Civil Law and the Fight Against Inflation - A Legal and Economic Analysis of the Quebec Case

Ejan Mackaay
Claude Fabien
Inflation is currently perceived in all Western economies as public enemy number one. As recently as May 31, 1983, the leaders of the seven largest industrialized economies, in their final communiqué following the Williamsburg summit meeting, maintained the fight against inflation among their top priorities. The fight against inflation has led governments to fix interest rates at unparalleled heights, causing Western economies to slide into severe recessions from which they have only recently begun to emerge. Unemployment has reached levels comparable to the 1930s.

In spite of all this, inflation has not yet abated, and unemployment is still rising. Although all social classes appear to be affected, low income families, the unemployed, and the elderly have undoubtedly been the most seriously affected. Although these phenomena have not yet led to the social dislocation that took place in the 1930’s, our society, at the cost of bad conscience, appears to be willing to live with the ills of inflation.

Inflation may be defined as the continuous increase of the price level in an economy, or as the corresponding steady decrease of the purchasing power of a nation’s currency in its national markets. This definition does not mean that the prices of all goods necessarily increase nor that the increases occur at the same pace for all goods. Quite conceivably, the prices of some goods actually decrease during an inflationary period, as has been the case for computers over the past decade.

Copyright 1984, by LOUISIANA LAW REVIEW.

* Professors of Law, Université de Montréal. This article has appeared in French as Le droit civil aux prises avec l’inflation, 28 McGill L.J. 284 (1983). Research for the article has been carried out in part within the Équipe Droit/Économie at the Université de Montréal as part of consumer protection law studies subsidized by the Formation des chercheurs et action concertée (F.C.A.C.) program and the Consumer Protection Office.

1. See Official Communiqué as published in the Le Devoir (Montreal) May 31, 1983, at 10. The consumer price index, with 1971 as 100, has reached the level of 262.5 in 1982 in Canada. The average inflation rate over the 1973-1982 period has been 9.7%, with a peak of 12.5% in 1981. See Appendix, infra p.754. For earlier years (1939-1970), see Garon & Royer, Les effets de la dépréciation monétaire sur les rapports juridiques contractuels en droit commercial canadien et québécois, 50 Can. B. Rev. 389, 420 (1972). Since the Autumn of 1982, inflation and interest rates both in the United States and in Canada have been dropping steadily. In May 1983, the inflation rate in Canada, measured over the preceding year, was 5.4%. Financial Post (Toronto) July 2, 1983, at A1.

2. See the declaration of the Canadian Minister of Finance on the 27th of October 1982. The Economy, 124 Debates of the House of Commons no. 396, at 20,077-81, 20,087 (Hansard 1982). See also the earlier declaration by Mr. Alan MacEachen, then Minister of Finance, on the 28th of June 1982. The Budget, id. no. 370, at 18,876-77, 18,883.

The decline in the purchasing power of a currency is generally called *depreciation*. This term is not to be confused with *devaluation*, which is the decrease in the value of one currency in relation to another. Inflation necessarily causes depreciation of currency, but it need not lead to devaluation. Inflation may progress at the same rate in two countries, with the comparative value of their currencies (the exchange rate) unchanged, leading to depreciation without devaluation. By contrast, where the inflation in one country is higher than in another, the currency of the former will, in due course, be devalued in relation to that of the latter.

Economists are not at all agreed on the causes of inflation, and the remedies they propose vary accordingly. Perhaps the only agreement among economists is that inflation will to some degree persist in the foreseeable future. Some economists believe that society can live very well with inflation, provided that it is foreseeable. It is therefore useful to examine both the effects of inflation and the solutions the law puts at the disposal of economic actors to enable them to live with inflation.

**The Effects of Inflation**

To understand the law’s reactions to inflation, it is necessary to be aware of who stands to gain and who stands to lose in the inflation game. The two groups may be identified by looking at the functions of money. Three functions are generally recognized: (1) a means of payment; (2) a yardstick for the assessment of value; and (3) a means of saving.

When money functions as a means of payment, inflation affects obligations to be performed long after they are contracted. The payment agreed upon, which is initially equivalent to the corresponding performance by the other party, is no longer equivalent when performance actually takes place. As a result of inflation, the obligation in kind corresponds to a larger number of units of the depreciated currency at the time of payment. The problem is particularly obvious in obligations with

---

4. Id. at 7-10.
5. Id. at 12-15.
8. In synallagmatic contracts, inflation produces this effect independently of the order in which the obligations are performed. The following example will illustrate this proposition. X orders a machine to be built and delivered to him at time t. Between t and t + 1, the agreed date of payment, unanticipated inflation takes place. The equivalence of the two performances is unquestionably no longer assured. Different results occur if the example is changed so that payment precedes performance in kind. X now prepays at time t - 1. Between t - 1 and t, the time of the scheduled delivery, there is unanticipated inflation. The manufacturer must pay his workers and his suppliers in depreciated currency and hence a nominally larger amount than planned. The equivalence of the two performances is no more assured than under the initial assumption. However, under the second assumption
a term and in duration contracts such as lease and hire, credit contracts, building contracts and labor contracts. Similarly, inflation affects money loans and life insurance: the insured pays a given sum and at a future date receives a sum which is nominally equivalent but represents less purchasing power as it is acquitted in depreciated money. Alimony and fixed life-rents are also to be included in this category; their value declines in real terms over time as a result of inflation.

The depreciation of money as a means of assessing value entails difficulties for the courts when they evaluate damages to be paid to an accident victim. The evaluation of the damages and of their payment takes place long after the initial mishap. Hence, it is appropriate for courts to consider at what time the loss is to be assessed. Moreover, the courts will have to estimate, in the case of serious injury, future losses which the victim will suffer. Such evaluations must necessarily take inflation into account.

Finally, inflation affects those who use money as a means of saving, particularly those who live on the income provided by a fixed capital sum. Inflation causes their means of subsistence to melt away.

The Law's Response to Inflation

Several areas of the civil law are likely to be affected by inflation. A variety of rules have been designed to cope with the problem, but further adjustments in the civil law will be necessary to enable society to live with the effects of inflation.

The Civil Code of Lower Canada (Quebec Civil Code) contains few rules regarding inflation. The codifiers of 1866 undoubtedly took the view that inflation was only a marginal phenomenon. The Code, like the French Civil Code after which it is modelled, presumes that money is relatively stable and is drafted as though a dollar today will always be a dollar tomorrow. This principle, which provides that the "nominal identity of money entails an irrebuttable presumption of identity of value," is called monetary nominalism. Its main expression may be found in Quebec Civil Code article 1779, which closely follows French Civil Code article 1895 and provides:

the manufacturer who has received payment as planned can invest it at market rates, which, according to empirical studies, reflect foreseeable inflation. Yet the manufacturer is no worse off under the first assumption. Since he knows the interest rates, which reflect anticipated inflation, he can build this foreseeable inflation rate into the price he proposes to X.

9. The province of Quebec is in the process of adopting a new civil code. Book two of the new Civil Code is already in force. To distinguish the two codes, the practice has been adopted of designating the old code by its original name, Civil Code of Lower Canada, and the new one by Civil Code of Quebec. The Civil Code of Lower Canada is hereinafter referred to as the Quebec Civil Code.

10. J. Carbonnier, supra note 7, no. 6, at 20; K. Rosenn, supra note 3, at 39.
The obligation which results from a loan in money is for the numerical sum received.

If there be an increase or diminution in the value of the currency before the time of the payment, the borrower is obliged to return the numerical sum lent, and only that sum, in money current at the time of payment.

Nominalism is a practical concept that allows agreements to be made and judgments to be awarded for fixed sums which do not need to be subsequently revised. Thus, the certainty or stability of legal relationships, one of the fundamental values of law, is clearly favored. Admittedly, where depreciation of money exists, this stability is acquired at the price of some injustice. With moderate inflation, however, the social costs of trying to avoid that injustice by continually adjusting fixed sums would be substantially higher. The foregoing makes it obvious why, in spite of suggestions to the contrary, no society has based its private law on the principle which is the opposite of nominalism, namely valorism or realism. This principle provides that "the identity of money no longer holds where the intrinsic value of the currency has been altered in law or in fact so that the debtor would have to pay more of the depreciated units of money to the creditor in order to offset the observed loss of value."11

Nominalism is not necessarily unfair to the creditor. To the extent that the creditor has taken inflation into account in determining the amount that he will ultimately be paid in depreciated money, he receives the precise value agreed upon. In the case of a synallagmatic contract, the equivalence of the two performances is thus assured in spite of inflation. In such circumstances, a mandatory adjustment of the agreed sum in order to take into account, after the fact, the inflation that has occurred since the agreement would breach the equivalence and create a windfall gain for the creditor as well as a windfall loss for the debtor. This result would be unfair; the law should not be used for such disguised forms of redistribution. Moreover, such correctives would tend to encourage people to rely on public authority rather than on their own foresight to cope with inflation. This contravenes the principle of autonomy underlying the civil law, and might stimulate inflation.

The foregoing analysis may lead to the conclusion that inflation may be left to market forces when two conditions are met: inflation must be foreseeable, and parties must have the opportunity to take account of

12. J. Carbonnier, supra note 7, no. 6, at 20.
inflation when they agree upon the sum of money to be paid at a later date. One may wonder whether contracting parties are capable of anticipating inflation, but empirical studies tend to show that inflation over a given period is generally anticipated correctly in the interest rates of the commercial banks in the preceding period. In these studies, the nominal interest rate which banks charge is shown to consist of three components: a net return on money lent (the real interest, remarkably stable at between two and three percent), a risk factor (varying according to the debtor's financial position and what he plans to do with the money), and a factor representing the anticipated inflation. Inflation rates which could not have been anticipated in this manner would be truly unforeseeable. Only empirical studies can reveal the frequency of such truly unforeseeable inflation. Whatever the results of such studies, only in the case of unforeseeable inflation would corrective intervention be appropriate, and even then it is questionable whether the disease justifies the cost of the cure.

One may object that the foregoing analysis of the problem only takes account of general inflation. Where the prices of specific goods rise more quickly than the general price level, the proposed method would be inappropriate. Yet would inflation be unforeseeable among those who deal in the goods concerned? Empirical study will again be necessary to determine the frequency of such situations. Even without such evidence, however, it may be fitting, particularly in the case of real estate, to consider that people buy in part for speculative reasons, and that they should bear the risk of unforeseen changes. If one sells his house for a given sum, anticipating five percent inflation between the time of the contract and the time of delivery, and bases the price on this increase, one would have no ground for complaint if the prices of real estate turned out to jump by twenty-five percent over that period.

If the inflation problem is to be left to market forces without resulting in unfairness, not only must inflation be foreseeable, but parties to a contract, particularly the creditor of the money obligation, must also have the opportunity to take inflation into account when they determine the sum to be paid. Only voluntary creditors can take inflation into account. Involuntary creditors, such as those who suffer damages as a result of someone else's negligence, cannot negotiate inflation adjustments with their debtors. Hence, legislative or judicial intervention should protect them from the impact of inflation, foreseeable or not.

14. K. ROSENN, supra note 3, at 241, 244.
Yet there are some classes of voluntary creditors who do not themselves bear the risks of inflation. The Quebec legislature has limited freedom of contract for certain classes of persons whom it deems particularly vulnerable, such as workers, tenants, and consumers. This protection is not granted because of inflation; the groups protected are thought to be generally in an unequal bargaining relationship to those with whom they conclude contracts. Under such circumstances, the general presumption that voluntary agreement ensures fair exchange can no longer be maintained. This is true with respect to inflation as much as for other aspects of contracts.

A proper analysis of the inflation problem can best be achieved by dividing the civil law into sectors in which inflation causes similar problems and hence calls for similar solutions. The division should be based on the three variables introduced earlier: the voluntary or involuntary nature of the relationship between creditor and debtor, the foreseeability of inflation, and the parties' bargaining power in relation to each other.

**Voluntary Relationships**

**Foreseeable Inflation**

In the context of foreseeable inflation, the legislature may be expected to refrain from all intervention, leaving it to the parties to protect themselves against inflation. In practice, however, things are not so simple. While parties who negotiate on equal terms are indeed left to protect themselves, there is substantial legislative and other intervention in cases of unequal relationships, where the weaker party is at the risk of being exploited by the stronger one.

**Equality of Bargaining Power**

When parties have equal bargaining power, they need only the general rules of contract law, which are based on the principles of freedom of contract and nominalism, in order to cope with inflation. They may stipulate anti-inflation clauses as they see fit.

The principle of freedom of contract may be distilled *a contrario* from Quebec Civil Code article 13 which states: "No one can, by private agreement, validly contravene the laws of public order and good morals." One may deduce from this article that parties to a contract are free to agree on any clause designed to shift the burden of inflation among them. The articles of the Quebec Civil Code concerning this area constitute subsidiary law (supplétifs) only.

One kind of clause has been prohibited since 1937 by an act of public order: the gold clause or gold-value clause, by which a creditor seeks

---

to protect the value of his due by stipulating that payment will be made in gold or will be a number of currency units equivalent to a certain amount of gold at the date of payment. Some legal scholars have opined that this prohibition, which is found in the legislation of several countries, is essential to monetary stability and to public confidence in the currency. The argument does not appear to convince most economists, however.

Be that as it may, federal legislation in Canada regarding gold clauses probably renders Quebec Civil Code article 1780—concerning loans in bullion—inoperative.

Besides freedom of contract, the civil law is based on the principle of the binding character of contracts (force obligatoire des contrats). This principle is obvious in Quebec Civil Code article 1024, but it also underlies the particular application of Quebec Civil Code article 1690, which provides that an architect or builder who undertakes construction work "upon a plan and specifications, at a fixed price . . . cannot claim any additional sum upon the ground of a change from the plan and specifications, or of an increase in the labor and materials," unless the change has been authorized in writing. The principle of the binding force of contract perhaps explains the hesitation of Quebec law to allow judicial revision of contracts, even under the pressure of inflation.

Nominalism, another important principle of the law of contracts, is expressed in Quebec Civil Code article 1779 which provides:

The obligation which results from a loan in money is for the numerical sum received.

If there be an increase or diminution in the value of the currency before the time of the payment, the borrower is obliged to return the numerical sum lent, and only that sum, in money current at the time of payment.

Although the article appears in the chapter on loan for consumption (mutuum), the rule it expresses is applicable to all payments. Article 1779 is considered to be subsidiary law and must be understood in the light

17. K. Rosem, supra note 3, at 135; 3 J. Carbonnier, supra note 7, no. 8, at 27.
18. K. Rosem, supra note 3, at 137.
19. Garon & Royer, supra note 1, at 397.
20. Quebec Civil Code article 1024 provides: "The obligation of a contract extends not only to what is expressed in it, but also to all the consequences which, by equity, usage or law, are incident to the contract, according to its nature."
of the freedom of contract principle. The lender may stipulate that the borrower reimburse not merely the numerical amount of the loan, but the identical value to what the borrower has received. This is but one of numerous contract clauses which parties may agree upon to counter inflation.

Within the general framework of the principles of freedom of contract and the binding force of contract, parties may organize their relationship as they see fit. Quebec practitioners have drafted an impressive array of ingenious clauses to alter the effects of inflation for the contracting parties. Without these clauses, inflation generally operates to the detriment of the creditor of the money obligation, who sees the value of his claim diminish over time. Anti-inflation clauses are meant to place the burden of inflation on the debtor or to divide it between the debtor and the creditor. While the list of anti-inflation clauses is limited only by the imagination, some of the more common ones include interest clauses, value clauses, revenue sharing clauses, indexing clauses, new value clauses, duration clauses and arbitration clauses.

The first mechanism a creditor will use to protect himself from inflation in the case of loans and credit contracts is stipulation of a favorable interest rate. Besides the net return and the risk component, the interest rate should contain an adjustment for the expected inflation during the contract. Empirical studies show that this practice is generally followed in financial markets. With certain restrictions, particularly with respect to the disclosure of the cost of credit, the creditor is free to stipulate whatever interest rate his debtor will accept. The disclosure requirements do not prevent the creditor from stipulating a premium or bonus clause to be added to the agreed interest rate.

The creditor may also protect his claim against inflation by substituting for the national currency some other value unit less susceptible to inflation, or by stipulating payment in the national currency of an amount equivalent to a specific number of reference units. Thus, he may stipulate payment in foreign currency or payment in the national currency of the value of a specified number of foreign currency units, the equivalence to be determined at the time of payment. Quebec judgments enforcing such clauses will be expressed in Canadian currency. Of course, if the exchange rate fluctuates, the time of conversion becomes critically important. Finally, the creditor may choose to rely on commodities rather

23. Id.
25. Garon & Royer, supra note 1, at 408.
26. Id.
27. Id. at 398-403.
than foreign currency as the reference unit (a commodity clause) or may stipulate a clause giving him a stock option in the debtor company.

Even in the field of contracts, legislative intervention with respect to inflation is not entirely absent. These interventions have, however, only a subsidiary character. For instance, in the case of a lease—emphyteutic or ordinary—the lessor, by virtue of Quebec Civil Code articles 524 and 1624, may keep improvements and additions made by the lessee by paying to the latter their value rather than their cost. The parties are faced with a monetary obligation the amount of which is not initially fixed but must be determined later according to the value of some good or service. In principle, such an obligation is shielded from inflation and is often referred to as a "debt of value." 

The creditor may also have recourse to a revenue sharing clause. This clause would be appropriate, for instance, for an hypothecary creditor who intends to benefit from favorable business results of his debtor (presumably against a lower base rate for the interest). This type of clause also appears to find much favor with investors who set up shopping centers: one attracts tenants by means of an initially low rent which increases, however, with the profits, whether due to business success or merely to inflation.

Indexing or escalator clauses constitute another means by which the

28. Id. at 403.
30. Quebec Civil Code article 582 provides:
   As to improvements which the lessee has made voluntarily, without being bound to do so, the lessor has the option of either keeping them, upon paying what they cost or their actual value, or permitting the lessee, if the latter can do so with advantage to himself and without deteriorating the land, to remove them at his own expense; otherwise, in each case, they belong, without indemnification, to the lessor, who may, nevertheless, compel the lessee to remove them, in conformity with the provisions of article 417.
Quebec Civil Code article 1624 provides:
   The lessee may, on the expiry of the lease, remove improvements and additions which he made to the thing.
   If they cannot be removed without deteriorating the thing, the lessor is entitled to retain them, on paying their value, or to compel the lessee to remove them.
   If it is not possible to restore the thing to its original condition, the lessor keeps them without indemnity.
31. This expression is the translation of the German term Wertschuld, coined in 1925 by Arthur Nussbaum. See K. Rosen, supra note 3, at 222; J. Caron, Droit civil—Les Obligations no. 5, at 22 (7th ed. 1972). Carbonnier considers the debt of value to be an obligation in kind (obligation en nature). For Quebec law, see M. Tancelin, supra note 15, nos. 539-40, at 354-55.
33. Tancelin, supra note 16, at 429.
creditor can transfer all or part of the inflation burden onto the debtor. Quebec law fully recognizes the validity of such clauses. Generally, they provide that the nominal amount of the debt will be adjusted according to some index figure, such as the consumer price index established by Statistics Canada. Such clauses are frequent in collective labor agreements. Several authors have proposed that this technique of revalorization of debts be applied to large classes of contracts. This solution, which has not yet been adopted, is open to criticism. Revalorization may seem fair when parties have not anticipated inflation. It creates injustice, however, where parties have taken the effects of inflation into account—as they should under the principle of freedom of contract—explicitly by agreeing on an indexing clause or implicitly by stipulating more onerous financial obligations than would be justified in the absence of inflation.

In the insurance field, inflation has led to a new practice involving the use of new-value clauses. In the case of loss or theft of property, the insured is entitled to a sum allowing him to buy corresponding new goods in replacement. Among other virtues, such a clause is, of course, a perfect hedge against inflation. It is not without dangers, however. By replacing old goods with new, such a clause entitles the insured to more than the real value of the insured property and thereby creates what economists call "moral hazard," i.e., an incentive for the insured to take less than optimal precautions against the insured risk. Moral hazard tends to drive up the insurance premium and may ultimately make this kind of insurance impossible.

An altogether different strategy to cope with the uncertainty resulting from inflation is to limit the duration of contracts and to renegotiate, taking into account the changed circumstances. Obviously, this way of absorbing inflation increases transaction costs, both in the form of negotiating costs and by way of increased chances of friction among the parties. Undoubtedly, however, this strategy is widely adopted in practice. One of the most visible consequences of inflation is a general reduction in the duration of long-term contracts. In hypothec contracts, for instance, the normal term used to be twenty-five years. A few years

36. See authorities cited supra note 11.
37. One writer has suggested that a trend in this direction may have already begun. See Hamel, La "valeur à neuf" contribue à la hausse des incendies criminels, Le Devoir (Montreal) Oct. 28, 1982, at 20.
ago, clauses started to appear providing for the renegotiation of the interest rate after five years. At present, hypothec contracts of two or three years, and even contracts for a single year or less, are not uncommon. The duration of leases has also diminished radically; residential leases for more than one year are rare. Additionally, collective labor agreements frequently are concluded for one year only and those that exceed a year provide for the "reopening" of the salary clauses if inflation reaches an agreed threshold. The field of labor relations poignantly illustrates the disadvantages of short-term contracts: the opportunities for friction and strikes multiply.  

A final way of combatting inflation is arbitration, a method unjustly ignored. Where inflation appears to be a problem and parties are unable to agree on how much allowance should be made for it in the contract, they may agree in advance to have recourse to outside arbitration if inflation exceeds a certain threshold. A contract which involves new materials on the world market is a good example of where this method would be practical. The arbitrator will ensure that the contract terms are changed so as to constitute a fair exchange.

When an obligation is not voluntarily performed, inflation has a definite effect during the time which elapses between the initially scheduled date of performance and the time when the creditor actually receives performance or damages. It will be helpful to distinguish between delayed performance, on the one hand, and total or partial inexecution (including defective performance) on the other. Included in this latter category are the cases where performance, although still possible and offered by the debtor, no longer presents an interest to the creditor because of the delay.

Inflation occurring during the period when performance is delayed does not affect obligations in kind and monetary obligations in the same manner. The creditor of an obligation in kind the performance of which has been delayed—whether it ultimately takes place by court order or through voluntary action of the debtor—receives the value to which he was entitled. Inflation has not eroded this value. Of course, the value of the good or service may have evolved differently from inflation in general during the delay, but the situation would not have been different with regular performance. The creditor, therefore, has little reason for complaint. Conceivably, the creditor may suffer damage from the mere fact of being deprived of the performance for a period of time, but he has the burden to prove such damage. Inflation enters the picture only when it becomes necessary to decide when to assess this damage and who bears the risk of subsequent inflation. These questions arise for all monetary debts.

39. Id.
From the foregoing it follows that the risk of inflation is borne by
the debtor of the obligation in kind whose performance is delayed. The
costs of performance and its value go up, while the price he receives in
return is fixed. This result seems fair. By putting the burden of inflation
on the party who controls the date of actual performance, the law creates
an incentive for parties to perform on time—*pacta sunt servanda*. The
force of this principle is somewhat undercut in the case of synallagmatic
contracts where the creditor of the obligation in kind has already paid
his part while his debtor delays performance. In this case, the debtor in
default can make at least commercial interest rates on the prepaid sum
and is hence protected from inflation. The law does not distinguish, in
damage awards, between creditors who prepaid and those who have agreed
to pay upon performance. Hence, prudence commands in inflationary times
that one not prepay for goods to be delivered or services to be provided
later.

For monetary or pecuniary obligations, the analysis is quite different.
The value which the creditor stands ultimately to receive is reduced exactly
at the rate of inflation over the period during which the debtor stalls.
Parties may, in anticipation of this problem, change the effects of nonper-
formance through a penalty clause or a compound interest clause, by
virtue of which the interest due bears interest itself. In this view the
legislature has only a limited role to play, *i.e.*, to establish, as subsidiary
law, the legal interest rate on overdue payments at a level that corresponds
to what parties would presumably have stipulated themselves. Since
freedom of contract reigns supreme here, increased inflation, although
widening the gap between legal and commercial interest rates, provides
no ground for a change of the law.

40. Que. Civ. Code arts. 1131-1137. The first paragraph of Quebec Civil Code article
1135 is of particular interest and provides:

*The amount of penalty cannot be reduced by the court.*

But if the obligation have been performed in part to the benefit of the creditor,
and the time fixed for its complete performance be not material, the penalty may
be reduced; unless there is a special agreement to the contrary.

41. Quebec Civil Code article 1078 which provides:

- Interest accrued from capital sums also bears interest:
  1. When there is a special agreement to that effect;
  2. When in any action brought such new interest is specially demanded;
  3. When a tutor has received or ought to have received interest upon the moneys
     of his pupil and has failed to invest it within the term prescribed by law.

In French this clause is known as *clause d'anatocisme*.

42. See Que. Civ. Code arts. 1077, 1785; see also The Interest Act, Que. Rev. Stat.
ch. 1-18, § 4 (1970). Quebec Civil Code article 1077 provides:

*The damages resulting from delay in the payment of money, to which the debtor
is liable, consist only of interest at the rate legally agreed upon by the parties,
or, in the absence of such agreement, at the rate fixed by law.*

These damages are due without the creditor being obliged to prove any loss.
This policy of laissez-faire has given rise to practices which one could only characterize as abusive. When inflation drives up the commercial interest rates and hence the return on money lent, the debtor may take advantage of the difference between the new commercial interest rate and the agreed upon or legal interest rate. By delaying payment and investing the amount to be paid, the debtor realizes, possibly at the cost of a law suit which is settled out of court at the last moment, a profit equal to the difference of the two interest rates over the period of his stalling. In these circumstances, he even profits by increasing the delays in court. One is thus faced with a serious case of moral hazard.

Arguably, under the principle of freedom of contract, the creditor who has not stipulated an interest rate sufficiently high to discourage this practice should suffer the consequences of his own foolishness. The law would thus provide an incentive for people to have proper foresight. The argument does not do justice to the complexities of real life, however. First of all, court delays do not affect merely the parties themselves; they interfere with the administration of justice by creating delays even where parties or society as a whole have an interest in avoiding them. Society cannot tolerate abuse of the judicial machinery by a few at the expense of vast numbers of others. Second, many of the creditors who would be victims of these stalling games are among those the legislator seeks to protect because of their inexperience or inferior bargaining power.

These considerations may explain a recent amendment of the Quebec Civil Code which extends to contract law a rule that has been in force since 1971 for delictual responsibility. This rule allows the court to award interest beyond the legal interest rate. The new article 1078.1 reads:

43. Article 1056c of the Quebec Civil Code provides:

The amount awarded by judgment for damages resulting from an offence or a quasi-offence shall bear interest at the legal rate as from the date when the action at law was instituted.

There may be added to the amount so awarded an indemnity computed by applying to the amount, from such date, a percentage equal to the excess of the
The amount awarded by judgment for the inexecution of an obligation, except that contemplated in article 1077, bears interest at the legal rate, or, where such is the case, at the rate lawfully agreed between the parties, from the date of the institution of the action.

There may be added to the amount so awarded, or to the amount awarded by judgment for the inexecution of an obligation contemplated in article 1077, an indemnity computed by applying to the amount, from such date, a percentage equal to the excess of the interest rate fixed according to section 28 of the Act respecting the Ministère du revenu (R.S.Q., chapter M-31) over the legal interest rate, or over the agreed rate, as the case may be.

When a nonmonetary obligation cannot be performed due to factors attributable to the debtor, the creditor may claim damages as compensation. The time at which the damages are to be assessed is the primary issue. If they are assessed at the time of the breach, fairness dictates that interest at the commercial rate should be added to them; any lower rate would lead to the perversities described above. In this light, article 1078.1 constitutes an important new tool of contractual justice. This solution does not take into account, however, that inflation in the particular market involved may well be much higher than the general inflation rate. In both real estate and the construction industry, for example, assessment at the time of breach with commercial interest would not place the creditor in the position he would have enjoyed upon proper performance. The possibility of assessing damages at the date of judgment must therefore be considered; such a policy amounts to transforming damages into a debt of value. Quebec jurisprudence supports assessment at the date of judgment.

The Quebec Civil Code creates debts of value for the purchaser who suffers eviction. Article 1514 obliges the vendor to pay him the value of the thing sold at the time of eviction. The same holds true, by virtue of article 1515, for repairs and improvements made by the purchaser to the property. If the purchaser is evicted from only part of the thing sold,
he is entitled to the value of that part at the time of eviction, not to a proportional part of the purchase price. In each of these cases, the purchaser is protected against inflation occurring between purchase and eviction. Hence, the Quebec Civil Code does not ignore the problem of inflation and correctly puts the burden of it on the negligent debtor—in this case the vendor. Yet, it would stretch these articles too far to read in them a general principle that the debtor who fails to perform his obligation through his own fault bears the burden of inflation until the time of judgment.

The discussion of these problems is more advanced in the common law literature than in that of Quebec. An interesting question raised in the common law literature is whether the creditor of the unperformed obligation must mitigate the damages resulting from inflation. The question is certainly relevant in Quebec, where, in apparent contradiction with most other civilian jurisdictions, a duty of the creditor to mitigate damages is explicitly recognized. The following hypothetical case will adequately illustrate the problem: imagine two purchasers of new houses, each of them victim of a breach of contract on the part of the vendor who sells and transfers title in the purchased houses to third parties for $100,000 for each house. The first purchaser, upon being informed of the betrayal of the vendor, turns around and buys an equivalent house at $100,000, while the other purchaser does nothing with his $100,000. A year later, judgment is rendered against the vendor. The three houses are now worth $120,000 each, whereas the commercial interest rate stands at ten percent. Thus, the interest on $100,000 over the relevant period is $10,000. If the vendor had paid interest on $100,000, this purchaser could have realized the capital theoretically set aside for the purchase a year earlier, damages would then be limited to $10,000. The two purchasers now find themselves in positions equivalent to those they would have had after regular performance of the obligation by the vendor. In this sense, one's sense of fairness is satisfied; and yet the first purchaser may be dissatisfied. He may have the uncomfortable feeling

that in purchasing the second house he has done the vendor's job even though the latter is to blame for the difficulties. Obviously, the duty of mitigating inflation damage may be a source of paradox.

In execution may give rise not only to compensation, but also to dissolution of the contract and restitution. This remedy raises particular problems if part of the obligation has already been performed. Inflation may upset the balance between the parts of the obligations that have been performed on either side and which must now be returned. For instance, when the sale of a house is dissolved because of latent defects, the vendor reimburses the purchase price and the purchaser returns the house. The purchase price has, however, depreciated at the general inflation rate. The house, on the contrary, has kept its value, barring abuse by the purchaser. In the case of real estate, the difference may be appreciable, and it benefits the vendor, the very party who is obviously meant to bear the entire burden of the latent defects in this instance. Admittedly, the purchaser in good faith becomes the owner of the fruits by virtue of Quebec Civil Code article 411; this corresponds to the interest which the vendor simultaneously realizes on the purchase price. However, the gains attributable to inflation are lost by the purchaser when he returns the house; they go to the vendor, who returns only the purchase price. An obvious inequality exists, to the disadvantage of the purchaser seeking dissolution of the sale and to the advantage of the vendor, particularly the vendor who has stipulated a giving-in-payment clause in his favor.

The Quebec Civil Code recognizes the problem in part in articles 1514 and 1518.\textsuperscript{49} There may be some consolation in that for most classes of goods, the problem does not arise. Usually, objects sold depreciate through use while gaining in value as a result of inflation. Although these opposite movements may not exactly cancel each other out, in practice, to simplify the task of the courts, it seems justifiable to presume that they do and to accept that the returned object is still worth its initial purchase price.

\textsuperscript{49} The giving-in-payment clause is a form of penalty clause created by practitioners and sanctioned by the courts. It is generally found in hypothec contracts. It gives the creditor the right, if the debtor fails to meet his obligations, to become full owner of the immovable on which the hypothec rests, while retaining the payments already made as a penalty.

\textsuperscript{50} Quebec Civil Code article 1514 provides: “If the thing sold be found, at the time of eviction, to have increased in value, either by or without the act of the buyer, the seller is obliged to pay him such increased value over the price at which the sale was made.” Quebec Civil Code article 1518 provides:

If in the case of eviction of a part of the thing, or things sold as a whole, the sale be not vacated, the buyer has a right to claim from the seller the value of such part, to be estimated proportionally upon the whole price, and also damages to be estimated according [sic] the increased value of the thing at the time of eviction.
Unequal Relationships

Generally, freedom of contract is still the rule in the law of obligations, and whatever guidance the Quebec Civil Code provides is subsidiary law. This legislative restraint has been abandoned in some specific areas where protective measures are adopted in favor of those thought to be parties to unequal relationships.

Recent developments in Quebec law, particularly over the past two decades, indicate that imperative rules are progressively encroaching upon contractual relations. One might fear for the survival of freedom of contract, indeed of contract itself. Such concern may be dispelled, it is believed, by a proper analysis of the reasons for legislative intervention.

The interventions are not the result of inflation and are not designed to be a cure for it. In most instances, they are meant to protect the weak against certain practices considered reprehensible or to regulate economic activity in sectors where the free interplay of market forces is thought to lead to socially unacceptable outcomes. Be that as it may, these rules may well incidentally affect the ways in which people face up to inflation.

Traditionally, the Quebec Civil Code has been limited to protecting such parties as the insane and minors. This protection is accomplished through, among other things, the annulment of contracts entered into by such parties, on the grounds of lack of consent or lesion. The concept of lesion is very broad and covers "any patrimonial prejudice a contracting party suffers as a result of a juridical act."5 In principle, the concept could serve to correct a variety of inequitable situations involving persons who have reached the age of majority. Quebec Civil Code article 1012, however, excludes this group categorically: "Persons of the age of majority are not entitled to relief from their contracts for cause of lesion only."

The principle embodied in article 1012 is tempered by some exceptions. Quebec law has permitted judicial intervention in favor of persons of age because of lesion in cases of pressured out-of-court settlements and money loans. In 1939, legislation was introduced to make unenforceable against those who have suffered bodily injuries the settlements to which they may have agreed within fifteen days of the act causing the injuries. The purpose of this legislation was to stop abusive practices by insurance companies which took advantage of the state of accident victims. In 1964, the legislator acted again and introduced an entire new section into the Quebec Civil Code (articles 1040a to 1040e) to deal with usury in money loans. This section was given the significant title: "Of

51. QUE. CIV. CODE arts. 995-1012.
52. J. BAUDOUIN, supra note 48, no. 152, at 91.
53. QUE. CIV. CODE art. 1056b; J. BAUDOUIN, supra note 48, no. 155, at 93.
equity in certain contracts." Article 1040c is of particular interest and reads:

The monetary obligations under a loan of money may be reduced or annulled by a court so far as it finds that, having regard to the risk and to all the circumstances, they make the cost of the loan excessive and the operation harsh and unconscionable. For such purpose, the court must consider all the obligations resulting from the loan in relation to the sum actually advanced by the lender notwithstanding any settlement of account, novation or transaction.

Without using the term, the legislator introduced a very broad form of lesion, based purely on fairness. The judge has the power not only to annul a contract, but also to alter its terms in order to reduce the debtor's obligation. The article applies to all loans, whether commercial, personal or hypothecary. It is interesting to note that Quebec Civil Code article 1149, which implicitly recognizes usury, has not been repealed. In case of conflict, article 1040c will undoubtedly prevail. In practice, cases involving article 1040c are rare, and those in which the courts have in fact intervened in a contract are even rarer. Apparently, the courts are reluctant to exercise the broad discretionary power which article 1040c grants them.

Some authors have attempted to show a link between article 1040c and inflation. Historically and systematically, such a link seems tenuous.

54. This section was inspired by legislation in common law jurisdictions, particularly Ontario's Unconscionable Transactions Relief Act, ONT. REV. STAT. ch. 514 (1980), which in turn draws on the earlier Moneylenders Acts of 1900 and 1927 in Britain. The constitutional validity of the Ontario act appears to be well-established since the Supreme Court's decision in Attorney General of Ontario v. Barfield Enterprises Ltd., 1963 S.C.R. 570.
55. J. BAUDOUIN, supra note 48, no. 157, at 94.
57. Article 1149 of the Quebec Civil Code provides:
   A debtor cannot compel his creditor to receive payment of his debt in parts, even if the debt be divisible.
   Nor can the court in any case by its judgment order a debt actually payable to be paid by instalments without the consent of the creditor.
   However, if the debt is made up of interest exceeding the legal rate, and seems to the court to be usurious, or if it includes such interest, whether such interest is called interest or be claimed under the name of discount, reduction in the advance, commission or otherwise, such court may order that such usurious interest, or such portion of usurious interest, be paid by instalments, and fix the amount of such instalments and their term of payment, at its discretion, according to circumstances.
59. Tancelin, supra note 16, at 424; Garon & Royer, supra note 1, at 411.
Article 1040c was adopted during a period of economic stability—when inflation was not a public concern—and it forms part of a section whose purpose it is to protect the debtor, not the creditor. Yet the effect of inflation upon a debt is to make it less burdensome for the debtor, not more so, since a debtor reimburses in depreciated money. However, the lender may have made excessively pessimistic forecasts of inflation and insisted on an excessive interest rate. The unfairness may have been obvious from the outset; more likely, however, it will appear subsequently as inflation turns out to be lower than foreseen.

One difficulty with applying article 1040c to such situations is that lesion is held to be a vice at the formation stage of the contract. In the cases of interest in these situations, the inequity becomes evident only as a result of events taking place after the formation of the contract. Normally, such problems would lie in the realm of imprévision, which is not accepted in Quebec law as a ground for revising contracts. Perhaps support could be found in the very general wording of article 1040c, which directs the judge to take all the circumstances into account. Thus, he could consider as one of those circumstances the inexperience of the borrower, or more precisely, his inability to foresee inflation adequately. The judge

60. Tancelin, supra note 16, at 422. Elsewhere Tancelin writes:

It should be noted that neither the Act of 1964 [QUE. CIV. CODE art. 1040c],
nor the Act of 1971 [Consumer Protection Act, QUE. STAT. ch. 74, § 118 (1971),
replaced by the 1978 Consumer Protection Act, QUE. REV. STAT. ch. P-40.1, §§
8-9] are applications of this theory [of the imprévision]. These Acts do not authorize
a judge to revise a contract which has become unfair as a result of changing
economic conditions; they only authorize him to annul or reduce the obligations
of the borrower or consumer who has entered into a contract which was exorbitant or disproportionate at the time of contracting. . . . [T]hese Acts are aimed at correcting an excessive disequilibrium at the time of contract formation, not a disequilibrium which has developed during the course of the contract that was fair to begin with.

61. See infra text accompanying notes 80-81.

62. J. BAUDOUIN, supra note 48, no. 579, at 305; M. TANCELIN, supra note 15, no.
172, at 115; Frank Ross Constr. v. Verona Constr., 1961 S.C.R. 195. However, the draft
of the new Civil Code of Quebec proposes the acceptance of the concept of imprévision
in exceptional circumstances. See CIVIL CODE REVISION OFFICE, I REPORT ON THE QUÉBEC

63. Since Quebec Civil Code article 1040c draws its origin from section 2 of Ontario's
Unconscionable Transactions Relief Act, ONT. REV. STAT. ch. 514 (1980), a quote from
a commentary from that province is appropriate. The commentary states that the test of
unconscionability must be made at "the time of agreement, but the subsequent events are
relevant in determining the true meaning of the agreement and in making apparent its latent
Que. C.A. 248, the court adopted the broad interpretation of Quebec Civil Code article 1040a.
is obviously in a predicament when the borrower asks him to revise the contract. If he revises when inflation is less than anticipated, but does not, in the absence of a statutory provision to that effect, in the opposite case, the inflation risk for the lender increases. This leads to higher interest rates, and hence to more corrective intervention, and so on. It is questionable whether the judge is really equipped to make the appropriate calculations in order to determine if the interest rate, considering all risk factors, is fair. Unquestionably, market rates adequately reflect the general risks, but risks which are specific to the borrower must be assessed otherwise.

Arguably, it may be simpler to adopt legislation authorizing any borrower of money to repay his loan at any time without penalty. Such legislation would allow him to refinance his debt when lower than expected interest rates make this option attractive to him.\(^{64}\) Such a provision already exists, for a particular case, in section 93 of the Consumer Protection Act.\(^{65}\) Under such a rule, competition may be expected to ensure to each borrower the lowest interest rate compatible with his particular risk pattern. Lesion provisions might then be reserved for gross abuse of patent inexperience of the borrower.

The Consumer Protection Act\(^{66}\) is best seen as a graft upon the body of the civil law found in the Quebec Civil Code. It restricts, for merchant-consumer relationships,\(^{67}\) the force of the principles underlying the civil law: autonomy, freedom of contract, consensualism and the binding force of contracts. These restrictions are only intended to reestablish a reasonable measure of equality of bargaining power between the parties by assisting the weaker and should be interpreted only to apply to the extent necessary to protect the consumer.\(^{68}\) They are part of what in the French legal literature is called the *ordre public économique de protection*,\(^{69}\) and they are imperative law in the sense that parties may not contractually derogate from provisions that ensure minimal protection to the consumer. Beyond this minimum, however, freedom of contract returns.

A few provisions of the Act may have a bearing on problems of inflation.\(^{70}\) Sections 8 and 9 of the Act contain very general lesion

---

64. The analysis equally applies to situations of deflation or sudden drop of interest rates, as have occurred since the autumn of 1982.
65. QUE. REV. STAT. ch. P-40.1, § 93.
66. Id.
67. QUE. REV. STAT. ch. P-40.1, § 2 reads: “This act applies to every contract for goods or services entered into between a consumer and a merchant in the course of his business.”
70. On Quebec consumer law, see generally Dagenais, Lalande, Roy-Lauzon, Lebeau,
provisions. The scope of these provisions goes beyond that of Quebec Civil Code article 1040c in that they cover all goods and services provided by merchants to consumers. The analysis presented earlier points to the difficulties in applying these provisions to inflation problems. In duration and credit contracts, it is the merchant, the creditor of the monetary obligation, who bears the inflation risk. He will protect himself against inflation by stipulating either a higher interest rate or an indexing clause. The lesion provision may come into play when these anti-inflation measures are excessively harsh for the consumer who did not fully understand their impact at the time of entering into the contract. The wording of section 8 is broad enough to allow the judge to take into account the possible disproportion of the obligations of the parties at the time of performance, when such disproportion may have resulted from changing circumstances caused by inflation. Section 93 permits costless payment of debts before maturity in credit contracts. Another protective measure is found in variable credit contracts, those that govern credit cards, for example. Interest rates on the unpaid balance may only be increased after six months notice by the lender, who is the card issuer in most cases.

Finally, inflation may be taken into account in installment contracts (conditional sales contracts). If the purchaser defaults, the merchant is not allowed simply to repossess the object sold, but must follow certain formalities. In the case in which the consumer has already paid more than half of the total sum, the merchant may repossess only with permission of the court. The judge deciding the issue must take into account a number of factors listed in section 109, one of which is "the value of the goods at the time of the consumer's default." Conceivably, the object

---

Masse, Morel & Vignola, Cahier 5: La consommation, in Guide d'information en droit (Soquij 1978); N. L'Heureux, Droit de la consommation (1981).
71. Sections 8 and 9 of the Consumer Protection Act, Que. Rev. Stat. ch. P-40.1, provide:

8. The consumer may demand the nullity of a contract or a reduction in his obligations thereunder where the disproportion between the respective obligations of the parties is so great as to amount to exploitation of the consumer or where the obligation of the consumer is excessive, harsh or unconscionable.
9. Where the court must determine whether a consumer consented to a contract, it shall consider the condition of the parties, the circumstances in which the contract was entered into and the benefits arising from the contract for the consumer.

72. See supra text accompanying notes 63-65.
73. Section 8 should be read distinctly from section 9. Since they are not written as two paragraphs of a single article, they should not be linked more closely by interpretation.
75. See id. ch. P-40.1, § 142.
76. See id. ch. P-40.1, §§ 109, 143. These sections read as follows:

109. The motion must be heard and decided by preference, considering, in particular, the following facts:
(a) the total of amounts that the consumer must disburse under the contract;
has depreciated little in nominal value or even has appreciated a little in spite of its use, in which case the court might refuse to authorize the merchant to repossess it.

Section 109 is also applicable to sales contracts involving credit which contain a clause of forfeiture of the benefit of the term. The consumer in default may ask the court to change the terms of payment as it deems reasonable or to authorize him to return the good to the merchant, thus extinguishing his obligation. The court, when deciding upon the consumer's request, takes into account, among other things, the value of the purchased good. Undoubtedly, this section was meant to prevent consumers from extinguishing their debts by returning purchased goods which have become worthless. Nevertheless, it could also be used by the courts to prevent consumers in distress from returning goods whose value is still a multiple of the balance to be paid.

**Unforeseeable Inflation**

A typical lawyer would distinguish foreseeable from unforeseeable inflation by referring to the test of the *bon père de famille* (prudent administrator): inflation is unforeseeable where a normally prudent and diligent person placed in similar circumstances would not have been able to foresee it. To give more specific content to such a formula, one might consider that a prudent person would expect inflation to be similar to what it has been in the immediate past. He might further draw ideas from the return on such things as government savings bonds, which take expected inflation into account. Hence, only *sudden* increases in the price level would be unforeseeable. In Quebec in 1982, an inflation rate of around ten percent over the next twelve months would be foreseeable on the basis of experience over the past years and publicly available information. An inflation rate of twenty percent or more, as exists in some South American countries, would be considered unforeseeable in Quebec.

(b) the sums already paid;
(c) the value of the goods at the time of the consumer's default;
(d) the balance due to the merchant;
(e) the consumer's ability to pay; and
(f) the reason for which the consumer is in default.

143. Such permission is applied for by a motion served on the consumer which must be heard and decided by preference. The court shall dispose of such motion after taking into account the facts mentioned in section 109.

77. See id. ch. P-40.1, § 110. It reads: "The return of the goods to the merchant authorized by virtue of section 107 extinguishes the consumer's contractual obligation and the merchant is not bound to return the amount of the payments he has received."

78. Since the autumn of 1982, the general inflation rate has been falling steadily. See *supra* note 1.

The law offers various solutions to contracting parties in the case of unforeseeable inflation. The first is judicial intervention based on *imprévisison*; the second is special legislation. The doctrine of *imprévisison* concerns situations where performance of the obligation, while not entirely impossible, has become much more burdensome than was initially anticipated as a result of changing circumstances. The contract, which may have constituted a fair exchange at the outset, no longer does so at the time of performance. According to this doctrine, the debtor is justified under those circumstances to refuse to perform. In other words, every contract is presumed to contain an implied *rebus sic stantibus* clause: the debtor is obliged to perform only if the essential conditions contemplated at the time of entering into the agreement have not changed. The consequences of a change vary according to the source consulted. For some, a change gives rise to dissolution or resolution of the contract upon demand; for others, the courts have the power to modify the contract, without the contract losing its validity.

The sudden increase in the price of all goods or of one particular good is perhaps the most obvious case in which the doctrine of *imprévisison* would apply. Unanticipated increases in the prices of raw materials or fuel used by a manufacturer are a prime example. The difficulties facing a German builder who undertook to construct and deliver a building for a fixed price, not anticipating the period of hyperinflation his country went through in the early 1920's, is an imaginable example.

Quebec law has not accepted the doctrine of *imprévisison*. Only for-tuitous events which render performance entirely impossible will free the debtor of his obligation. Where a change in circumstance makes it more onerous for the debtor to perform, without making it impossible, the debtor must perform and the court has no power even to alleviate his obligation. It may only intervene in the agreement where special legisla-

---

81. See K. ROSENN, *supra* note 3, at 84; Bohemier & Fox, *supra* note 80, at 81-83.
83. J. BAUDOIN, *supra* note 48, no. 579, at 305; M. TANCELIN, *supra* note 15, at 114-16. The *Cour de cassation* of France has also refused to accept the doctrine of *imprévisison*. B. STARCK, *Droit civil—Obligations* no. 1919, at 568 (1972) (summarizes the position of the court with respect to the various arguments in support of the doctrine of *imprévisison*: an implied clause *rebus sic stantibus* does not exist; equity and good faith are principles of interpretation and cannot be used to modify a clear contract; to insist on performance of a contract is not an abuse of right; there is no unjustified enrichment, since the justifica-
84. J. BAUDOIN, *supra* note 48, no. 579, at 305.
ly authorizes it to do so, but such exceptions are narrowly construed. In principle, the courts respect the binding force of contracts. Several authors have criticized Quebec law on this point, and one author has suggested that the courts could base the doctrine of imprévision on the general principle of equity expressed in Quebec Civil Code article 1024, which provides: "The obligation of a contract extends not only to what is expressed in it, but also to all the consequences which, by equity, usage or law, are incident to the contract, according to its nature." This article authorizes the court to complete and interpret contracts on the basis of equity. The article does not, however, authorize the court to construe the contract against the express agreement of the parties. Another author has proposed to introduce into Quebec law a general mechanism of judicial revision of obligations based on equity. The proposal would put an end to the current practice of multiplying the special cases in which an act authorizes the courts to intervene in contracts.

Would judicial intervention be a better response to acute inflation than across-the-board legislative revalorization of debts? At first blush, the courts would seem to be better able to take account of the particular circumstances of each case, such as the extent to which parties already took inflation into account when entering into the contract. Whether such confidence in the judicial process is justified remains to be seen. The sources of information open to the courts surely do not adequately prepare them for the delicate task of adjusting contracts undermined by inflation. Whether a judge is capable of assessing the impact upon the economy as a whole of his decision to grant full indexing in one instance is questionable. One may wonder whether fairness in the individual case, as the courts can express it, should prevail over consideration of economy-wide efficiency which the legislator can bring to bear in the fight against inflation. In most countries trying to cope with inflation of such a magnitude, judicial and legislative revalorization of debts seem to coexist.

Since Canada has had remarkable economic stability over the past decades, it is not surprising that Canadian legislation contains no permanent mechanism to deal with serious economic crises. Federal as well as provincial governments have coped with each crisis through ad hoc legisl-
tion. One recent example of such federal legislation was the Anti-Inflation Act, assented to on December 15, 1975. The preamble of the Act recognized that "inflation in Canada at current levels is contrary to the interests of all Canadians and that the containment and reduction of inflation has become a matter of serious national concern." The Act placed restraints on wages, prices, profit margins, dividends and compensation in Canada. On March 10, 1976, Quebec became the seventh province to sign an agreement with the federal government making the Anti-Inflation Act applicable to all sectors within its jurisdiction.

As far as the civil law is concerned, the controls obviously constituted an encroachment on freedom of contract. The price of a good or service was no longer determined by the contracting parties alone but was subject to administrative approval. Similarly, individual and collective labor agreements were subject to a commission's approval after the Act came into force. Except for minor retroactive effects, the Act looked to the future. This approach is very different from that which involves revalorizing existing debts in order to preserve the purchasing power of capital. The anti-inflation program appears to aim at the causes of inflation, rather than merely at the symptoms.

Legislation such as the Anti-Inflation Act remains exceptional. In principle, the legislator does not interfere with freedom of contract, leaving it to the parties to protect themselves against foreseeable inflation. A very different approach, however, is taken with respect to involuntary creditors.

**IN Voluntary Legal Relationships**

Involuntary legal relationships are distinctive from voluntary legal relationships in that, since the creditor does not acquire his claim against the debtor by contract, he is not at liberty to arrange it according to his preferences and to protect himself against inflation, even predictable inflation. Unless the creditor is expected to support the inflation risk, judicial or legislative intervention is essential to transfer that risk onto the debtor.

Involuntary legal relationships arise from delicts or quasi-delicts or from the direct operation of the law under Quebec Civil Code article 1057, which provides:

Obligations result in certain cases from the sole and direct operation of law, without the intervention of any act, and independently of the will of the person obliged or of him in whose favor the obligation is imposed.

89. 1974-75-76 CAN. STAT. ch. 75; see also Decary, Vers une nouvelle Loi anti-inflation?, La Presse (Montreal) July 14, 1982, at A6.
Such are the obligations of tutors and other administrators who cannot refuse the charge cast upon them;

The obligation of children to furnish the necessaries of life to their indigent parents;

Certain obligations of owners of adjoining properties;

The obligations which in certain cases arise from fortuitous events;

And others of a like nature.

An important example of the latter case is alimony. One may object that alimony results from what was a voluntary contract at the outset—the contract of marriage. Such an objection would stretch the meaning of freedom of contract far beyond its normal limits. The current idea of marriage excludes the possibility of requiring future spouses to settle the effects of a possible divorce before their marriage. Current law in Canada forbids the settlement of future claims for alimony by marriage contract. Hence, for alimentary creditors, as for other involuntary creditors, judicial or other intervention is essential if they are to be protected against inflation.

Those who suffer damage without a contractual link with the perpetrator generally have recourse against the latter under the chapter "Of offences and Quasi-offences" in the Quebec Civil Code.90 Within this group, the persons who stand to lose most as a result of inflation are those who have sustained physical injury. Physical injuries frequently have consequences throughout the victim’s life, and the compensation thereof raises delicate problems for the courts under ordinary civil law.91 For some specific groups, the legislature has set up exceptional compensation schemes, which are less generous than the ordinary civil law, but which afford better protection against inflation.92

In an ordinary delictual responsibility action, the victim may claim two kinds of damages: compensation for losses suffered and damages for the delays by his debtor in paying damages of the first kind. Compensation damages raise the problem of assessment; for damages due to delay, the relevant issue is the applicable interest rate.

A victim should be compensated for both present and future damages he may suffer. Present damages may cover, for instance, the loss resulting from the destruction of some good. Future damages may consist in earnings foregone as a result of physical injuries leading to permanent in-

90. Que. Civ. Code arts. 1053, 1056d.
92. See infra text accompanying notes 112-18.
CIVIL LAW AND INFLATION

capacity. Where compensation is claimed for the loss of a good, the courts must decide at what time the damages are to be assessed: at the time of the loss, at the time the action is brought, at the time of the hearing or at the time of judgment. Indeed, the assessment could be made at the time of the final judgment on appeal or even at the time of execution of this judgment. The question is academic in times of economic stability; in inflationary times, however, the question is highly relevant since the value of the lost good, expressed in depreciating currency, increases steadily at the pace of inflation. The later the damages are assessed, the more the creditor benefits; the earlier it is done, the more the debtor benefits. The date of assessment is equally relevant in cases concerning goods whose value fluctuates, such as a shipload of petroleum or bars of gold.

Two principles must be kept in mind in answering the question of when damages should be assessed. First, the victim creditor is entitled to full compensation of his loss. Second, he is not entitled to enrich himself at the expense of the debtor by receiving money damages the value of which exceeds his loss. Arguably, such an enrichment does not occur even where the sum of money necessary to compensate the victim at the time of judgment is higher than it was at the time of the loss, if the difference is due to inflation. The value of the loss has remained constant; only its monetary equivalent has increased as a result of inflation.

In order to ensure full compensation to the victim, Quebec courts have tended to push forward the date of assessment of damage to the time of the trial. They award the sum necessary to replace the loss as it is established during the trial. Their aim appears to be to restore the victim to his original position. Assessment does not take place at the time of the judgment. In rendering judgment, the court is bound by the evidence produced during the trial as regards the value of the good. This value may have increased between the hearing and the date of judgment, but recommencing the production of evidence on the subject would not be feasible. Hence, the trial judge establishes the value of a good at the time of the hearing. Courts of appeal, bound by the evidence produced at the trial level, follow the same rule. The practice of assessing damages at the time of the trial puts the burden of inflation until that time upon the debtor. This rule is only fair since the victim has done nothing to become creditor. He should, therefore, be shielded as much as possible from the effects of inflation.

A less frequent occurrence is one in which a good loses value between the date of the loss and trial. For example, a shipload of petroleum may be destroyed on the way to the harbor where it was to be sold at

a good price the next morning. The court should again aim at restoring the creditor to the position he would have had in the absence of the mishap. To accomplish this goal, the court should take into account the use to which the good was to be put. Since the petroleum was to be sold immediately, the proper damages are not the value of the same quantity of petroleum, but rather the price for which the party could expect to sell it at the agreed date. When petroleum prices tend to drop, the difference may be appreciable. Similarly, where gold has been bought for speculative purposes and not for immediate resale, the proper damages are not the price for which it could be sold at the time of the loss, but rather the replacement value at the time of the trial. In this manner, the victim recovers his speculative position.

These few examples show that the principle of *restitutio in integrum* gives rise to varying solutions in inflationary times. If the party who suffered the loss would still be in possession of the good had the accident not taken place, he should have a debt of value against the person who inflicted that loss. Such debts follow the value of the good involved, which may well change at a pace which differs from the general inflation or deflation rate. The assessment of the damages should, therefore, take place at the time of the trial. If, however, the party suffering the loss had the intention of selling the good between the time of the loss and trial, the assessment should take place at the time of the intended sale, and the sum should bear interest from that date.

Quebec law does not presently permit an accident victim who has sustained physical injuries to be compensated by means of an annuity consisting in periodic payments subject to revision as the circumstances of the victim or the economy in general change. The entire amount of the damages to be paid, including the losses which the victim will suffer in the future as a result of the accident, are to be expressed in a lump sum. The assessment of future damages in a lump sum has the advantage of settling disputes once and for all. This policy entails fewer costs for the courts and, hence, for society as a whole, than would a scheme permitting revision of periodic payments where circumstances warrant. Moreover, it has the advantage of creating incentives for the victim to return to active life as soon as possible. Although these advantages are readily apparent, they are offset by the inevitable imprecision in judicial evaluation of lump sums. The measurement of the incapacity sustained is already a process fraught with difficulties which are frequently resolved by rather arbitrary decisions. The forecasting of inflation for the rest of the victim's life is virtually within the realm of the occult sciences.

96. J. Baudouin, supra note 94, no. 125, at 94 & no. 141, at 105.
The procedure generally followed contains the following steps:

1. Determine the percentage of permanent incapacity of the victim;
2. Determine his working life expectancy;
3. Determine his expected average revenues during the remainder of his working life;
4. Compute the proportion of these revenues of which the victim will be deprived as result of the injury;
5. Compute the lump sum which has to be paid in order to produce an annuity equivalent to the lost revenues and which will be exhausted at the end of the victim's active life;
6. Reduce this sum by a certain amount because of hazards of life.

Inflation comes into this procedure at steps three (determination of future earnings) and five (calculation of a lump sum).

To determine future revenues of the plaintiff, the courts must estimate expected revenues for each of the remaining years in his working life. Several sources of uncertainty affect these estimates, and inflation is one of them. Inflation also enters into the estimate of the lump sum necessary to replace the lost revenues. The capital sum must be depleted at the end of the victim's working life, since he is entitled to full compensation, but no more. The estimate of the sum presupposes that the interest rate at which the victim can invest it during his working life is known.

The courts are not at liberty to refuse to grant judgment on the ground that estimating the loss of future revenues due to permanent incapacity would be difficult. They have developed, from their own experience and with the aid of experts, a set of principles and rules of thumb to guide them in estimating lump sums. Inflation appears to have played havoc with these rules in recent times.

The debate centers on the discount rate to be applied in estimating the lump sum to be paid which is to produce periodic payments over a long period. The Supreme Court of Canada, in three recent, severely criticized cases, placed the discount rate at seven percent. Mr. Justice

98. See Héritiers Nadeau v. Savard, 1972 Que. C.A. 802. Several cases recognize the principle that inflation or the depreciation of money should be taken into account in establishing the awards. How this should be done is not well established. See Riel v. Murren, 1972 Que. C.A. 367; Coca-Cola v. Driver, 1960 Que. C.B.R. 313; Pelletier v. Voyageurs, 1972 Que. C.A. 795.

Dickson arrived at this figure by subtracting from the average return on invested capital at the time, which he put at 10.5%, an inflation factor of 3.5%. Two recent decisions of the Superior Court of Quebec have put the discount rate at three percent. The economic evidence put before the court in these two cases appears to have been more sophisticated than that which was submitted to the Supreme Court. The superior court should have stated its reasons for deviating from the earlier Supreme Court decisions more convincingly. The issue is quite important because a high discount rate favors the defendant, the party who caused the accident, and a low rate is favorable to the victim. In one of the cases in which the Supreme Court had to decide the issue, a discount rate of seven percent would lead to a lump sum of $641,713, whereas at three percent the victim would have received $1,109,373.

The argument for adopting the three percent discount rate rests on the observation that in the long run, the difference between the inflation rate and the return on risk-free investment tends to remain constant. Over the past thirty years, this difference has fluctuated between 1.1% and 2.4%. This observation aids in calculating the proper discount rate without knowledge of either the inflation rate or the return on capital. The discount rate should be set at the best estimate of the gap between these two rates. The three percent figure adopted by the Superior Court appears to reflect such a policy, allowing for a small correction representing an error margin in favor of the victim. While this figure is arguably the correct one, it leads to substantial lump sums and will undoubtedly give rise to protests due to misunderstanding, such as those voiced a few years ago.

This solution of taking the difference between inflation and the return on risk-free capital without actually knowing either is seductively simple. One author has proposed that the Supreme Court adopt a discount rate along these lines in a decision of principle or policy statement, to avoid needless repetition of economic evidence in thousands of similar cases. Yet the same author submits that the solution cannot be quite so simple since the tax situation of the victim, which may substantially affect the lump sum required to replace lost revenues, should also be accounted for if the principle of full compensation, but no more, is to be respected.
Once the court has fixed the damages to which the victim is entitled for present and future losses, it cannot intervene again to adjust the amount for the inflation which occurs between the judgment and its execution. The creditor-victim is, however, protected by a different mechanism, namely the interest due on unpaid damages as provided for in Quebec Civil Code article 1056c. Until 1971, the first paragraph of article 1056c stipulated an interest rate of five percent. This rate was obviously insufficient; certain classes of debtors (primarily insurance companies) made profits by adopting the practice of delaying the payment of indemnities to their victims. To stop this abuse, the legislature added a second paragraph to article 1056c authorizing the courts to supplement this legal interest rate in order to make it equal to the rate charged to delinquent taxpayers under the Revenue Department Act.

Under this new rule, the interest rate has passed from eight percent in January 1972, to ten percent in May 1977, to fifteen percent in April 1980, to nineteen percent in January 1982 and back to sixteen percent in January 1983.

In contrast to the legal interest rate of five percent, the additional indemnity provided for in the second paragraph of article 1056c is not granted to the creditor automatically. He must ask for it, and the court has discretion to grant it. In practice, the discretion is limited to deciding whether, all circumstances taken into account, the victim has forfeited the benefit of this indemnity, totally or in part, for a cause attributable to him, such as unduly delaying the trial. This mechanism, surely essential in preventing abuse in inflationary times, has very recently been extended to all damages, whatever their source.

The ordinary rules of civil responsibility have made way, in a number of areas, for special compensation plans aimed at victims for whom the ordinary recourses of civil law are too onerous and hence ineffective, and who, as a result, have become social problems. Such plans have been instituted for victims of industrial accidents, for victims of criminal acts, for victims of automobile accidents and for victims of accidents related to acts of good citizenship. For industrial and automobile

111. See supra note 44.
accidents, the ordinary recourse against the responsible party has been eliminated in principle.\textsuperscript{116} The other two plans are optional and are complementary to the ordinary civil law.

The indemnities awarded under these plans differ in two important respects from those available under ordinary civil law. First, they are lower, but \textit{all} victims are compensated without delay. Second, those who suffer permanent loss of future earnings are given awards in the form of periodic payments as opposed to a lump sum. This last feature makes it possible to protect the beneficiaries of these acts against the consequences of inflation. The acts provide for revalorization of both the periodic payments and the guidelines for establishing the indemnity. For example, the maximum admissible revenue for the purpose of the calculation of the indemnity under the Automobile Insurance Act has risen from $18,000 in 1978, when the Act came into force,\textsuperscript{117} to $26,000 currently.\textsuperscript{118}

Although the benefits awarded under these acts are indexed to an extent, the complaint is frequently made that they are insufficient in that they do not fully compensate those whose earnings exceed the admissible maximum. The reply to this complaint is that nothing prevents this group from taking out additional insurance, the amount of which can be revised upwards as income increases.

Another class of involuntary creditors are those who depend on someone else for their subsistence,\textsuperscript{119} such as spouses or relatives in the direct line.\textsuperscript{120} They are protected against inflation by two mechanisms: judicial revision and indexing. Alimony, whether paid periodically or as a lump sum,\textsuperscript{121} may be revised "whenever circumstances so justify."\textsuperscript{122} The person who seeks a revision must prove a change in the needs and means

\begin{itemize}
\item \textsuperscript{116} Quebec Civil Code article 1056a provides: "No recourse provided for under the provisions of this chapter shall lie, in the case of an accident contemplated by the Workmen’s Compensation Act, 1931, except to the extent permitted by such act.” Quebec Civil Code article 1056d provides: "No recourse provided for under the provisions of this chapter shall lie, in the case of an accident contemplated by the Automobile Insurance Act, except to the extent permitted by such act.”
\item \textsuperscript{117} Que. Rev. Stat. ch. A-25, § 27.
\item \textsuperscript{118} See An act to amend the Automobile Insurance Act and other legislation, G.O.Q. pt. II, at 637, § 12 (English version 1983).
\item \textsuperscript{119} Barière, \textit{Influence de la dépréciation monétaire sur les obligations alimentaires}, in \textit{Influence de la dépréciation monétaire sur la vie juridique privée} 35 (P. Durand ed. 1961).
\item \textsuperscript{120} Article 633 of the Civil Code of Quebec provides: “Spouses, and relatives in the direct line, owe each other support.”
\item \textsuperscript{121} Article 637 of the Civil Code of Quebec provides: “Support is payable as a pension; the court may, by way of exception, replace or complete the alimentary pension by a fixed sum payable immediately or by instalments.”
\item \textsuperscript{122} Article 642 of the Civil Code of Quebec provides: “The judgment awarding support, whether or not it is adjusted, may be reviewed whenever circumstances so justify.”
\end{itemize}
of the parties or in their circumstances. Inflation may be a reason for revision, provided that it has affected the situation of the creditor. The creditor should not be forced to present himself before the court every time he seeks to have a minor adjustment made due to inflation. For this reason the new Civil Code of Quebec provides for the possibility of automatic indexing of alimony. Article 638 reads:

The court orders, on the motion of the creditor or, in the absence of such a motion, ex officio, that support payable as a pension be adjusted in accordance with the annual Pension Index established pursuant to section 119 of the Act respecting the Quebec Pension Plan (chapter R-9), unless the circumstances of the parties justify the fixing of another index.

Indexing of alimony does not take place automatically; the court must order it. This presupposes a hearing at which the parties may express their point of view, after which the judge chooses the most appropriate solution.

CONCLUSION

Inflation raises, in lawyers' eyes, three fundamental questions: (1) Should the law intervene in legal relationships because of injustice created by inflation? (2) If so, which authority should intervene? (3) By what criteria should this authority be guided?

The answer to these questions is not uniform throughout the civil law; from one area to the next, different degrees of intervention may be observed. It would be erroneous to conclude from this that lawyers are clueless with regard to inflation. By examining the way in which inflation affects people, one readily discovers principles which allow clarity to be brought into the apparent confusion of the law of inflation.

Inflation affects all obligations expressed in money by reducing their value. The creditor of a monetary obligation does not necessarily suffer damage as a result of inflation. To the extent that he has been able to foresee inflation—by means of the interest rate of commercial banks, for example—and to take it into account at the time when the obligation was created, he receives the value he expected. In other words, those who are parties to voluntary relationships do not need the law's protection against foreseeable inflation: freedom of contract should be sufficient.

123. Article 635 of the Civil Code of Quebec provides: "In awarding support, account is taken of the needs and means of the parties, their circumstances and, as the case may be, the time needed by the creditor of support to acquire sufficient autonomy."


The law limits itself, in their regard, to provisions of subsidiary law corresponding to what they would presumably choose themselves.

This principle is slightly mitigated to accommodate a group of people who are deemed unable to take care of their own interests properly, even though they are parties to voluntary relationships. These groups are given special protection aimed at correcting their vulnerability in contractual relationships. Since these rules are exceptions to the ordinary principles of civil law, they have been created by the legislature rather than the courts and they do not specifically address the problem of inflation. The different focus of these rules creates difficulties for the courts in applying them to inflation.

The law must find solutions for those who face unforeseeable inflation and those who are parties to involuntary relationships. Where inflation is truly unforeseeable, solutions must govern society as a whole. Only the legislature has the powers required to solve the problem in this case since such solutions require data to which, in the Quebec judicial tradition, the courts do not generally have access.

Finally, there are the involuntary relationships. The creditor of the monetary obligation in such a relationship cannot protect himself against inflation, foreseeable or not, and to make him bear the burden of inflation would be unfair. Hence, public authority must come to the rescue. Where inflation is unforeseeable, the legislature must protect him. In cases of foreseeable inflation, the courts may assume this role concurrently with the legislature.

The classification proposed here explains why the reasons to intervene in private relationships as well as the intervening authority vary from one area to another. Two of the three questions formulated above are thus answered. The third question is more complex. The criteria underlying the decisions of intervening authorities are not always obvious; in some cases there appear to be none at all.

Where the legislature has stepped in to adjust pensions and other monetary obligations, the correction has usually been less than the inflation rate. Such a policy can be defended as an attempt to dissuade citizens from being indifferent to inflation, where such indifference would prolong and even stimulate inflation. Nonetheless, this policy may well have modified the wealth distribution among groups in society. Be that as it may, the great losers in the inflation game are those who live on fixed revenues.

Elsewhere, the legislature has intervened to prevent certain groups from taking advantage of differences between the market and the legal system. The legal system should have the same flexibility as the market in inflationary times. This principle also plays a role (but for the courts this time) in the calculation of future loss of revenue as a result of
CIVIL LAW AND INFLATION

personal injury. By choosing the proper discount rate, the courts must prevent irresponsible individuals from destroying the physical integrity of their fellow citizens at bargain prices. There is room here for an explicit rule on the subject, which would put an end to the needless repetition of economic evidence before courts of first instance. Such a rule, be it judicial or legislative, should have the flexibility of market discount rates.

A final guideline adopted by the courts is leaving the assessment of damages to the last possible moment. The assessment takes place not at the time when the damage was caused, but at the time of the trial. The creditor, the party who has suffered the damage, is thus shielded from inflation between the occurrence of the damage and trial. This benefit is of some importance at high inflation rates such as were experienced from 1980 through 1982. Thus, the courts implicitly convert such claims into debts of value, a concept of German origin for which several bases can be found in the Quebec Civil Code.

The difficulty inflation creates for the lawyer is that it complicates his sense of equivalence: equivalence of performance in contract, which is the basis of fair exchange, and equivalence of damages to the harm that was done. The equivalence must be judged not only for the past, but also for the future. Equivalence for the future is based on expectations, surely one of the most subjective and elusive concepts in the law. Inflation thus forces the lawyer to refine his sense of justice by recognizing equivalence, the principle of *suum cuique tribuere*, in new disguises.

## APPENDIX

### Consumer Price Index, Inflation Rate, and Unemployment Rate

<table>
<thead>
<tr>
<th>Year</th>
<th>C.P.I.*</th>
<th>Rate of Inflation**</th>
<th>Rate of Unemployment**</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971</td>
<td>100.0</td>
<td>2.9</td>
<td>6.2</td>
</tr>
<tr>
<td>1972</td>
<td>104.8</td>
<td>4.8</td>
<td>6.2</td>
</tr>
<tr>
<td>1973</td>
<td>112.7</td>
<td>7.5</td>
<td>5.5</td>
</tr>
<tr>
<td>1974</td>
<td>125.0</td>
<td>10.9</td>
<td>5.3</td>
</tr>
<tr>
<td>1975</td>
<td>138.5</td>
<td>10.8</td>
<td>6.9</td>
</tr>
<tr>
<td>1976</td>
<td>148.9</td>
<td>7.5</td>
<td>7.1</td>
</tr>
<tr>
<td>1977</td>
<td>160.8</td>
<td>8.0</td>
<td>8.1</td>
</tr>
<tr>
<td>1978</td>
<td>175.2</td>
<td>9.0</td>
<td>8.4</td>
</tr>
<tr>
<td>1979</td>
<td>191.2</td>
<td>9.1</td>
<td>7.5</td>
</tr>
<tr>
<td>1980</td>
<td>210.6</td>
<td>10.1</td>
<td>7.5</td>
</tr>
<tr>
<td>1981</td>
<td>236.9</td>
<td>12.5</td>
<td>7.6</td>
</tr>
<tr>
<td>1982</td>
<td>262.5</td>
<td>10.8</td>
<td>11.0</td>
</tr>
</tbody>
</table>
