court of Canada

formalize the concept of "equity" as a principle to be applied to every contract governed by the law of Québec.

The Court of Appel concluded that Churchill Falls was really complaining of gross disparity i.e. the energy market evolved such that in the framework of a contract otherwise advantageous for the parties, one of them, namely Hydro, was collecting profits disproportionate to those earned by Churchill Falls in selling its electricity to Hydro. Consequently, given the current state of Quebec civil law, the argument of good faith to succeed in the absence of hardship would be to grant relief because of lesion arising from Hydro's excessive benefit. That proposition was not accepted by the Court of Appeal. This decision has now been appealed to the Supreme Court of Canada.

Pamela McGovern, Aust Legal

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French Perspective

In 1876, in the very famous (for the French legal community) *Canal de Craponne* case, the French Supreme Court expressly forbade civil and commercial courts from modifying or amending a contract at the request of one of the parties claiming that the performance of that contract had become too burdensome because of a change in the circumstances which prevailed when the contract was made, even where that change had extremely important consequences.

This prohibition remained in force for exactly 140 years.

The only hope for a party to a civil or commercial contract to obtain an adaptation of this contract by reason of a change of circumstances was where the contract itself contained a hardship clause expressly providing for such a situation.

The validity of hardship clauses in civil or commercial contracts was indeed perfectly accepted.

A timid attempt to introduce hardship in French civil law had been made in 2014, when the Commercial Code was amended to impose an obligation to provide a hardship clause in certain contracts for which the volatility of the price of raw materials was prevalent but there was still no general regime of hardship applicable to civil and commercial contracts.

Finally, in October 2016, a major reform of the provisions of the Civil Code on contracts came into effect and the new article 1195 of the Civil Code now provides that:

> "*If a change in circumstances which was not predictable at the time the contract was entered into renders the performance of the contract excessively onerous for a party who did not accept to bear that risk, that party can request from the other party a renegotiation of the contract. That party must keep performing its obligations while the contract is being renegotiated.*
>
> *In case the other party refuses to renegotiate, or if the renegotiation fails, the parties may agree to terminate the contract on the date and under the conditions of their choice, or may by common consent request the judge to adapt the contract. If no agreement is found*

within a reasonable time, the judge may, at the request of one of the parties, revise the contract or terminate it, on the date and under the conditions set by him.

Clearly, the French Supreme Court's long-time opposition to the interference of the judge in the process of adapting the contract to a change in circumstances is overruled, and the parties who fail to provide for a hardship clause in their contract are no longer unprotected when a change in circumstances occurs. But the new legal regime of hardship under French law remains full of uncertainties and will probably not be fully shaped before several years of jurisprudence and practice.

Pauline Arroyo

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German Perspective

German courts developped legal principles to handle cases of hardship in contract law for the first time in the early 1920s when, as a consequence of WWI Germany went through a massive hyperinflation which significantly affected the economic basis of transactions and long-term contracts (ultimately prices were doubling almost every four days). In the early 2000s, the principles on contractual hardship were ultimately codified in the German Civil Code under the title Inteference with the basis of the transaction:

Section 313 German Civil Code: Interference with the basis of the transaction

(1) If circumstances [or material conceptions] which became the basis of a contract have significantly changed since the contract was entered into and if the parties would not have entered into the contract or would have entered into it with different contents if they had foreseen this change, adaptation of the contract may be demanded to the extent that, taking account of all the circumstances of the specific case, in particular the contractual or statutory distribution of risk, one of the parties cannot reasonably be expected to uphold the contract without alteration. (…)

(3) If adaptation of the contract is not possible or one party cannot reasonably be expected to accept it, the disadvantaged party may revoke [or terminate] the contract. (…)

Henning Moelle

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