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Supreme Court upholds non-liability clause in Québec commercial contract in key ruling

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Canada's highest court has unanimously ruled that Québec law allows parties to limit or exclude their liability in a freely negotiated non-consumer contract. In *6362222 Canada inc. v. Prelco inc.*,[1] the Supreme Court of Canada had to decide whether a limitation of liability clause could be nullified based on the doctrine of breach of a fundamental obligation. In its decision, the Court deferred to the intention of the commercial parties and upheld the validity of the clause. This judgment is critically important for commercial parties contracting under Québec law.

Background

The underlying dispute concerned a contract between 6362222 Canada inc. (Createch), a software consulting firm, and Prelco inc. (Prelco), a manufacturer. Under a 2008 agreement between them, Createch was to supply software and professional services to assist Prelco in implementing an integrated management system.

Createch took the lead in preparing the contract between the parties. Among other provisions, the contract included a limitation of liability clause that stipulated that Createch's liability to Prelco for damages attributed to any cause whatsoever was confined to fees paid to Createch. In addition, Createch was exonerated from liability for damages resulting from the loss of data, profits, revenue or use of products, or for any other special, consequential or indirect damages. Prelco accepted these conditions, without requesting any changes.

The performance of the integrated management system was fraught with issues. In 2010, Prelco terminated the contract and engaged another firm to improve the system's functionality. Prelco brought an action against Createch for damages in the amount of $6,246,648.94 for reimbursement of an overpayment, costs for restoring the system, claims from customers and loss of profit.[2] Ultimately, the fundamental issue at hand was whether the limitation of liability clause in the contract effectively limited damages recoverable by Prelco.

At trial, the Superior Court of Québec held that the limitation of liability clause was inoperative, relying on the doctrine of breach of a fundamental obligation.[3] It held that Createch had breached its fundamental obligation by failing to properly consider Prelco's operating needs when implementing the integrated management system. The Québec Court of Appeal upheld the decision, agreeing that a breach relating to a fundamental obligation was sufficient to neutralize a limitation of liability clause.[4]

The doctrine of breach of a fundamental obligation in Québec law

Pursuant to the doctrine of breach of a fundamental obligation, an exoneration clause or limitation of liability clause (together referred to by the Supreme Court as "non-liability clauses") is without effect when it operates to override the very essence of an obligation. This doctrine is founded upon two possible and distinct legal bases.

Public order

First, a non-liability clause relating to a fundamental obligation is inoperative if it is contrary to a rule of public order that limits freedom of contract.

As a preliminary point, non-liability clauses are valid in principle. This notion has its roots in the Supreme Court's 1897 decision in *The Glengoil Steamship Co. v. Pilkington*[5] where the non-liability clauses were affirmed based on freedom of contract. This validity in principle also arguably implicitly arises from articles 1474 and 1475 of the *Civil Code of Québec.*[6]

However, the permissibility of non-liability clauses may be circumscribed by legislative and judicial public order. For instance, article 1437 CCQ explicitly references the doctrine of breach of a fundamental obligation for consumer contracts and contracts of adhesion. This was a legislative choice in response to the power imbalance between the contracting parties. Should a party include a non-liability clause relating to a fundamental obligation in these specific circumstances, the Code would render it invalid.

Courts in common law provinces have similarly interpreted non-liability clauses. In the common law, this analysis is considered by way of the doctrine of fundamental breach. The Supreme Court's 1989 decision in *Hunter Engineering Co. v. Syncrude Canada Ltd.*[7] established that the doctrine of fundamental breach must recognize that exclusion clauses are not necessarily unreasonable. This was further elaborated upon in *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*,[8] which confirmed that courts must consider whether a clause should be rendered inoperative due to the existence of any overriding public policy.

Reciprocity of obligations and total absence of cause

Second, there is an argument that, by allowing a debtor to rely on a non-liability clause to avoid responsibility for breaching a fundamental obligation, the debtor effectively neutralizes the reciprocal prestation (benefit) owed to the creditor and deprives the contract of its cause. Article 1371 CCQ states that it is of the essence of an obligation that there be persons between whom it exists, a prestation that forms its object and a cause that justifies its existence.

This reciprocity of obligations argument is based upon the premise that, should a debtor be released from all its fundamental obligations, the reciprocal nature of the contractual relationship would be violated. Without this reciprocity, the creditor's contractual obligation is effectively deprived of its cause — i.e., the logical and objective reason a party accepts its obligations, expecting the performance of the correlative obligations.

The Supreme Court's ruling

Writing for a unanimous Court, Chief Justice Wagner and Justice Kasirer allowed the appeal and held that the limitation of liability clause between Prelco and Createch was valid.

The Court emphasized that the parties were entirely free to structure their contractual relationship as they saw fit. Unlike a situation involving a consumer contract or a contract of adhesion, both Prelco and Createch were sophisticated and economically balanced parties. Citing the freedom of contract principles established in *Glengoil* and supported by article 1437 CCQ, the Court noted that a judge has no legislative basis upon which to apply a principle inconsistent with the Code.

On the argument regarding a lack of reciprocity of obligations, the Court held that the limitation of liability clause in this case was not one that would preclude reciprocity. Rather, pursuant to the terms of the agreement, Createch owed substantial obligations to Prelco. For example, Prelco was entitled to keep the integrated management system, obtain damages for unsatisfactory service and be compensated for the necessary costs for specific performance by replacement.

Although the Court acknowledged that the benefits to the parties may have been relatively imbalanced, it held that imbalance is not the litmus test for a lack of reciprocity. Instead, article 1371 CCQ forbids a contract with *no* counterprestation (reciprocal benefit) whatsoever, which was not the case for the contract between Prelco and Createch. Ultimately, the Court opted not to opine on whether an exoneration clause or limitation of liability clause can deprive the correlative obligation of its cause more generally.

Conclusion

The principles set forth by the Supreme Court are critical in upholding the basic principle of freedom of contract as between sophisticated commercial parties and establishing that such a principle is not easily negated by the doctrine of breach of a fundamental obligation. This decision is a reminder that while non-liability clauses may be considered "boilerplate," they can have a significant impact and should be managed accordingly.

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[1] 2021 SCC 39.

[2] Createch also filed a cross-application for $331,134.42, representing the unpaid balance on the project.

[3] 2016 QCCS 4086.

[4] 2019 QCCA 1457.

[5] (1897), 28 SCR 146 (*Glengoil*).

[6] "CCQ" or the "Code."

[7] [1989] 1 SCR 426.

[8] 2010 SCC 4.