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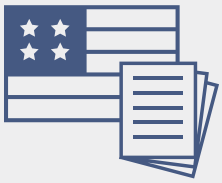
Trading with Americans: applying Canadian law is not always advantageous

By **Martin Aquilina, International Business Lawyer**



According to conventional wisdom, a party should always push to have its local laws govern its contract. True, applying your own country's law to a contract can provide certain advantages such as more certainty in the legal process and costs. However, in certain cases, it may be advantageous for a party to have a foreign law apply instead. In this article, we review the circumstances where it might be more beneficial for a Canadian party to a sales contract to disregard convention and select U.S. law as the governing law of the contract.

Commercial contracts, in addition to choice of forum and law clauses, often contain clauses that limit the liability of parties. This is especially prevalent in contracts for sale of goods and services. For instance, a contract could limit the liability of an equipment manufacturer up to the replacement value of the equipment. In determining the enforceability of such clauses, courts in Canada will apply the test as set out in the Supreme Court of Canada case of Tercon Contractors Ltd v British Columbia (Transportation and Highways), 2010 SCC 4. There are three elements that the courts will consider when applying the test:

1. WHETHER AS A MATTER OF INTERPRETATION, THE LIMITATION OF LIABILITY CLAUSE IS APPLICABLE;

A court will look at the intention of the parties as expressed in the contract to determine whether the limitation of liability clause applies to the case before it.

2. IF THE CLAUSE APPLIES, WHETHER IT WAS UNCONSCIONABLE AND THUS INVALID AT THE TIME THE CONTRACT WAS MADE;

"Unconscionability" refers to a great inequality of bargaining power between the parties such that the clause is substantively oppressive to one party.

3. WHETHER THERE IS AN OVERRIDING PUBLIC POLICY REASON FOR THE COURT TO NOT ENFORCE THE CLAUSE.

A court may look at factors such as the behaviour of the party relying on the limitation clause and whether the value derived from enforceability outweighs important societal values.

It is rare for our courts to find a limitation of liability clause unenforceable for unconscionability (second element) or for public policy reasons (third element). Therefore, unless they are not properly drafted, such clauses are almost always enforced by Canadian courts. This means that it will be difficult for aggrieved customers of suppliers of goods and services to obtain remedies beyond the limited liability contemplated in the contract if it is governed by Canadian law.

On the other hand, our neighbour to the south has a law, the Uniform Commercial Code (the "UCC"), which has been adopted by all 50 states (although some states have adopted only parts of it) that under certain circumstances provides a party with remedies beyond what is stipulated in the limitation of liability clause. Specifically, Section 719 of the UCC states the following:

1. Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages,

   (a) the agreement [for the sale of goods] may provide for remedies in addition to or in substitution for those provided in this [Article 2, which deals with sales] and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and

   (b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

2. Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act.

3. Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

The two elements to consider from above are: (a) if the remedy as provided for in the contract fails of its essential purpose (that is to say, it does not provide a minimally adequate remedy in the circumstances such as a repair or replacement of a damaged or defective good), other remedies such as recovery of consequential losses may be available; and (b) a limitation of liability

clause will be invalid if it is unconscionable. The interpretation of these two elements vary from state to state. For instance, in many states, if there is a failure of essential purpose, the clause will be unenforceable. On the other hand, for states such as California and New York, the prevailing view is that the two elements are independent such that a limitation of liability clause can still be valid despite the failure of essential purpose.

So, what is the takeaway from all this? Canadian suppliers who believe that the limitation of liability causes that are in their contracts will shield them from claims from their customers should be wary of contracts governed by U.S. law. As for Canadian buyers, it may actually be advantageous to have U.S. law apply in case of disputes as this may open the door to circumventing limitations on a buyer's rights to make a claim against its supplier that are set out in the contract. Buyers may need to balance that advantage with the costs of bringing an action in the U.S. as the same jurisdiction is often selected for both choice of forum and choice of law. However that is another piece of conventional wisdom that should not be treated as an undisputed truth.

ABOUT THE AUTHOR

Martin Aquilina is a seasoned international business lawyer with twenty years of experience in structuring domestic and cross-border transactions, including purchases and sales of businesses, joint ventures, corporate partnering and loan transactions. Furthermore, he regularly advises Canadians doing business overseas and foreign clients doing business in Canada. Given his broad knowledge of foreign legal systems, he is called upon to assist in sorting out a wide panoply of situations with an extra-territorial element, such as foreign inheritance laws. Over the years, Martin has built a reputation as an astute negotiator and he particularly enjoys tackling complex business and legal issues on behalf of his clients.

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