The Supreme Court of Canada's Decision in Prelco: The Application of Limitation of Liability Clauses in Case of a Breach of a Fundamental Obligation of a Contract

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Introduction

Non-liability clauses are often included in many types of contracts. In principle, they are valid and used to limit (limitation of liability clause) or eliminate (exoneration clause) the liability of a party with respect to its obligations contained in a contract.

The recent unanimous decision of the Supreme Court of Canada confirms that under Quebec law, parties may limit or exclude their liability in a contract by mutual agreement. However, a party may have such a clause declared inoperative by invoking the doctrine of breach of a fundamental obligation of the contract. In this case, the Supreme Court of Canada confirmed the validity of the clause at issue and circumscribed the limits of the application of the doctrine.

The Supreme Court of Canada's decision

The facts

The dispute relates to a contract signed between 6362222 Canada inc. ("**Createch**"), a consulting firm specializing in the improvement and implementation of integrated management systems, and Prelco inc. ("**Prelco**"), a manufacturing company specializing in the fabrication and transformation of flat glass. Under the terms of the contract that the parties concluded in 2008, Createch was to provide software and professional services to help Prelco implement an integrated management system.

Createch prepared a draft contract and Prelco did not ask for any changes to the proposed conditions. A clause entitled Llimited Liability was included in the contract, which stipulated that Createch's liability to Prelco for damages attributed to any cause whatsoever would be limited to amounts paid to Createch, and that Createch could not be held liable for any damages resulting from the loss of data, profits or revenues or from the use of products or for any other special, consequential or indirect damages.

When the system was implemented, numerous problems arose and Prelco decided to terminate its contractual relationship with Createch. Prelco brought an action for damages against Createch for the reimbursement of an overpayment, costs incurred to restore the system, claims from its customers and loss of profits. Createch filed a cross-application for the unpaid balance for the

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project.

At trial, the Superior Court of Québec concluded that the limitation of liability clause was inoperative under the doctrine of breach of fundamental obligation, because Createch had breached its fundamental obligation by failing to take Prelco's operating needs into account when implementing the integrated management system.

The Court of Appeal of Québec confirmed the trial judge's decision and held that the doctrine of breach of fundamental obligation can annul the effect of an exoneration or limitation of liability clause by the mere fact that a breach relates to a fundamental obligation.

The Supreme Court of Canada's reasons

The Supreme Court of Canada allowed the appeal and set aside the decisions of the lower courts. *Per* Chief Justice Wagner and Justice Kasirer, the Supreme Court held that the limitation of liability clause in the parties' contract was valid, despite the fact that Createch had breached its fundamental obligation.

The Supreme Court addressed the two legal bases for the existence of the doctrine of breach of fundamental obligation:

1. the validity of the clause having regard to public order and
2. he validity of the clause having regard to the requirement relating to the cause of the obligation.

In this case, the Court determined that public order could not render the limitation of liability clause inoperative as the contract at issue was one by mutual agreement and the parties were free to share the risks associated with a contractual breach between them, even if the breach involved a fundamental obligation.

As for the validity of the limitation of liability clause, the Court determined that it was not a no obligation clause that would exclude the reciprocity of obligations. Createch had significant obligations to Prelco, and Prelco could keep the integrated management system, obtain damages for unsatisfactory services and be compensated for necessary costs for specific performance by replacement, but no higher than what had been paid to Createch. A limitation of liability clause does not therefore deprive the contractual obligation of its objective cause and does not exclude all sanctions. The Court explains:

"[86] Thus, art. 1371 *C.C.Q.* applies to contract clauses that negate or exclude all of the debtor's obligations and, in so doing, deprive the correlative obligation of its cause. Where a contract includes such clauses, it can be said that the reciprocal nature of the contractual relationship is called into question (arts. 1371, 1378 para. 1, 1380 para. 1, 1381 para. 1 and 1458 *C.C.Q.*). To apply a more exacting criterion would amount to annulling or revising a contract on assessing the equivalence rather than the existence of the debtor's prestation and, as a result, to indirectly introducing the concept of lesion, which is narrowly delimited in the *Code*."[1]

Prelco remains bound by the limitation of liability clause in this case. The Supreme Court of Canada is of the view that the trial judge and the Court of Appeal erred in law in declaring the limitation of liability clause inoperative. It allowed Createch's appeal.

Conclusion

This Supreme Court of Canada decision confirms the importance of the principles of autonomy of contracting parties and freedom of contract between sophisticated legal persons in Quebec law. The doctrine of breach of fundamental obligation does not permit the circumvention of the principle of freedom of contract: It cannot be said that an obligation is deprived of its cause when a sanction for nonperformance of obligations fundamental to the contract is provided for in a limitation of liability

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clause.

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1. [1] *6362222 Canada inc.* v. *Prelco inc.*, 2021 SCC 39, para. 86..

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