Commercial Litigation and Arbitration Review

VOLUME 8, NUMBER 4 Cited as 8 C.L.A.R. NOVEMBER 2019

• FRAUD AND KNOWING ASSISTANCE – BETWEEN THE INNOCENTS •

Munaf Mohamed, Partner, Michael Mysak, Partner, and Aoife McManus, Associate, Bennett Jones LLP

Munaf Mohamed

Michael Mysak

Aoife McManus

INTRODUCTION

Fraud continues to plague businesses and individuals in Canada and abroad at an alarming rate. Those involved in asset recovery frequently turn to the equitable doctrine of knowing assistance to catch those who are "strangers" to the act of the fraud but who nonetheless have some actual knowledge of it. Many times assets are held by these strangers and are the main means of recovery. But what happens when two sets of sets of victims are pitted against each other with a suggestion one set is liable for knowing assistance?

Two different answers recently came to a head before the Supreme Court of Canada ("SCC") in *Christine DeJong Medicine Professional Corp v DBDC Spadina Ltd*,[1] ("*DBDC*") heard on appeal from the Ontario Court of Appeal.[2]

DBDC involved a complex multi-party multi-million dollar real estate fraud. A majority of the Ontario Court of Appeal extended the doctrines of knowing assistance and corporate identification to effectively prioritize one set of innocent fraud victims over another, which created potentially significant ramifications for fraud recovery litigation.

• In This Issue •

LexisNexis®

COMMERCIAL LITIGATION AND ARBITRATION REVIEW

Commercial Litigation and Arbitration Review is published four times per year by LexisNexis Canada Inc., 111 Gordon Baker Road, Suite 900, Toronto ON M2H 3R1 by subscription only.

ISBN 0-433-47142-5 (print)
ISBN 0-433-47144-1 (PDF)
ISBN 0-433-47146-8 (print & PDF)

Subscription rates: $360.00 per year (print or PDF)
$555.00 per year (print & PDF)

Please address all editorial inquiries to:

General Editor
Evan Thomas
Firm: Osler, Hoskin & Harcourt LLP
E-mail: ethomas@osler.com

Michael Kotrly
Firm: Freshfields Bruckhaus Deringer LLP
E-mail: michael.kotrly@freshfields.com

LexisNexis Canada Inc.
Tel. (905) 479-2665
Fax (905) 479-2826
E-mail: clrv@lexisnexis.ca
Web site: www.lexisnexis.ca

As such, on the appeal the issue was one of the proper construction and application of these doctrines and, in particular, what constitutes "participation" or "assistance" in a dishonest and fraudulent design. In a short judgment, the SCC allowed the appeal and adopted, in its entirety, the decision of Justice van Rensburg, the dissenting judge in the Court of Appeal. The net result is a strong restatement of a balanced approach to fraud victims that avoids favouring one set of victims over another.

THE FRAUDULENT SCHEME

Norma and Ronauld Walton created a fraudulent scheme whereby they entered into numerous investment agreements with various parties under which they arranged to purchase and improve commercial real estate properties in the Toronto area. Each property was owned by a specific corporation that was intended to be funded by equal 50-50 investment by the Waltons and the other investing party, with the funds contributed by both parties to be held in project-specific bank accounts for the purpose of renovating and managing the particular property in question. None of the agreements that established the funding of these investment-driven corporations contemplated third-party investors, nor allowed for the investors' contributions to be comingled with other monies or used for anything other than the individual project.

The Waltons largely failed to contribute their portion of equity to each project, and instead, against the direct contemplation of the investment agreements, diverted the funds advanced by the other investors, moving monies in and out of the numerous project-specific corporations, to themselves and through their own clearing house, Rose & Thistle Group Ltd ("Rose & Thistle").

DBDC dealt with a particular contest between two sets of defrauded investors, Christine DeJong Medicine Professional Corporation, which invested approximately $4 million with the Waltons' "Schedule C Companies", and DBDC Spadina Ltd., which invested approximately $111 million with the

Waltons' "Schedule B Companies." As part of the fraud, the Waltons moved large sums of money from the Schedule B Companies, through Rose & Thistle and into the Schedule C Companies.

In 2016, Justice Newbould of the Ontario Superior Court of Justice awarded DBDC $66 million against the Waltons personally for fraudulent misrepresentation, deceit and breach of fiduciary duty.[3] DBDC also claimed joint and several liability against the Schedule C Companies, whom DBDC alleged were knowing participants in the fraud. DBDC sought to recover from the proceeds of the sale of the Schedule C companies. Newbould J. dismissed those claims.

THE COURT OF APPEAL – MAJORITY

In 2018, Justice Blair, writing for the majority of the Ontario Court of Appeal, overturned Newbould J's decision regarding the liability of the Schedule C Companies, finding that while Ms. Walton was only a 50% shareholder of the companies, in reality she was the *de facto* controlling mind of the Schedule C Companies, thereby making these companies liable for knowing assistance in the fraudulent scheme. In doing so, the decision made some seemingly important changes to the doctrines of knowing assistance and corporate identification.

Knowing Assistance

The basic elements of the tort of knowing assistance in breach of fiduciary duty are well known:

1. there must be a fiduciary duty;
2. the fiduciary must have breached that duty fraudulently and dishonestly;
3. the stranger to the fiduciary relationship must have had actual knowledge of both the fiduciary relationship and the fiduciary's fraudulent and dishonest conduct; and
4. the stranger must have participated in or assisted the fiduciary's fraudulent and dishonest conduct.

In a series of cases in the 1990's, the SCC clarified the knowledge requirement for liability in knowing assistance, finding it to be fault-based and dependent "on the basic question of whether the stranger's conscience is sufficiently affected to justify the imposition of personal liability."[4]

However, the SCC has never spoken on the issue of what constitutes "participation" or "assistance" in a dishonest and fraudulent design. This void of interpretive guidance has resulted in a lack of clarity in a crucial element of knowing assistance, and formed the first issue on appeal in this case.

In the majority decision at the Court of Appeal, Blair JA held that participation requires no significant act or omission on the part of the stranger. There was no evidence that the Schedule C Companies had actively engaged in assisting in diverting the funds fraudulently taken from the Schedule B Companies. In fact, Blair JA described these companies' roles as "conduits" or "pawns" in the Waltons' scheme.[5] The majority emphasized and relied upon a net transfer analysis that showed a net transfer of funds moving from the Schedule B Companies, through Rose & Thistle, and into the Schedule C Companies. The Court found this transfer sufficiently evidenced participation by the Schedule C Companies in the fraudulent scheme.

The majority's approach of establishing participation based on a stranger's mere incidental presence in a fraudulent scheme differed significantly from the jurisprudence in British Columbia, the United Kingdom, and the United States. Moreover, it was seemingly inconsistent with the SCC's previous comments that culpability in knowing assistance is fault-based, indicating that a level of participation or assistance beyond *de minimis* passivity should be required to bind a stranger's conscience.

Corporate Identification Doctrine

The second issue in the case was the application of the corporate identification doctrine, which is used impute an individual's actions to a corporation. In this case, the strangers accused of knowing assistance in the Waltons' fraud were a number of corporations. As such, the corporate identification doctrine was used to attribute Ms. Walton's knowledge and deceitful

actions to a number of the Schedule C Companies, allowing DBDC to "pierce" through to the Schedule C Companies.

In 2017, the SCC, in *Deloitte & Touche v Livent Inc (Receiver of)*, affirmed that the test for the corporate identification doctrine as set out in the Court's 1985 decision, *Canadian Dredge & Dock Co v The Queen*,[6] remains the authoritative test.[7] Under the test, the doctrine applies when the action taken by the directing mind of the corporation was: (a) within the field of operation assigned to the individual; (b) not totally in fraud of the corporation; and (c) by design or result partly for the benefit of the company.[8] In *Livent* the court qualified this test, stating that while it provided a sufficient basis for attributing the actions of a directing mind to a corporation, it was not the definitive necessary test, and in all circumstances the courts retain the discretion to refrain from applying it where it would not be in the public interest to do so.[9]

Relying on the qualifications in *Livent* and the less onerous burden of proof in civil cases, Blair JA held that the criteria in *Canadian Dredge*, in particular (b) and (c) may be approached in a more flexible manner in complex and large multi-corporation, multi-party fraud cases. Further, contrary to the dissenting opinion of van Rensburg JA, the majority held that it is not necessary for a claimant to show evidence of each company's individual benefit from the scheme.

Applying this "flexible approach", the Court of Appeal found that while the money from the Schedule B Companies could not be traced directly into the Schedule C Companies, the Schedule C Companies were not themselves victims of the fraud because "the listed Schedule C Companies were not totally defrauded and, indeed, benefitted at least partly from Ms. Walton's actions."[10]

THE COURT OF APPEAL – DISSENT

In direct contrast to the majority's approach (which seemed to pit the victims against each other), van Rensburg JA characterized the two sets of investor companies as similarly situated groups, both victims of the Waltons' fraud.[11] As such, van Rensburg JA disagreed with the reliance on the net transfer analysis to show the participation of the Schedule C Companies. She pointedly clarified that the net transfer analysis was merely a summary of cash transfers out of the Schedule B Companies and into Rose & Thistle at a particular point in time. In addition, the net transfer analysis was undertaken and created as part of DBDC's original oppression action against the Waltons to show their fraud at a stage in the proceedings when the listed Schedule C Companies were not parties to the action – meaning it did not necessarily reflect a full and complete picture of the path of the misappropriated funds. Except for a few instances where the funds could be traced and a constructive trust was awarded, the net transfer analysis did not identify where the Schedule B Companies' money went after being transferred into Rose & Thistle—the funds could not be traced into any particular Schedule C Company account.

Further narrowing in on the issue of participation, van Rensburg JA clarified that the required participation in a claim of knowing assistance must be with regard to the specific breach of duties owed by the Waltons to the Schedule B Companies, and not just participation in the overall fraudulent scheme.[12] In this case, both sets of companies were shells employed by the Waltons to perpetrate the fraud; however, while the Schedule C Companies were used in the overall fraud and may have received funds from the Schedule B Companies, this did not equate to their participation in the fiduciary's fraudulent conduct as there was no evidence the Schedule C Companies participated in the relevant breach of fiduciary duties, i.e. the diversion of funds out of the Schedule B Companies.[13] Accordingly, and because the rationale for finding personal liability in a claim of knowing assistance is fault-based and rooted in the stranger's dishonest conscience of actual knowledge and assistance in the fraudulent conduct, contrary to the majority at the Ontario Court of Appeal, van Rensburg JA held that the participation necessary to establish such a claim requires actual knowledge by the participant. Mere constructive knowledge will be insufficient.[14]

Lastly, van Rensburg JA also rejected the majority's adoption of a less demanding standard for application of the corporate identification doctrine criteria from Canadian Dredge.[15]

THE SUPREME COURT OF CANADA

As noted, the SCC's decision was brief. On the issue of knowing assistance, the Court used a single sentence to adopt van Renssburg's dissent as the law in Canada.

In a second, also brief paragraph, the SCC went on to clarify the majority's interpretation of *Canadian Dredge* and *Livent*. The Court stated that the test in *Canadian Dredge* provides a set of minimum criteria that must be met when attributing individual wrongdoing to a corporation; the flexibility and discretion in application of the test as alluded to in *Livent* merely provides that even where all criteria are satisfied, in the presence of public interest concerns, the court maintains the discretion to heighten the burden on the party seeking to have the actions of a directing mind attributed to a corporation.

COMMENT

This case raises the broader question of how a court should properly handle cases involving multiple innocent victims of fraud. The majority at the Court of Appeal largely framed this case from the point of view of one set of victims, DBDC, and the reasoning that followed can be seen to flow in one direction from these victims towards finding avenues of recovery for them. Conversely, in dissent van Rensburg JA took a more holistic, macro approach, viewing the entire scenario without placing or ranking either set of victims as the starting point for her analysis. The decision of the SCC to adopt van Rensburg JA's reasons as its own demonstrates that future courts faced with claims for fraud recovery should similarly be mindful to take into account equity and the position of all fraud victims.

This could have a significant impact on the direction of fraud recovery litigation in Canada. In other jurisdictions, it has become somewhat common to see "clawback" litigation, whereby one set of victims or a court-appointed receiver actively pursues recovery against early victims of a fraud who may have unknowingly received some of the proceeds stolen from later victims. The firm restatement of the requirements of knowing assistance would seem to suggest a hurdle for such litigation in Canada; absent some moral culpability and sufficient participation by those early victims, knowing assistance seems unavailable as a route to recovery for the later victims.

[***Munaf Mohamed*** *is the national co-chair of Bennett Jones LLP's fraud law practice and maintains a national litigation practice with a strong emphasis on civil fraud and international asset recovery claims.*

Michael Mysak *is a partner at Bennett Jones LLP, where he has a corporate/commercial litigation practice with an emphasis on securities litigation, shareholder disputes and fraud litigation.*

Aoife McManus *is an associate at Bennett Jones LLP and has a general corporate commercial law practice.*]

---

1 2019 SCC 30.

2 *DBDC Spadina Ltd v Walton*, 2018 ONCA 60, leave to appeal to SCC granted, 38051 (15 November 2018) [*DBDC Appeal Decision*].

3 *DBDC Spadina Ltd v Walton*, 2016 ONSC 6018.

4 *Air Canada v M & L Travel Ltd*, [1993] 3 SCR 787, at 808; *Citadel General Assurance Co v Lloyds Bank* Canada, [1997] 3 SCR 805; *Gold v Rosenberg*, [1997] 3 SCR 767.

5 *DBDC Appeal Decision* at para 102.

6 *Canadian Dredge & Dock Co v The Queen*, [1985] 1 SCR 662 [*Canadian Dredge*].

7 *Deloitte & Touche v Livent Inc (Receiver of)*, 2017 SCC 63, [2017] 2 SCR 855, at para 104 [*Livent*].

8 *Canadian Dredge* at para 66.

9 *Livent* at para 104.

10 *DBDC Appeal Decision* at paras 124, 125, 79.

11 *Ibid* at paras 160, 166.

12 *Ibid* at paras 215-221.

13 *Ibid* at paras 221, 230-231.

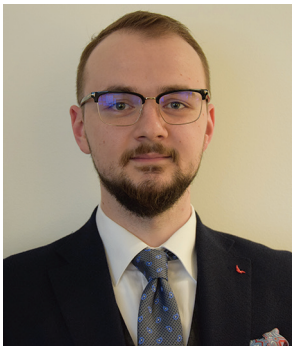
14 *Ibid* at paras 237, 246.

15 *Ibid* at para 237.

• CHURCHILL FALLS (LABRADOR) CORP V HYDRO-QUÉBEC: A LESSON IN COMPARATIVE CONTRACT LAW •

Vasuda Sinha and Gabriel Fusea, Freshfields Bruckhaus Deringer

Vasuda Sinha



Gabriel Fusea

INTRODUCTION

Common and civil systems of law are commonly understood to have different approaches to private law and the role of the courts in adjudicating private disputes. Contract law is one area in which the differences are highlighted, and it is sometimes assumed that courts in civil systems are more able to interfere with the terms of agreements concluded between private parties. In this regard, the role of good faith in contractual performance is identified as a distinct feature of law that a party can use to argue that an agreement might mean something other than what one might think it means.

The Supreme Court of Canada grappled with the scope of this and related issues in *Churchill Falls (Labrador) Corp v Hydro-Québec*,[1] in which it examined implied contractual obligations, the doctrine of unforeseeability, good faith and equity in Québec civil law. At its core, this case was about whether market developments that effectively created a windfall for one of the parties had de-stabilised the initial contractual equilibrium and whether the courts had a role in restoring it. In a 6-1 majority decision, the Court held against requiring the renegotiation of the underlying long-term agreement.

The majority decision was partially informed by its examination of how other civil law frameworks dealt with some of the key civil law concepts invoked by the appellants. In this article we pick up on that comparative exercise and consider how two other civil law jurisdictions address these concepts. In particular we look at the laws and jurisprudence of France[2] and Romania, two jurisdictions whose civil codes are closely connected with Québec's: the Napoleonic Code of 1804 inspired both Québec civil law and the former civil code of Romania, the Cuza Civil Code of 1865, while Romania's Civil Code of 2011 was significantly influenced by the modern Civil Code of Québec.

Finally, we conclude with a brief analysis of how the Court's decision regarding the scope of good faith and related concepts in Québec's civil law engages with its decision in *Bhasin v Hrynew* on the role of good faith in the common law of contract in Canada.[3] While it is important not to overstate the convergence of the common and civil laws of Canada in relation to contracts, we propose that the Court's approach in both of these cases, in which its decisions were informed by reference to established law and commentary

regarding the other legal system, is instructive and may be useful in other areas of law.

BACKGROUND

The case arose out of a dispute between the Québec Hydro-Electric Commission ("Hydro-Québec") and the Churchill Falls (Labrador) Corporation Limited ("CFLCo") in relation to a contract they concluded in 1969 (the "Contract") for the construction and operation of a hydroelectric plant (the "Plant"). The Contract created a long-term take or pay relationship, whereby, among other things, Hydro-Québec undertook to purchase most of the electricity produced by the Plant,[4] regardless of its actual needs. This certainty of revenue allowed CFLCo to obtain financing for the construction of the Plant. In exchange, Hydro-Québec secured the right to purchase electricity at a fixed price for the entire duration of the Contract.[5]

Some years after the Contract's conclusion, but within its 65-year term, the electricity market changed and the price of electricity rose well above the prices that CFLCo was locked into selling at to Hydro-Québec. This resulted in a significant windfall for Hydro-Québec, which was able to sell electricity to its customers at the new high market prices, while continuing to pay CFLCo the contractually-fixed price.[6]

CFLCo was unhappy being denied the benefit of the price increase in the electricity market. It sought to recalibrate the prices set out in the Contract accordingly. In this context, CFLCo sought a court order compelling a renegotiation of the Contract.[7] CFLCo argued that the new reality of the electricity market had not been foreseeable when the Contract was concluded. On this premise it argued that the Contract terms should not be binding. According to CFLCo, adhering to the Contract upset the contractual equilibrium envisaged by the parties when the Contract was concluded and also offended the principle of good faith.[8]

There were two tenets of CFLCo's case: it argued that the Contract had "proved to be an unanticipated source of substantial profits" for Hydro-Québec and that Hydro-Québec was therefore obligated to renegotiate the Contract in order to "allocate the profits more equitably between the parties".[9] The duty to renegotiate itself was based on a variety of arguments, including:

- that the Contract was a joint venture or a relational contract, which implicated a duty to cooperate and an obligation to renegotiate its terms;[10]
- that there was an implied renegotiation clause under the Contract, within the meaning of Article 1434 of the Civil Code of Québec;[11]
- that the doctrine of unforeseeability,[12] good faith and equity all obliged the parties to renegotiate the Contract.[13]

At the outset of its analysis, the Supreme Court dismissed a number of facts and mixed fact and law allegations underlying CFLCo's case. It did not accept that the Contract provided for "flexible economic coordination" such that it created a "relationship of cooperation between the parties";[14] as a result, the Court rejected any argument that depended on the Contract being relational in nature.[15] The Court also rejected CFLCo's allegation that "it was impossible in 1969 for the parties to foresee the changes that were soon to occur in [the] market" such that "it was impossible for the Contract to deal with that new reality."[16] Additionally, the Supreme Court deferred to the trial judge's finding that "the parties intended to allocate the risk of price fluctuations and that there was an agreement of wills on this point",[17] which effectively disposed of the proposition that a change in the electricity market had upended the contractual equilibrium.

Having rejected key premises underlying the appeal, the Supreme Court effectively dispensed with its merits. It nevertheless proceeded to consider CFLCo's legal arguments, including regarding the scope of good faith and equity because the appellant had argued that these notions legally required Hydro-Québec to renegotiate the Contract "independently of the lack of any factual basis [for doing so]".[18] It is to those legal arguments to which we now turn.

UNFORESEEABILITY, GOOD FAITH AND EQUITY IN COMPARATIVE PERSPECTIVE

Relying on the role of good faith and equity in Québec contract law, CFLCo argued that Hydro-Québec could not strictly rely on the words of the Contract "because to do so in circumstances in which the Contract effectively provides for disproportionate prestations would be contrary to its duty to act in good faith and in accordance with equity".[19] The Supreme Court observed that this argument relied "indirectly on the doctrine known as unforeseeability";[20] it therefore considered the appellant's case as though it relied on unforeseeability as a standalone doctrine as well as within the frameworks of good faith and equity under Québec law.

The Doctrine of Unforeseeability

The doctrine of unforeseeability is a rule that can require contractual counterparties to renegotiate a contract if "as a result of unforeseen events, performance of the obligations stipulated in the contract would be excessively onerous for one of them."[21] The Court observed that the doctrine of unforeseeability had never been expressly included in Québec's civil code. This, according to the Court, indicated that the "legislature made a conscious choice" to exclude it.[22] As a result, the Court denied even the possibility of the doctrine of unforeseeability assisting CFLCo.

In contrast with Québec, other civil law jurisdictions have expressly adopted unforeseeability into their law of obligations. For example, as the Supreme Court noted, in France it was codified when the civil code was revised in 2016.[23] Article 1271 of the Romanian Civil Code is similar.[24]

Therefore, in both France and Romania, the respective legislators chose to expressly permit the courts to intervene in the event of an unforeseeable change in circumstances. That said, the threshold for intervention in these jurisdictions is quite high. Both jurisdictions require performance to have become excessively onerous and the Romanian Civil Code provides the added requirement of a "highly unjust" result. Neither of them contemplates "unequal" benefit as a trigger for the court's intervention. Therefore, it seems unlikely, even if the Supreme Court had permitted CFLCo recourse to the doctrine of unforeseeability, that this would have made a difference in the result.

Good Faith

Good faith is a tenet of contract law in Québec that confers courts with broad discretion to intervene in contractual relationships where merited by justice and contractual morality.[25] The question for the Court was whether in this case good faith merited judicial interference with the contractual bargain.[26] The Court therefore had to first establish the proper scope of good faith and then to apply it accordingly.

The premise of the Supreme Court's decision was that Québec law protected freedom of contract; therefore, absent a particular exception, parties were bound by the words to which they had agreed.[27] This was the prism within which CFLCo's good faith argument had to be considered. The Court therefore had the task of reconciling two of its potentially competing notions: first, that good faith "serves as a basis for courts to intervene […] based on a notion of contractual fairness" and could be used to "temper formalistic interpretations of the words of certain contracts"[28] and second, that good faith "serves to maximize the meaningful effect of a contract and of the prestations that are for the parties the object of the contract."[29]

In its conclusion, the Court seemed to prioritise the second notion. It ultimately held that while good faith permitted the courts to intervene in some circumstances, it was "incompatible with a rule that would depend on external circumstances rather than on the conduct and the situation of the parties."[30] It arrived at this conclusion by considering the arguments that CFLCo had anchored in the duty of good faith: whether good faith in Québec included an amplified version of the doctrine of unforeseeability; and whether the duty to cooperate that stems from the duty of good faith could require a redistribution of the benefits

(profits) that one party generated as a result of the contractual bargain.

Good Faith as a Basis for Unforeseeability

CFLCo argued that good faith permitted courts to "impose the renegotiation of the Contract and a reallocation of the benefits that flow from it" following a change in circumstances from those that existed when the agreement was concluded.[31]

The Court saw this as an argument for reading a broad understanding of unforeseeability into the good faith obligation, which the Court referred to as "positive unforeseeability".[32] This broad reading disregarded the prerequisites at the core of the doctrine – namely (i) an unforeseeable development that (ii) resulted in the imposition of an onerous burden on one of the parties,[33] and focused instead on a significant change in surrounding circumstances. The Court dismissed the argument on the basis that where the legislator had dismissed the doctrine itself "a protection analogous to it that would be linked only to changes in circumstances without regard for the core conditions of the doctrine as recognised in other civil law jurisdictions could not become the rule in Québec law."[34] In essence, the Court determined that good faith could not encompass rights and duties that the legislature had otherwise chosen to exclude from Québec civil law.

The Supreme Court's cautious approach to the relation between good faith and unforeseeability is consistent with the approach historically taken by some French courts, but contrasts with some more recent developments before the introduction of Article 1195 and the express adoption of the doctrine.

The conservative view is seen in the 6 March 1876 decision of the Cour de cassation in the *Canal de Craponne* case, where it held that time and equity could not allow a court to modify the agreement between the contracting parties. The Cour de cassation ruled that "the courts shall not, under any circumstances and even if the decision might seem equitable, take into account the time and the circumstances to modify the contracts entered into by the parties and substitute new clauses for the ones freely accepted by the contracting parties".[35]

This bright-line approach was slightly softened during the many years that passed from the *Canal de Craponne* case to the 2016 Civil Code reform.

One such example is the Cour de cassation's decision in the *Huard* case,[36] which involved a distribution contract. An unforeseen and extreme change in fuel prices put the distributor at risk of being unable to compete. In this context, the Cour de cassation held that good faith required the defendant to renegotiate the contract in order to remain a going concern.[37] Crucially, the decision was based on the "critical circumstances"[38] faced by the party that sought to renegotiate; that is, it related to facilitating contractual performance, which is well recognised in the analysis of good faith, rather to any alleged unfairness in the distribution of contracted benefits. In another case[39] the Cour de cassation was asked to censor a Cour d'appel de Paris decision in relation to a 12-year contract for the maintenance of the engines of a production plant. The appellant had argued that the general economy of the contract had been affected when it was left without cause[40] as a result of its cost of performance outpacing the contract price. The Cour de cassation quashed the Cour d'appel de Paris's decision for not analyzing whether the disruption of the economy of the contract meant that it no longer had to be performed, for want of cause.[41] Here too the Court's analysis focused on the complainant's ability to perform the contract, rather than an unfair distribution of advantages.[42]

Although the pre-2011 civil code in Romania did not expressly provide for the doctrine of unforeseeability, the concept nevertheless also made its way into Romanian jurisprudence, albeit differently from its French counterpart.

The Cuza Civil Code of 1865 (Article 970, Paragraph (1)), like the former Article 1134 of the French Civil Code, was simple, stating that "agreements must be performed in good faith".[43] On the basis of this provision, Romanian courts applied the doctrine of unforeseeability within the good faith framework as early as the 1920s, holding that a contract was binding only with respect to what the parties could have foreseen when it was concluded.[44]

After Romania shifted from a monarchy to a socialist republic, however, the doctrine lost favour in the jurisprudence even though the code provision did not change. The doctrine was considered incompatible with Romania's socialist society:[45] unforeseeability was a product of the legal system that aimed to protect the economic classes, and was therefore unnecessary.

After the fall of communism, Înalta Curte de Casaţie şi Justiţie[46] again started to interpret contractual good faith to include the doctrine of unforeseeability, relying on the same analysis as pre-communist jurisprudence.[47] Yet, the practice was not a uniform one.[48] In the absence of a general rule of *stare decisis*, some lower court decisions continued to rule against unforeseeability factoring into contract law. For example, in one case, Curtea de Apel Iaşi[49] held that "the contract is the law of the parties, which have the obligation to respect it pursuant to the Latin maxim pacta sunt servanda", and that the contract's binding nature must also be observed by the courts, which are not allowed to modify its content.[50]

In 2016, Curtea Constituţională[51] weighed in on the issue in relation to contracts that continued to be governed by the Cuza Civil Code of 1865,[52] finding that Romanian courts and scholars alike had accepted the applicability of the doctrine under the former code on the basis of good faith and equity.[53] The Court pronounced that Romanian contract law did include the doctrine of unforeseeability. Although authoritative in Romanian law, the decision was widely debated, not the least because it failed to acknowledge disagreement within the legal community on whether it was analytically encompassed in notions of good faith and equity rather than other key concepts of civil law, such as force majeure, abuse of rights, or want of cause.[54]

The Duty to Cooperate

CFLCo also argued that Hydro-Québec breached its good faith obligation when it failed to cooperate with CFLCo "to help it overcome its financial problems and enable it to benefit from the Churchill Falls project".[55] The Supreme Court acknowledged that a duty to cooperate may flow from the duty of good faith. It also noted that such a duty may be positive, encompassing "accommodating the interests and legitimate expectations of [the] contracting partner".[56] Consequently, it acknowledged that a party's strict reliance on the words of a contract, without consideration of the other party's situation, could violate the duty. Nevertheless, it concluded that in the case of Hydro-Québec, this duty could not form the basis of an argument that a refusal to renegotiate or share profits was contrary to good faith.[57]

The Court's conclusion followed from its view regarding two fundamental principles of the civil law of Québec.

The first principle was that good faith does not preclude a party from satisfying its own contractual interests.[58] In other words, a party may rely on the words of a contract, if such reliance does not effectively frustrate the purpose of the contract. On this point the Court concluded that Hydro-Québec's refusal to share its windfall profits did not violate its duty to cooperate because it was not stopping CFLCo from receiving the benefit of the long-term fixed price arrangement the parties had agreed to.[59]

The second principle was that "the purpose of the duty to cooperate is thus to give the contract, as it exists, the broadest scope possible […] The many expressions of the duty of good faith therefore serve to maintain the relevance of the prestations that form the basis of the contract for the two parties even if the words of the contract do not specifically prohibit the parties from doing something that would impede its fulfilment."[60] Of course, CFLCo's complaint was not that Hydro-Québec was impeding the fulfilment of the Contract, but that it refused to alter the Contract. This was a problem for CFLCo's argument, and the Court accordingly stated that:

> no court has ever forced a party to renegotiate the prestations on which the commutative nature of the contract was based. In my view, this is justified by the very logic behind the duty of good faith: if the main prestations of a contract are renegotiated and modified, they will rarely remain relevant.[61]

This understanding of the relationship between good faith and cooperation is on par with its French

counterpart.[62] In normal commercial relationships, the cooperation obligation in French law has its limits. For example, in a case arising out of an agreement to supply a power plant with thermal energy, the party that had to supply the plant with energy sought renegotiated terms in light of the significant financial burden it was experiencing due to an increase in the price of gas.[63] The Cour de cassation ordered the parties to initiate a renegotiation but refused to impose a duty on the other party to accept the revision of the contract.[64]

In other relationships that might imply a duty of loyalty, cooperation has broader implications. For example, in one case the Cour de cassation affirmed that in a franchise relationship, the franchisor was obliged to propose acceptable contractual amendments to its franchisee, which was then facing serious financial difficulties. This decision was premised on an understanding of the contract as one that required the close and loyal collaboration of the parties, which imposed a more robust duty to cooperate than in a normal commercial relationship.[65]

Yet the general rule under French law remains that the duty of good faith (which includes the duty to cooperate) cannot oblige a party to protect the interests of its counterparty to its own detriment.[66]

In Romanian law, good faith also includes a duty to cooperate during contractual performance[67] that aims at facilitating contractual performance and preserving the contractual balance. This duty also requires a party to avoid creating unnecessary costs for the other party.[68] All contractual relationships also encompass an element of loyalty,[69] which means that a party cannot impede its counterparty from obtaining the bargained-for benefits and must also avoid causing it onerous hardship.[70] Yet, as with Québec and France, in Romania the duty to cooperate cannot require a party to protect the interests of its counterparty to the detriment of its own interests.[71]

The Limits of Equity

Where the law comes up short, a litigant may implore the court to rule in its favour on the basis of equity. Relying on Article 1434 of the Civil Code of Québec, CFLCo argued that the courts could, and should, "ground a duty to renegotiate following an unforeseeable event in the duty of equity" that applied to all contracts under Québec law.[72] Consistent with its approach elsewhere, the Supreme Court considered that this argument would effectively introduce unforeseeability or lesion into contract law as a matter of course, when it was not legislated. The Court considered that CFLCo was asking it to exceed its proper role in administering equity. It therefore dismissed the argument.

In French law, equity is also unlikely to justify court intervention regarding the outcome of a contractual allocation of risk. In this regard, in Canal de Craponne, the Cour de cassation followed the approach that "the courts shall not, under any circumstances and even if the decision might seem equitable, take into account the time and the circumstances to modify the contracts entered into by the parties and substitute new clauses for the ones freely accepted by the contracting parties".[73] This suggests that while equity may sometimes be relevant in the context of unforeseen circumstances it cannot permit the courts to effectively revise the terms the parties had agreed to.

However, some French courts have not followed such a bright-line approach to the role of equity. One such example is that of the Cour d'appel de Nancy in the case of *SAS Novacarb c SNC Socoma*.[74] In that case, the parties had entered into an agreement whereby Socoma would operate the plant and supply the steam to Novacarb, which was financing the steam plant's construction. Several years after the contract was concluded, the government introduced environmental legislation that implemented a system of CO_2 emission quotas, which meant that if Socoma exceeded its quotas, Novacarb had to bear the relevant costs as they flowed through in the sale price of steam, but Novacarb had no right to share in any profits made by Socoma from selling the excess to third parties when it underproduced on its relative to its emissions quota (amounting to millions of euros).[75] Novacarb objected being made to share in Socoma's downside risk, without benefitting from the upside, and sought to

compel its counterparty to renegotiate the agreement. The court agreed. It noted that the parties could not have foreseen the implementation of the CO_2 legislation. But it also focused on the asymmetrical effect on the parties of the interaction between the legislation and the cost allocation under the contracts. It found that this asymmetry contradicted the principle of equity enshrined in former Article 1135 of the French Civil Code. The court also considered the environmental objective of the legislation. It noted that if Novacarb were allowed to share in the profits from the sale of quotas it would be encouraged to set steam production periods that would reduce CO_2 emissions – which was of national and global interest. Through this combination of unforeseeability, equity and public policy-based reasoning, the court ordered the parties to renegotiate the contract.[76]

There are certain similarities between this case and the *Churchill Falls* case, which suggests the French approach could have benefited CFLCo. But there is also a key distinction that undermines that possibility. That is that the court focused not on an unfair allocation of benefit, but an unfair allocation of cost, which affected contract performance.

This analysis echoes that of the Romanian courts, which, even before unforeseeability was codified, held that when circumstances changed to render performance excessively onerous, equity permitted the courts to intervene.[77] Yet, equity has its limits. Curtea de Apel Bucureşti[78] has held that good faith and equity do not require absolute altruism and the latter can only intervene to impose an obligation if it is grounded on a reasonable interpretation of the contract.[79] Thus, in Romanian law, equity feeds into the contractual interpretation exercise in certain circumstances, but does not extend as far as courts ordering the redistribution of profits. As in Québec, freedom of contract thus remains of paramount importance.

CONCLUSION

There appear to be at least two currents underlying the Supreme Court's majority decision in Churchill Falls. First, a strong emphasis on giving effect to the ordinary meaning of the terms of the parties' agreement and a caution against changing the meaning of the words following a change in surrounding circumstances. That is, the court is keen to avoid reading in meaning to the parties' intentions rather than giving effect to the allocation of risk that flows naturally from the words of their agreement. Second, while emphasising the importance of good faith in contractual relations, the Court is cautious to ensure to define its implications and apply it accordingly – that is, good faith is good faith, but should not be used to shoehorn more expansive obligations that lack an independent basis in Québec law or the parties' agreement.

Although the decision in Churchill Falls is about Québec contract law, some of the analysis of the majority decision rings familiar, as it harkens back to themes in the Supreme Court's unanimous decision in *Bhasin v Hrynew,* which pronounced good faith as an "organising principle" in the common law of contract in Canada.[80] Indeed, the Churchill Falls majority decision itself recognised this similarity when it cited the Supreme Court's own good faith analysis in *Bhasin* (a common law case) in its discussion of "two fundamental principles of Quebec civil law that cannot be disregarded in any analysis of good faith in the circumstances of a given case."[81] For its part, the *Bhasin* decision drew on Québec's experience with good faith in its justification for proclaiming the existence of a "duty of honest performance" in the common law of contract.[82] Whether the Supreme Court will continue to unite common and civil contract law in Canada through notions of good faith and the duty of honest performance will be seen in three cases on its docket for 2019: *David Matthews v Ocean Nutrition Canada Limited,*[83] CM *Callow Inc v Tammy Zollinger,* et al,[84] and *Wastech Services Ltd v Greater Vancouver Sewerage and Drainage District.*[85]

At the same time that the *Churchill Falls* decision suggests that contract law in Québec civil law and Canadian common law may not be as different as they once were, it also confirms that there is no uniformity of approach to the issue in civil legal systems. Even between three jurisdictions that are closely related – with civil codes that have borrowed

from and built on one other through various phases of development – there are distinct approaches to concepts that are designed to protect the contractual expectations of parties. Among other things, these differences illustrate that what courts will do tends to reflect deeper cultural approaches to private law and understandings of the proper role of the legal system in regulating relations between private actors. This is but one important reason to avoid indiscriminate borrowing of concepts across legal systems, even those that are ostensibly similar. But it also suggests that when a court is faced with a question to which the applicable law does not provide a complete answer there may be some value in looking to jurisdictions where the law is different but courts are similarly situated in the local political and legal order. The civil and common law divide is real, but not so wide as to serve as an inherent barrier to learning by comparison.

[***Vasuda Sinha*** *is a lawyer in the International Arbitration Group of Freshfields Bruckhaus Deringer and a member of the Paris Bar and the Ontario Bar.*

Gabriel Fusea *is a lawyer in the International Arbitration Group of Freshfields Bruckhaus Deringer and a member of the New York Bar and the Bucharest Bar (non-practising).*]

The views expressed in this article are those of the authors and do not necessarily reflect the views of Freshfields Bruckhaus Deringer.

---

1 *Churchill Falls (Labrador) v Hydro-Québec*, 2018 SCC 46.

2 The Supreme Court's decision itself examined French law to a degree as a part of its comparative law exercise.

3 *Bhasin v Hrynew*, 2014 SCC 71 [*Bhasin*].

4 The contract term was 40 years, but renewed automatically for an additional 25 years, with the fixed price in the later 25 years being at a single fixed price slightly lower than the rate it was to pay at the end of the initial term of the Contract.

5 *Churchill Falls*, para 2.

6 *Ibid*, para 3.

7 *Ibid*, para 5.

8 *Ibid*.

9 *Ibid*, para 40.

10 *Ibid*, paras 60-71. This was viewed as a question of mixed fact and law, following the decision in *Uniprix inc v Gestion Gosselin et Bérubé inc*, 2017 SCC 43, paras 41-42.

11 *Churchill Falls*, paras 72-76.

12 *Ibid*, paras 86-101.

13 *Ibid*, paras 102-125.

14 *Ibid,* para 71.

15 *Ibid*, para 76.

16 *Ibid,* para 77.

17 *Ibid,* para 80.

18 *Ibid*, para 83.

19 *Ibid*.

20 *Ibid*, para 85.

21 *Ibid*, para 86.

22 *Ibid*, para 93.

23 *Ibid*, para 87. Article 1195 of the French Civil Code states: "If an unforeseeable change in circumstances at the conclusion of a contract makes its performance excessively onerous for a party who has not agreed to assume the risk, the latter may request a renegotiation of the contract from the other party. It continues to perform its obligations during the renegotiation.

In case of refusal or failure to renegotiate, the parties may agree to the termination of the contract, on the date and under the conditions they determine, or ask the judge to agree to adapt it. In the absence of agreement within a reasonable time, the judge may, at the request of a party, revise the contract or terminate it on the date and on the conditions he fixes." (Article 1195, French Civil Code – as modified by *Ordonnance* n° 2016-131 of 10 February 2016 (own translation)).

24 Article 1271, Romanian Civil Code of 2011 (own translation): "(1) Parties must perform their obligations, even if the performance of such obligations has become more onerous as a result of an increase in the costs of a party's performance or a decrease in the value of the performance a party receives.

(2) However, if the performance of the contract has become excessively onerous due to an exceptional change of circumstances that would make it highly unjust for a party to continue to perform its obligations, the court may:

a) adapt the contract to evenly distribute among the parties the losses and benefits that result from the change of circumstances;

b) terminate the contract, from the moment and subject to the conditions it determines.

(3) Paragraph (2) only applies if:
a) the change of circumstances occurred after the conclusion of the contract;
b) the change of circumstances, as well as its extent, could not have reasonably been foreseen by the debtor at the moment of conclusion of the contract;
c) the debtor did not assume the risk of the change of circumstances and it cannot be reasonably implied that he did;
d) the debtor attempted, in good faith and within a reasonable time, to negotiate the reasonable and equitable adaptation of the contract."

25 JL Baudouin, PG Jobin, N Vézina, *Les obligations* (7th edn 2013), para 127.

26 *Churchill Falls*, para 105.

27 *Ibid*, para 131; Articles 6, 7, 1375, Civil Code of Québec.

28 *Ibid,* para 103.

29 *Ibid.*

30 *Ibid*, para 98. As will be seen below, this is different from the conclusion reached by Romanian courts before the codification of the doctrine of unforeseeability into the Romanian Civil Code.

31 *Ibid,* para 105.

32 *Ibid*, para 90, citing D Jutras, "La bonne foi, l'imprévision, et le rapport entre le général et le particulier" in : H Barbier "Obligations et contrats spéciaux: Obligations en général" (2017) 1 RTD civ p 118, pp 138-139.

33 *Ibid*, para 106.

34 *Ibid*.

35 A Pietrancosta, "Introduction of the hardship doctrine ("théorie de l'imprévision") into French contract law: A mere revolution on the books?" (2016) 3 Revue Trimestrielle de Droit Financier p 83, p 83.

36 Cass. com., 3 novembre 1992, n° 90-18.547.

37 Y Picod, Fascicule unique: « Contrat. – Effets du contrat. – Imprévision » (2018) JurisClasseur Civil Code – Art. 1195 (downloaded from https://www.lexis360.fr), p 8.

38 A Pietrancosta, *op cit supra note* 35, p 84.

39 Cass. com., 29 juin 2010, n° 09-67.369.

40 A concept similar, but not identical to, consideration under common law contracts law.

41 Y Picod*, op cit supra note* 37, pp 9-10.

42 French commentators examining the body of law of which these cases form part have observed that unforeseeability only tends to work as a reason for court interference in contractual relations in cases where the relevant party has argued that it was unable to perform the contract due to the change of circumstances. *See* JB Seube *et al*, *Pratiques contractuelles, ce que change la réforme du droit des obligations* (2nd edn 2016), p 115.

43 Article 970(1), Romanian Civil Code of 1865 (own translation).

44 C Zamşa, „Privire comparativă asupra impreviziunii în sistemul vechiului şi actualului Cod Civil cu trimitere la Decizia Curţii Constituţionale nr. 623/2016" (2017) 1 Revista Română de Drept Privat p 220, p 222, referring to the following case: *Tribunalul Ilfov*, Decizia nr 253/1922.

45 T Ionaşcu *et al*, *Tratat de Drept Civil, Volumul I, Partea Generală* (1967), p 308.

46 The Romanian High Court of Cassation and Justice (formerly known as *Curtea Supremă de Justiţie*).

47 C Zamşa, *op cit supra note* 44, p 222, referring to several decisions of *Curtea Supremă de Justiţie*.

48 *See* I Coafaru, „Curtea Constituţională a transformat teoria impreviziunii în instituţia impreviziunii" (2017), available at: https://www.juridice.ro/489891/codul-civil-din-2011-curtea-constitutionala-transformat-teoria-impreviziunii-institutia-impreviziunii.html (last accessed on 10.06.2019).

49 The Iaşi Court of Appeal.

50 C Zamşa, „Teoria impreviziunii" (2003) 1 Analele Universităţii din Bucureşti p 79, p 88, quoting from the following case: *Curtea de Apel Iaşi*, Decizia nr 892/2000 (own translation).

51 The Romanian Constitutional Court, which is distinct from the High Court of Cassation and Justice.

52 *Curtea Constituşională a României*, Decizia nr 623/2016.

53 *Ibid*, para 95.

54 *See* C Zamşa, *op cit supra note* 50, pp 91-93.

55 *Churchill Falls*, para 114.

56 *Ibid*, para 115.

57 *Ibid*, para 116, where it also observed that "this duty to cooperate has only quite rarely led a court to find that an obligation to amend a contract applied, [and no court has] found that an obligation to redistribute profits earned under a contract did."

58 *Ibid*, para 117.

59 *Ibid*, para 119.

60 *Ibid*, para 120 (citations omitted, emphasis added).

[61] *Ibid*, para 121 (emphasis added).

[62] P Malaurie, L Aynès, P Stoffel-Munck, *Droit des obligations* (10th edn 2018), p 259.

[63] Cass. com., 3 octobre 2006, n° 04-13214.

[64] D Mazeaud, « Renégocier ne rime pas avec réviser ! » (2007) 11 Recueil Dalloz p 765, p 767.

[65] Cass. com., 15 mars 2017, n° 15-16.406. In this regard, one commentator has observed that the duty to cooperate in a relational contract changes the analysis and might even require a party to collaborate to the detriment of his own interests. The commentator also gives an example of a case where the contract – not too different from the Contract in *Churchill Falls* – was clearly not relational, and where the *Cour de cassation* refused to impose a duty to renegotiate, even in the presence of a hardship clause. *See* P Stoffel-Munck, « Quand le devoir de renégocier impose de faire des contre-propositions acceptables » (2018) 1 Revue des Contrats, p 22.

[66] P Malaurie, L Aynès, P Stoffel-Munck, *op cit supra note* 62, p 261.

[67] FA Baias *et al*, *Noul Cod civil comentariu pe articole* (1st edn 2012), p 1224.

[68] M Floare, „Observații privind buna și reaua-credință în executarea contractelor de drept comun, în noul Cod civil al României și în dreptul comparat" (2014) 5 Revista Română de Drept Privat p 73, p 79.

[69] FA Baias *et al, op cit supra note* 67, p 1223.

[70] C Zamșa, „Buna-credință în executarea obligațiilor contractuale" (2014) 3 Revista Română de Dreptul Afacerilor p 28, p 34.

[71] FA Baias *et al*, *op cit supra note* 67, p 1224.

[72] *Churchill Falls*, para 108.

[73] A Pietrancosta, *op cit supra note* 35, p 83.

[74] CA Nancy com. 2e, 26 septembre 2007, n° 06/02221.

[75] Here, the facts differ from *Churchill Falls* in that it was not the party that had financed the plant that was also making the profits, but the other way around.

[76] It is debatable whether the court would have ruled similarly if only equity was at issue. One prominent commentator discussing the case stated that, at least as a general rule, neither former Article 1134 (good faith) nor 1135 (equity) of the French Civil Code imposed an obligation to share profits generated following an unforeseen external event. *See* B Fages, « Invitation judiciaire à adapter le contrat » (2008) 2 Revue trimestrielle de droit civil p 295.

[77] *Curtea Constituțională a României*, Decizia nr 623/2016, para 95.

[78] The Bucharest Court of Appeal.

[79] *Curtea de Apel București*, Decizia nr 50/2017.

[80] *Bhasin*, paras 62 *et seq*.

[81] *Churchill Falls*, para 117.

[82] *Bhasin*, paras 83-85.

[83] The Supreme Court granted leave to appeal from *Ocean Nutrition Canada Ltd v Matthews*, 2018 NSCA 44. The case involves the duty of honesty in the context of a constructive dismissal.

[84] The Supreme Court granted leave to appeal from *CM Callow Inc v Zollinger*, 2018 ONCA 896. The case involves the duty of honesty in the context of disclosing information pertaining to the termination of a contract.

[85] The Supreme Court granted leave to appeal from *Greater Vancouver Sewerage and Drainage District v Wastech Services Ltd*, 2019 BCCA 66. The case involves good faith and the duty of honesty in the context of legitimate expectations of the contractual parties.