COVID-19: The exceptional right to renegotiate the terms of a contract in the absence of a force majeure

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The COVID-19 pandemic has led to conditions that may have rendered the execution of contractual obligations more onerous. As a result, a lot of recent commentary has focused on the *force majeure* provision to relieve contracting parties from their obligations. Even in the absence of a *force majeure* clause within a contract, however, the application of the duties of good faith and equity in analyzing the scope of a contractual obligation in the context of business disruptions caused by the pandemic could allow for the parties to renegotiate certain terms of the contract.

SCC analysis in *Churchill Falls*

The Supreme Court of Canada (SCC) recently analyzed the application of the doctrine of unforeseeability in *Churchill Falls (Labrador) Corp.* v. Hydro-Québec[1]. In some civil law jurisdictions other than Québec, following the occurrence of an unforeseeable event, this doctrine allows the renegotiation of contractual terms and conditions whose performance are rendered excessively onerous for one of the parties. Although the facts in *Churchill Falls* did not permit the development or adoption of such a doctrine since the conditions for its application were simply not satisfied, *i.e.* the obligations of Churchill Falls (Labrador) Corporation Limited had not become more onerous and there were no unforeseeable circumstance involved, the decision nevertheless provides important lessons about the broader duties of contracting parties.

In this case, the SCC concluded that the increased price of electricity did not constitute a sufficient motive to renegotiate the terms of the contract formed in 1969 by Churchill Falls (Labrador) Corporation Limited (CFLCo) and Hydro-Québec (HQ). This contract fixed the legal and financial framework for the construction and operation of a hydroelectric power plant. As per the contract, HQ agreed to purchase, for a period of 65 years, most of the electricity produced at a fixed price, regardless of its needs, which in return allowed CFLCo to finance the construction of the power plant. However, based on the fact that the price of the electricity sold to HQ was below the market price, CFLCo requested a renegotiation of the contract to redistribute the profits generated by HQ. The SCC held that HQ had no obligation to renegotiate the terms of the contract

because, among other things, the variation in the price of electricity was reasonably foreseeable and did not make CFLCo's obligations more onerous.

The SCC further highlighted that the theory of unforeseeability is not generally recognized in Québec civil law. The Québec legislature's choice is explained by a desire to favour the principle of contractual stability, which is incompatible with a rule that would depend on purely external circumstances, rather than on the conduct and situation of the parties. Even so, the Québec Civil Code states that parties must conduct themselves in good faith at every step of their obligations, and the SCC's recognition and interpretation of this duty is where we find the grounds to support contract renegotiation.

SCC framework for contractual fairness

Although many jurists believe that under Québec law it would be impossible for parties to justify a renegotiation of a contract based on the impacts of the COVID-19 pandemic by referring to the *Churchill Falls* decision, we believe, on the contrary, that Justice Clément Gascon, writing for the majority, allows us to conclude that such a right exists under the present extraordinary and unique circumstances.

The SCC states that the duties of good faith and equity allow the courts to intervene and impose positive obligations to parties based on the notion of contractual fairness. Courts can thereby temper literal interpretations of certain contracts in order to protect the underlying obligations intended by the parties. Good faith confers a broad, flexible power to create law, which helps to tie various legal principles to the concept of fundamental justice, depending on the circumstances, in an effort to protect contractual equilibrium.

The SCC further adds that "[f]or example, in a situation of "hardship" that corresponds to the description of that concept set out in the *Unidroit Principles*, **the conduct** of the contracting party who benefits from the change in circumstances **cannot be disregarded and must be assessed** ".

This concept of "hardship" in the *Unidroit Principles* is defined as an event beyond the control of a party, which could not reasonably be taken into account, which occurs after the conclusion of a contract and which fundamentally alters the equilibrium of obligations, either because the cost of performance has increased or because the value of the consideration has decreased[2]. As for the notion of "conduct" that could be found blameworthy or give rise to a sanction under the duty of good faith and equity in this context, the SCC's decision specifically mentions the case where a "party who insists on adhering to the words of the contract is inflexible or is gratuitously impatient or intransigent".

Takeaway for businesses

It is clear to us that the impacts of the COVID-19 pandemic could constitute a case of "hardship" within the meaning of the *Unidroit Principles*, and in particular in cases where the cost of execution of the obligation for one party is increased, or when the value of the consideration is reduced. By following the SCC's teachings in *Churchill Falls*, a party

showing a lack of flexibility or inappropriate intransigence in the present exceptional social context could be sanctioned.

The case of a landlord-tenant relationship during the pandemic where the access to the property is restricted by public health directives is an example that comes to mind. When a tenant cannot freely and fully make use of the leased premises, a landlord who refuses to renegotiate the terms of a lease on the basis of the reduced value of the benefit received by the lessee might be found in breach of the duty of good faith.

Finally, it is important to note that a contract is an agreement of wills formed by the mutual exchange of consent, binding those who have agreed to it not only for expressed terms but also for what is incident to it in accordance with its nature and in conformity with applicable usage, equity or law. Moreover, when interpreting a contract, one must seek the common intention of the parties rather than adhering to the literal meaning of the words used.[3]

By applying these principles, we believe that a party could seek relief from the strict application of the contractual provisions through a renegotiation of the contract on the basis that the risk of a COVID-19 pandemic was not reasonably foreseeable and therefore not assumed at the time of entering into the contract and, consequently, that such risk should instead be shared by both parties in the interest of contractual fairness.

[1] *Churchill Falls (Labrador) Corp.* v. Hydro-Québec, 2018 SCC 46, [2018] 3 SCR 101 at para. 92, 98-99, 102-105, 113 [our emphasis] and 118 [Churchill Falls].

[2] Art. 6.2.1 and 6.2.2 of *Unidroit Principles of international contracts*.

[3] See art. 1378, 1385, 1425 and 1434 CCQ.

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