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THE POTENTIAL IMPACT OF THE UKRAINE CONFLICT ON CONTRACTS BETWEEN CANADIAN AND RUSSIAN COMPANIES

Posted on March 8, 2022

Categories: Insights, Publications

Canadian companies that have commercial contracts with Russian entities now face immediate legal and reputational risks arising from the invasion of Ukraine and the resulting economic sanctions imposed by Canada and other countries. Many commercial arrangements simply cannot be performed as contemplated by the parties, either physically or legally, and Canadian companies need to understand their potential liabilities, or those of their counterparties, if contracts are terminated or not performed.

McMillan is providing ongoing updates on the unprecedented economic measures that Canada is taking in response to the war in Ukraine. Those updates can be viewed here and here . This bulletin complements those updates and addresses three legal tools that Canadian companies should understand and seek advice on if they are no longer able to perform contractual agreements because of the events surrounding the war in Ukraine and the world's response.

1. Sanctions Compliance and Mandatory Rules of Canadian Public Policy

Canadian companies that have entered into commercial contracts with Russian counterparties should begin by considering the governing law and dispute resolution provisions of those contracts. The governing law, together with the terms of the contract, will determine a party's right to terminate the agreement or the application of doctrines such as force majeure that excuse non-performance. The contract may also indicate whether any disputes are to be resolved in Canadian or foreign courts, or through international arbitration.

Regardless of the governing law and the choice of forum, a contract may be unenforceable if it is against Canadian public policy. What is against public policy is determined on a case-by-case basis and, in a fast-moving situation like the war in Ukraine, it is difficult to predict. However, generally speaking, a contract will not be enforced if performance would require one party to do something illegal, such as violating economic sanctions. Depending on how the situation evolves, other public policy considerations may raise issues of fundamental morality that would render a contract unenforceable, even in the absence of strict illegality.

Public policy can also form the basis for a Canadian court to refuse to recognize and enforce a foreign judgment or arbitration award. For example, if a party breached its contract because Canadian sanctions

would not permit that party to perform, and that party was found liable in a foreign court or international arbitration tribunal seated outside of Canada, then Canadian courts may still refuse to recognize and enforce that concept or award against that party in Canada. At the same time, not every inconsistency with Canadian law raises an issue of public policy. The foreign judgment or arbitral award would need to raise issues of fundamental morality or public order.

2. Force Majeure Clauses and Suspension of Obligations

Companies dealing with Russian entities or with operations affected by the war in Ukraine should examine their commercial contracts to see if they have a force majeure clause. A force majeure clause sets out the parties' agreement to suspend contractual obligations when the non-performing party is not at fault for specific reasons. These reasons can include war, civil unrest, insurrection or other events that inhibit performance of the contract as contemplated when the parties entered into it.

In most common jurisdiction laws, force majeure rights only exist if they are expressly included in a contract. By contrast in many civil law jurisdictions, such as Quebec, force majeure applies as a matter of law even if the parties have not expressly included such a clause in their contracts.

In both common law and civil law jurisdictions, the scope and consequences of a force majeure event will depend on the wording of the contract. Some force majeure clauses may simply suspend performance of specific obligations, but leave others intact. Others may allow a party to bring the entire agreement to an end if the force majeure event persists for a length of time, and define the process and who bears the costs or other consequences.

Canadian companies should check whether their contracts contain force majeure clauses and take advice on the scope and consequences now, to ensure they can utilize such protection, should the need arise. For example, there may be requirements set out in the contract, such as providing notice or taking other steps, before the party may avail itself of protection offered by a force majeure clause.

3. The Doctrine of Frustration and Termination of Contractual Obligations

If the objective of a contract becomes impossible to fulfill as originally contemplated, then the doctrine of frustration may apply and both parties may be released from their obligations going forward. This may occur if, for example, war physically destroys the subject matter of the contract. Alternatively, it may occur if economic sanctions prohibit dealing with specific Russian entities or with their property, thereby making performance of a contract impossible without doing something illegal. In these instances, the law may recognize a contract as being at an end.

However, frustration is a high bar to meet. It not only requires that the parties cannot perform the contract as

originally contemplated *right now* , but also that there is a level of permanence to the situation sufficient to bring the contract to an end. The existence of frustration must be evaluated on a case-by-case basis, but events like war and economic sanctions can satisfy these strict requirements if, by their nature, they are indeterminate.

Frustration is not a cure-all, as the courts may bring to an end the parts of a contract which are frustrated while leaving others intact. In doing this, courts will seek to discover whether part of the contract can still be performed, as well as whether the parties contemplated the risk of certain events occurring at the time they entered into the contract. To the extent that parties can still perform part of the contract or could have reasonably foreseen the events that have transpired, the court may be reluctant to simply discharge the contracting parties from their obligations.

As a result, if Canadian companies are disrupted in their performance of contractual obligations, then they need to understand the reason and extent to which their obligations under the contract are rendered impossible by the current situation.

McMillan's commercial dispute team guides clients through the most complex commercial issues. He has extensive experience in cross-border litigation and international arbitration matters, as well as providing advice in dynamic political and economic situations. They regularly work closely with McMillan's trade experts on issues relating to economic sanctions and other regulatory matters.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.