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When you're in a trade war, Canadian contract law matters

By **Marco P. Falco**

Law360 Canada (April 8, 2025, 2:35 PM EDT) -- Apart from the severe economic consequences like rattled markets and threat of a recession, a trade war also imposes significant uncertainty on commercial agreements with cross-border components. The decision by the American government to impose tariffs on various Canadian goods will have huge implications for Canadian businesses.

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Where Canadian contract law applies, corporations should be aware of the legal arsenal they may have at their disposal to enforce obligations or end their agreements entirely. Should the threat or imposition of tariffs continue, these contract law doctrines will prove paramount in the months to come.

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With the help of legal counsel, Canadian businesses must strategize to make the most of contractual principles and provisions that could provide a remedy. These doctrines include the following:

1. Force majeure

A *force majeure* clause in a business agreement addresses situations where the performance of the contract changes significantly as a result of circumstances beyond the control and foresight of the parties.

These clauses usually require the following:

- The party who claims to be excused must give notice (usually the seller or supplier);
- A period of grace during which the situation can, perhaps, be dealt with (or revert to normal) should be included; and

- A point at which either party can bring their contractual relationship to an end must be specified.

Force majeure clauses typically provide for excuses from contractual duties in the event of "acts of God," "acts of the Queen's or public enemies" and labour disruptions.

In Canadian contract law, these clauses are typically interpreted narrowly, requiring the party relying on them to meet rigid prerequisites to trigger their effect.

In the leading 1976 Supreme Court of Canada decision, *Atlantic Paper Stock Ltd. v. St. Anne-Nackawic Pulp and Paper Co.*, [1976] 1 S.C.R. 580, the court explains the operation of a *force majeure* clause as follows:

> An act of God clause or *force majeure* clause … generally operates to discharge a contracting party when a supervening, sometimes supernatural event, beyond the control of either party, makes performance impossible. The common thread is that of the unexpected, something beyond reasonable human foresight and skill.

Broadly speaking, Canadian courts have shown a reluctance to enforce *force majeure* clauses, unless all the necessary preconditions of the clause have been met. For example:

- In *Atlantic Paper*, *supra*, the Supreme Court of Canada declined to enforce a *force majeure* clause where the plaintiff wanted to stop purchasing paper under its contract because there was no market for the corrugating medium at that time. The plaintiff sought to rely on the *force majeure* clause in the parties' contract. The court held that the lack of a market for the goods was in fact due to the plaintiff's failure to devise an effective marketing plan, and not any of the circumstances set out in the f*orce majeure* clause; and
- In *Transcanada Pipelines Ltd. v. Northern and CentralGas Corp Ltd.*, [1983] O.J. No. 2999, the Ontario Court of Appeal declined to enforce a *force majeure* clause in an agreement between gas distributors due to labour disruptions and an explosion at a rotary cooler. The court interpreted the clause narrowly, holding that it should be restricted only to events that occurred on the parties' own gas system.

The strict approach to *force majeure* clauses has its exceptions, however.

During the COVID-19 pandemic, for example, parties to commercial leases frequently obtained rent abatements and other relief on the strength of an enforceable *force majeure* clause. (See *Windsor-Essex Catholic District School Board v. 2313846 Ontario Ltd. (c.o.b. Central Park Athletics)*, 2021 ONSC 3040, aff'd 2022 ONCA 235.)

2. Frustration

The doctrine of frustration is triggered where, due to a supervening event for which no provision was made by the parties in their contract, the performance of the contract itself becomes "radically different from that which was undertaken" (*Patterson Veterinary Professional Corp. v. Stilton Corp.*, [2019] O.J. No. 4853, at para. 17).

If frustration occurs, all obligations under the contract are extinguished as of the date of the frustrating event.

Given the significant consequences of a successful claim of frustration, the courts have also interpreted this doctrine narrowly. The burden is on the party seeking to rely on frustration to show that a supervening event occurred, which would cause one of the contracting parties to do something that is "radically different" than what the parties had agreed to under their agreement (*Perkins v. Sheikhtavi*, 2019 ONCA 925).

Because price changes are an inherent risk in any market, for example, frustration claims based on dramatic fluctuations in the economy often fail.

3. Fundamental breach

Unlike *force majeure* and frustration, which are dependent on extra-contractual events, fundamental breach speaks to the parties’ conduct under their agreement.

A fundamental breach occurs when one party fails to perform a “primary obligation” under the contract, which has the effect of depriving the other party of “substantially the whole benefit” of the agreement itself (*Hunter Engineering Co. v. Syncrude Canada Ltd.*, [1989] 1 S.C.R. 426).

Where one party breaches a contract in a “way that is so serious or fundamental that the breach goes to the root of the contract,” the offending party has repudiated.

Where the contract is repudiated by a fundamental breach, the innocent party may elect to either treat the contract as being in full force, or accept the repudiation and terminate it.

If the innocent party elects to terminate the agreement, both parties are discharged from their future obligations. Where the price of goods in a supply agreement, for example, changes in such a significant way so as to go to the root of the contract itself, there may be a fundamental breach.

The innocent party then has an election to terminate the contract, or accept it, and continue at the new and varied price.

4. Good faith

All contracts in Canada are subject to the organizing principle of good faith. This includes both a duty to act honestly (*Bhasin v. Hrynew*, 2014 SCC 71) in the performance of the contract itself, and an obligation to exercise contractual discretion reasonably, i.e., in accordance with the purposes for which the discretion was granted (*Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage District*, 2021 SCC 7).

Where a party to a contract lies, is dishonest, or exercises any discretion unreasonably, the other party has a claim for breach of contract, usually resulting in damages. The duty of good faith applies to all Canadian contracts, and the parties cannot contract out of this obligation.

In dealing with the imposition of tariffs, if a contracting party does not act in a reasonable and forthright manner, they may be in breach of their duty of good faith.

Importance of contract law doctrine in the context of tariffs

There is no question that the imposition of tariffs will affect many North American supply agreements and commercial contracts. If Canadian courts have jurisdiction over the agreement in question, parties would do well to consider their rights and potential liabilities in the context of the doctrines above. Strategy and preparation, in times of volatility, remain key.

While U.S. tariffs continue to inject uncertainty in the market, legal remedies may provide the necessary antidote. At a minimum, they constitute a form of recourse, holding parties to their end of a contractual bargain.

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