Managing unforeseen risks in supply chain contracts: Choice of law considerations

March 20, 2025

While the topic of U.S. tariffs has dominated recent headlines and turned the attention of business leaders and legal advisors to supply chain matters, often there are more basic legal considerations at play that are not adequately scrutinized by those carrying out cross-border business: basic contractual terms respecting unforeseeable events, which can be significantly impacted by applicable law governing supply agreements, purchase orders, bills of lading and other legal documentation. During the COVID-19 era, businesspeople and legal professionals were extremely focussed on force majeure and “material adverse change” clauses in key agreements. Although the pandemic has subsided, there remain contractual risks in supply chains that may be avoided with a better understanding of basic principles excusing contractual performance such as the theory of unforeseeability under Québec law and the doctrine of frustration at Canadian common law.

Key takeaways

Within Canada, absent particular clauses to the contrary, it is difficult for suppliers to be excused from contractual performance due to unforeseen economic hardship.

Unlike other civil law jurisdictions, Québec law does not recognize the doctrine of unforeseeability as a way to excuse performance or force a renegotiation of a contract when unforeseen events make performance excessively onerous. This doctrine is a private law rule under which parties can be required to renegotiate a contract if, as a result of unforeseen events, performance of the obligations stipulated in the contract would be excessively onerous for one of them.

By contrast, Canadian common law provides for the doctrine of frustration, which permits the termination of a contract when unforeseen events make performance impossible or fundamentally alter the contract’s nature. Since economic hardship alone is not sufficient to invoke frustration, Canadian common law provinces are reluctant to excuse supplier performance for unforeseeable events causing suppliers economic harm.

Foreign jurisdictions take similar but nuanced approaches. New York State law, for example, divides frustration into two separate doctrines: impossibility (excusing

performance when an event makes it objectively impossible) and frustration of purpose (relieving a party when an unforeseen event renders the contract "virtually worthless"). Here too, however, there is a high bar to excuse supplier performance.

To mitigate risks to suppliers associated with suppletive law, parties should proactively seek to incorporate clauses within their commercial contracts that relieve suppliers of their contractual obligations where unforeseen events render performance unduly expensive.

Background: The importance of fundamental principles related to excusing contractual performance

Subsection 1: *Théorie de l'imprévision* under Québec law

Under the civil law doctrine of unforeseeability, also referred to as *Théorie de l'imprévision*, parties can be required to renegotiate a contract if, as a result of unforeseen events, performance of the obligations stipulated in the contract would be excessively onerous for one of them. A number of civil law jurisdictions, including France, have adopted the doctrine of unforeseeability into their domestic laws to temper the binding force of contracts where changes in market conditions alter the nature of a contract. However, in 2018, the Supreme Court of Canada reaffirmed that the doctrine is not recognized in Québec civil law.

This doctrine of unforeseeability should not be confused with the concept of force majeure. The latter, incorporated in the Civil Code of Québec, allows parties to be relieved from their contractual obligations when events are unforeseeable and irresistible, making performance impossible. However, parties can broaden the concept by specifying events in the contract that would qualify as *force majeure*. In such cases, this clause generally takes precedence over the suppletive civil law concept. If the contract does not contain a force majeure clause, the general civil law concept will apply by default.

Subsection 2: Doctrine of frustration at Canadian common law

At Canadian common-law, contractual hardship is governed by the rules of non-performance, including the doctrine of frustration. This doctrine allows for the termination of a contract when unforeseen circumstances render its performance impossible or give it a fundamentally different nature from what was originally contemplated by the parties at the time of the contract's formation.

Canadian common law sets a very high threshold for frustration. The doctrine only applies in circumstances where it has become impossible to perform the contract due to an unforeseen event and without fault on the part of either party. A mere increase in cost or difficulty in performing the contract is generally not sufficient to invoke frustration; the event must impact the very essence of the contract. An event that merely makes performance less desirable, economically valuable, or more expensive will not constitute frustration. Unless the court finds that the triggering event impacts the nature,

meaning, purpose, effect and consequences of the contract, it is unlikely to conclude that frustration has occurred — regardless of the severity of the economic damage.

At common law, the term force majeure is used in contractual clauses but does not function as an independent legal doctrine as it does in civil law jurisdictions. The parties must explicitly define the specific events that will be considered as force majeure in their contract.

Whether a force majeure event is triggered depends on the interpretation of the specific clause in question. For example, in *Porter Airlines Inc. v. Nieuport Aviation Infrastructure Partners GP*, the Court was tasked with determining whether the COVID-19 pandemic was a force majeure event under the terms of the contract between Porter Airlines Inc. (Porter), a commercial air carrier, and Nieuport Aviation Infrastructure Partners GP (Nieuport), the owner, manager and operator of the airport terminal out of which Porter operated. In March 2020, Porter suspended its operations in support of ongoing public health efforts to contain COVID-19 and advised Nieuport that COVID-19 constituted a force majeure event under the terms of the parties' agreement. In response, Nieuport disputed that COVID-19 was a force majeure event. In its decision, the Court concluded that the parties' force majeure clause was not triggered by the pandemic. While the Court acknowledged that the pandemic caused a decline in demand, negatively impacting Porter, the airline had failed to establish that the pandemic directly prevented it from fulfilling its payment obligations to Nieuport or made performance impossible. The Court determined that, based on the specific wording of the force majeure clause at issue, the pandemic would have had to restrict Porter from meeting its payment obligations under the agreement in order to constitute a force majeure event.

Can the threat of U.S. tariffs coming into force on products from Canada qualify as a force majeure event? The risk of increased costs due to tariffs or government action is typically allocated under the parties' contract and is not likely to constitute a force majeure. Canadian courts have refused to apply force majeure provisions when government actions outside the parties' control simply result in increased costs of performance. A force majeure clause is typically intended to address extraordinary events, not protect a party from the ordinary risks of a contract or to reallocate risks already agreed upon by the parties, even if those terms create economic hardship for one of them.

While traditional force majeure language may not excuse performance due to rising tariffs, each force majeure clause will be interpreted based on its own specific language. As such, parties can reconsider and expand the scope of their force majeure clauses to include economic and other disruptions. Courts are more likely to uphold force majeure provisions when the contract expressly outlines the specific events that would trigger them.

Subsection 3: Consideration of NY law

New York law does not recognize the doctrine of frustration, but instead recognizes two related yet distinct doctrines, each covering different types of situations. The doctrine of impossibility excuses performance when extraordinary intervening events occur. The party invoking this doctrine must prove that the subject matter of the contract or the means of performance have been destroyed, making performance objectively

impossible. It is not sufficient to show that an event has rendered performance prohibitively expensive or impractical.

On the other hand, the doctrine of frustration of purpose excuses performance when an unforeseen event renders the contract “virtually worthless” to the affected party. The unexpected supervening event must eliminate the impacted party’s main purpose for entering into the transaction, even though performance remains possible. The key question in frustration of purpose is not whether a party can perform the contract, but whether its reason for doing so still exists. As with the doctrine of impossibility, frustration of purpose does not typically apply merely because performance has become more economically burdensome.

As in Canadian common law, force majeure under New York law refers to a contractual clause that excuses a party from performing its obligations when an event beyond its control prevents performance. New York courts interpret these clauses narrowly, strictly adhering to the events listed in the contract. If an event is not specifically mentioned, it is unlikely to qualify as force majeure.

This why parties sometimes include "catch-all" provision to either broaden the concept (e.g., or other similar or dissimilar events) or narrow it. In such cases, courts apply the principle of *ejusdem generis*, meaning only events of the same nature as those explicitly listed in the clause will be considered within its scope.

Subsection 4: BLG’s take on this

In light of the different default rules applicable in various jurisdictions, businesses engaged in cross-border transactions should exercise caution when selecting applicable law in Canada and abroad and turn their attention to the applicable rules in the jurisdiction of choice. Including clauses to deal with unforeseen events is typically a wise choice, particularly if you are the supplying party or advising one. This is particularly important under Québec law since it offers no recourse to a vendor facing a significant price increase if the contract does not contain a relief clause.

While Canadian common law may, in some cases, provide relief to a vendor facing a drastic rise in costs, the uncertainty of judicial interpretation, the high threshold for frustration, and the exclusion of purely economic hardship should also encourage parties to direct their attention to doing their utmost to address the contractual management of unforeseeable events.

Practical advice for C-suite / executive-level clients

- **Understand the consequences of choice of law in supply contracts before signing**
  Unlike in jurisdictions where unforeseen and severe economic hardship may excuse a party from its contractual obligations, businesses supplying goods or services pursuant to Canadian contracts should exercise caution. They must understand the legal consequences of governing law and its default provisions.
- **Navigate legal nuances with expert guidance**
  A business deal is only as secure as the legal framework supporting it. Companies should seek legal counsel from professionals well-versed in

Canadian contract law before finalizing agreements and paradoxically do their best to address the consequences unpredictable circumstances leading to economic hardship. BLG's lawyers have the expertise to guide clients through complex contracts and mitigate unforeseen risks.

BLG can assist

If you have any questions or need further clarification on these legal matters, please contact the author of this article. Our team of experts is well-versed in navigating complex cross-border contractual issues and can help guide you through the intricacies of Canadian contract law.

Footnotes

[1] *407 E. 61st Garage, Inc.* v. *Savoy Fifth Avenue Corporation*, 296 N.Y.S.2d at 344

[2] *A + E Television Networks*, 2016 WL 8136110, at *13

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