SUPERIOR COURT

CANADA
PROVINCE OF QUEBEC
DISTRICT OF MONTREAL

Nos: 500-05-070786-023
500-17-015647-038

DATE: DECEMBER 12, 2012

PRESIDING: THE HONOURABLE GARY D. D. MORRISON, J.S.C.

No: 500-05-070786-023

HEWLETT-PACKARD FRANCE
Plaintiff
vs
MATROX GRAPHICS INC.
Defendant and Plaintiff in warranty
and
STMICROELECTRONICS INC.
Defendant in warranty

No: 500-17-015647-038

MATROX GRAPHICS INC.
Plaintiff
vs
STMICROELECTRONICS INC.
Defendant

JUDGMENT

JM2455

I. INTRODUCTION

[1] Matrox Graphics Inc. "MGI" required a memory device to incorporate into various series of redesigned graphic cards. These cards would eventually be incorporated by MGI's customers into computers which display graphics. Hewlett-Packard France "HPF" is one of those customers that acquired the redesigned graphic cards from MGI.

[2] MGI's redesign was intended to reduce costs. It was moving to a serial architecture with lower density that would reduce the electronic board's footprint. STMicroelectronics Inc. "ST" was one of only a few manufacturers world-wide that could produce such a memory microchip with the density required. Its product was the M35560 E^2PROM, an electrically erasable programmable read-only memory device "E^2".

[3] Once it qualified the E^2, MGI began using ST's device. Malfunctions on electronic boards equipped with MGI's graphic cards began to be identified and HPF reported failures. MGI points so ST's E^2 as the cause of those problems – an alleged defect.

[4] Various law suits have been born of these events. HPF claims that it has suffered damages, in excess of twenty-four million dollars, as a result of the defective graphic cards[1]. It has sued MGI for payment. That claim remains to be heard. It is not the subject of this judgment.

[5] As a result, MGI has instituted an Action in Warranty against ST, claiming that if MGI is held liable to HPF, then ST should reimburse MGI: an anticipatory indemnity action. As well, MGI has instituted a Direct Action[2] against ST, claiming other damages, in excess of twenty-one million dollars, which it alleges resulted from the defective E^2. This judgment does not deal directly with either determining liability or damages in those claims.

[6] Faced with those two actions, ST alleged that its contractual terms and conditions included a choice of forum clause. ST sought to have the Quebec proceedings referred to the competent courts in the State of Texas. Both this Court[3] and the Court of Appeal[4], for different reasons, dismissed ST's demand.

[7] With the Superior Court of Quebec retaining jurisdiction, ST sought to have certain issues determined prior to a trial on the issues of liability and damages. It filed a

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1 500-05-070786-023, Province of Quebec, District of Montreal.
2 500-17-015647-038, Province of Quebec, District of Montreal.
3 *Hewlett-Packard France* c. *Matrox Graphics Inc,* 2007 QCCS 31, (the "Dismissal Judgments").
4 *STMicroelectronics Inc.* c. *Matrox Graphics Inc.*, 2007 QCCA 1784, (the "Appeal Decision").

Motion to Split in each of the Action in Warranty and the Direct Action. The Court granted the request and ordered the splitting of action in both[5].

[8] The Splitting Judgments contain specific questions "Stipulated Questions" which this Court ordered be decided in a first stage trial in each action. The Stipulated Questions relate to the applicability of a choice of law provision and, if applicable, the consequences thereof in accordance with Texas law. The Direct Action and the Action in Warranty have been joined for the present purposes. The First Stage Trial has taken place.

[9] The present judgment decides the answers to the Stipulated Questions.

II. THE STIPULATED QUESTIONS

[10] The Stipulated Questions to be answered are set out in the Splitting Judgments. They are the following:

> The Direct Action:
>
> I) Are the contracts between ST and Matrox governed by the laws of the State of Texas?
>
> 2) Is the Matrox Action time-barred, in whole or in part, under Texas law?
>
> 3) Is the Matrox Action ill-founded based on Clauses 12(a) and 14 of ST's Ts & Cs?
>
> The Action in Warranty:
>
> 4) Are the contracts between ST and Matrox governed by the laws of the State of Texas?
>
> 5) Is Matrox's Action in Warranty ill-founded based on either:
>
> a. Texas law governing claims in warranty; or
>
> b. Clause 14 of ST's Ts and Cs as applied under Texas law?

[11] For practical reasons, the Court will deal with the Stipulated Questions in a different order.

- Firstly, Questions 1 and 4, as to the applicability of Texas law, will be determined together;

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[5] *Hewlett-Packard France* c. *Matrox Graphics Inc*., 2009 QCCS 6737, (the "Splitting Judgments").

- Secondly, Questions 3 and 5b, dealing with limitations of warranty, remedies, liability and damages;

- Then, Question 2, as to whether the Direct Action is prescribed;

- And finally, Question 5a, as to whether the Action in Warranty is ill-founded due to Texas law governing warranty actions.

[12] The Stipulated Questions raise additional related questions. Those will be identified and dealt with in the appropriate sections of the analysis that follows.

[13] The positions of the Parties will be stated and analyzed on a question by question basis. Suffice it to say as a general comment that ST answers the Stipulated Questions in the affirmative; MGI answers in the negative.

[14] Before proceeding further, a few abbreviations used in the Stipulated Questions merit clarification:

- The name "Matrox" refers only to MGI and no other corporate entity. That is the definition given to it in the Splitting Judgments. The fact that various witnesses include different corporate entities in the term "Matrox" does not change the definition for these purposes. Nor does it change the identity of the Party to the proceedings.

- The abbreviations "Ts & Cs" and "Ts and Cs" mean Terms and Conditions.

- "Matrox Action" means MGI's Direct Action.

III. ANALYSIS

QUESTIONS 1 + 4: ARE THE CONTRACTS BETWEEN ST AND MATROX GOVERNED BY THE LAWS OF THE STATE OF TEXAS?

[15] The essence of this question is whether the parties mutually consented to the choice of Texas law provision found in ST's Ts & Cs. That provision is found in Clause 19, the same clause as the choice of forum provision analyzed in the Appeal Decision. As the determination applies to both the Direct Action and the Action in Warranty, the Court will deal with Questions 1 and 4 simultaneously.

[16] To understand the issue more clearly, Clause 19 of ST's Ts & Cs contains both the choice of forum and the choice of laws provisions. It reads as follows:

> **19. GOVERNING LAWS:** This contract will be governed by and construed in accordance with the laws of the State of Texas, and in the case of an

> international sale of goods with respect to which the Convention on Contracts for the International Sale of Goods ("CISG") or any other law would otherwise apply, the Uniform Commercial Code as adopted in the State of Texas, and not CISG or any such other law, shall apply. Buyer agrees that it will submit to the personal jurisdiction of the competent courts of the State of Texas and of the United States sitting in Dallas County, Texas, in any controversy or claim arising out of the sale contract, and that service of process mailed to it at the address appearing on the reverse side hereof by registered mail, return receipt requested, shall be effective service of process in any such court[6].

[17] ST proposes that the Appeal Decision has already decided that Clause 19 applies – *res judicata*. Therefore, Texas law must apply.

[18] MGI disagrees. Its position is that the dispositive[7] of the Appeal Decision is limited in scope. The Court of Appeal only decided the issue of choice of forum. The rest of the Appeal Decision is composed that is not binding and not conclusive – *obiter dicat*.

[19] MGI raises a substantial number of specific arguments against the application of the choice of law provision. These can be summarized by the following categories:

> (1) Not all the necessary criteria are met to support *res judicata*. There is no identity of object or of cause;
>
> (2) It would be a flagrant injustice to conclude that the Appeal Decision already decided that the law of Texas applies. This would violate the rules of natural justice and the principle of *audi alteram partem*; the issue was never argued in relation to the choice of forum;
>
> (3) There are "live" issues to be determined at Trial, such that a prudent approach is warranted at this stage.

[20] The first issue to address is whether *res judicata* applies to the choice of Texas law provision in Clause 19. The application of *res judicata* to the limitation Clauses 12(a) and 14 will only be analyzed after.

[21] In order to answer whether Texas law applies, there are a number of sub-questions that need be answered:

> (i) What are the applicable criteria under Quebec law for applying *res judicata* and are those criteria met in this case?

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6 D-27.

7 The word "dispositive" is used to mean the same as "dispositif" in French. Although "dispositive" is currently used as an adjective in the English language, the Court uses it as a noun, which it once was, so as to respect the meaning of the French word.

(ii) Assuming Clause 19 is binding, does it state a valid choice of law?

(iii) Does *res judicata* apply to Clauses 12(a) and 14?

(iv) Would applying Texas law result in a violation of natural justice and the *audi alteram partem* principle?

(v) Are any "live issues at trial" prejudiced?

[22] An absolute legal presumption is born of the authority of a final judgment - *res judicata*. It cannot be rebutted. This absolute presumption is established in Article 2848 C.C.Q.

[23] The purpose of the presumption has been the subject of doctrine and jurisprudence over decades. Suffice if to say that it is intended to serve both a public and private interest, including avoiding a multiplicity of trials and the possibility of contradictory judgments[8]. It is essentially a matter of the efficient and orderly use of the judicial system in such a manner as to provide reliability and certainty to the parties. As will be seen later, this purpose is relevant to this particular case.

[24] Moreover, the presumption of *res judicata* is so important under Quebec civil law that it will apply even to a final judgment that contains an error[9].

[25] This latter principle is of some relevance to the present matter. MGI contends that the Appeal Decision was based in part on a Record containing an incorrect fact, such that the proof before the Court of Appeal was wrong.

[26] MGI refers to an enlarged copy of Clause 12(a) of the ST's Ts & C's which was filed before the Superior Court and formed part of the Record before the Court of Appeal[10]. MGI argues that the actual wording of Clause 12(a) differs. It qualifies this as an "earthquake", since the difference favours ST. It argues that it is enough to prevent ST from benefiting from *res judicata*. But MGI has not demonstrated that it did not know or could not have known of these differences at the time. MGI's contention that it has relied on ST, in good faith, is not a justification for saying it was unaware of the word differences in Clause 12(a). Not having responded to ST's Notice to Admit[11], MGI is even deemed to have admitted D-4; in any event, its attention was drawn to the exhibit and it did not raise the wording differences at that time. Nor has MGI demonstrated, or even argued, that it attempted to either have a new hearing or have the Appeal Decision corrected. That being said, such errors, as in this case, are not of such nature or impact

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8 *Rocois Construction Inc.* c. *Québec Ready Mix Inc.*, [1990] 2 R.C.S. 440 at p. 448.

9 *Roberge* c. *Bolduc*, [1991] 1 R.C.S. 374; Julie McCANN, *Prescriptions extinctives et fins de non-recevoir*, Montréal, Wilson & Lafleur, 2011, p. 185 et 186.

10 D-4.

11 Notice to Admit (Art. 403 C.C.P.), dated June 29, 2010.

to justify refusing the presumption of *res judicata*, should it otherwise apply. The Court has no reason whatsoever to consider the wording differences to have negatively impacted on the judgments rendered to date in these files – those judgements have not somehow been tainted by the different wording.

[27] That said, does an absolute presumption result from the Appeal Decision? This will be decided through the sub-questions identified above and analyzed below.

i) What are the applicable criteria under Quebec law for applying res judicata? Are those criteria met in this case?

[28] The applicable criteria are identified in Article 2848 C.C.Q.[12]. These include the triple identify of parties, object and cause. In addition, there are other requirements which are threshold in nature: the judgment must be rendered by a competent court and it must be final.

[29] No one questions the competency of the Court of Appeal to have rendered the Appeal Decision. Before addressing the three identities, however, MGI does question whether the Appeal Decision is a final judgment, at least as regards everything other than the strict choice of forum issue. Everything else, it contends, is *obiter dicta*.

[30] The Court does not view MGI's position as germane to the existence of *res judicata* per se. It is essentially an argument as to scope – if there is *res judicata*, what does it cover? The Appeal Decision is most certainly a final decision. Its dispositive governs the parties. But for that decision, the parties would likely be before the courts of Texas, not the Superior Court of Quebec. The issue of scope, if need be, will be dealt with later.

[31] As for the triple-identity criteria, there is no dispute as to the identity of the parties. The two remaining identity issues need to be analyzed – object and cause.

[32] Is there identity of object? Put otherwise, is the "immediate legal benefit[13]" sought in relation to the Dismissing Judgment and the Appeal Decision the same as it is here.

[33] MGI argues that the dispositive in the Appeal Decision only deals with the object of referring the case to the courts of Texas. It concedes that the essential reasons intimately connected to a court's dispositive are also covered by *res judicata*.

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[12] Art. 2848 C.C.Q.: "The authority of a final judgment (*res judicata*) is an absolute presumption; it applies only to the object of the judgment when the demand is based on the same cause and is between the same parties acting in the same qualities and the thing applied for is the same."

[13] *Rocois Construction Inc.* c. *Québec Ready Mix Inc.*, *supra* at p. 451.

And rightly so, as that is precisely the wording that has been used by the Quebec Court of Appeal[14].

[34] Given that statement, were essential reasons for the Court of Appeal's decision on choice of forum intimately connected to the application of Clause 19, and the choice of law provision?

[35] The Appeal Decision states that the first of two (2) questions raised in the appeal before it is: "les «terms and conditions» de STM, et particulièrement la clause 19 de ces derniers, font-ils partie du contrat entre les parties et lient-ils Matrox[15]?"

[36] The Court of Appeal then analyzes the entire issue of the exchange of terms and conditions between the parties. It concludes that the parties are indeed bound by their various Ts & Cs, that those of MGI do not exclude Clause 19 and that MGI is bound by Clause 19. That portion of the Appeal Decision is an essential and integral component of its dispositive as to the choice of forum. That question is raised in the Appeal. It is most definitely intimately connected to that dispositive.

[37] But does that settle the criteria of "object"? Can we now say that there is *res judicata* as to the binding effect of Clause 19? Not quite yet; one more step is required.

[38] As already mentioned, the Appeal Decision identifies two (2) questions. The first has now been analyzed. The second question is the following: "Supposant que la clause 19 lie les parties, cette clause énonce-t-elle une élection de for valable et effective[16]?"

ii) Assuming Clause 19 is binding; does it state a valid choice of law?

[39] The Court of Appeal analyzes the content of Clause 19 in order to determine whether it was a valid choice of forum. In doing so, the Court of Appeal states that Clause 19 has two components: one is the choice of law, the other is the choice of forum. It proceeds to analyze the choice of Texas law component. It recognizes that it is permitted by Art. 3111 C.C.Q. As well, it recognizes that Quebec courts are competent to apply foreign law, the proof of which is made in conformity with Art. 2809 C.C.Q.

[40] Is this analysis in the Appeal Decision simply *obiter dictum*? Is it simply said in passing, or is it intimately connected to its dispositive on choice of forum?

[41] The Court concludes that the analysis of the choice of law provision is intimately connected to the Court of Appeal's dispositive. The Court of Appeal[17] specifically

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14 *Contrôle Technique appliqué ltée* c. *Québec (Procureur général)*, J.E. 94-743 (C.A.).
15 Appeal Decision, par. 21.
16 Appeal Decision, par. 21.
17 Appeal Decision, par. 88 and 89.

applies a test of the valid choice of law provision to determine whether that is sufficient to confirm a choice of forum. It determines that, although there is a valid choice of law provision, it is not sufficient to confirm the choice of forum. But, that does suffice, however, for this Court to conclude that the determinations are intimately connected. The Court of Appeal has already determined that Clause 19 is a valid choice of law provision.

[42] And even if the choice of law component of the Appeal Decision was *obiter dicta*, the end result would be the same. This Court would need to determine if it was a valid choice of law. On its face, it is. The choice of foreign law in Clause 19 is clear and unequivocal. The commentary of the Court of Appeal would be the same reasoning that this Court would apply to conclude that it is a valid choice of law clause. However, this Court need not so decide.

[43] The Court determines that the identify of object has been met.

[44] So, is the third identity, that of "cause", met?

[45] MGI argues that there is no identity of cause. Essentially, it argues that the legal characterization of the various Ts & Cs is different for choice of law than for choice of forum. Being different, it is open to apply a different standard of consent. That standard, it argues, is higher for choice of law in Clause 19 (and for Clauses 12(a) and 14) than it is for choice of forum.

[46] As for Clause 19, MGI characterizes the choice of Texas law as a renunciation of rights under Quebec law, and therefore requires a higher level of consent.

[47] That higher level of consent is essentially that a party's consensual renunciation of a right must be unequivocal, even if tacitly given[18]. MGI adopts the position that the Appeal Decision only applies a standard of consent for choice of forum, not the standard of consent required for renouncing to applicable principles of Quebec civil law. It says this given the Court of Appeal's reference to Art. 3148, 2nd paragraph[19], which relates only to choice of forum and arbitration clauses - it argues that the Court of Appeal obviously did not intend to determine any other issue.

[48] What rights does MGI say it would be renouncing should the choice of law clause apply?

[49] MGI answers that the renunciation is twofold. Firstly, it is the right of a buyer under Quebec law to prevent a manufacturer or professional seller from excluding or limiting its liability for latent defects (Art. 1728-1733 C.C.Q.). The Court considers this is an argument more in relation to Clauses 12(a) and 14 than as to choice of law

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[18] *The Mile End Milling Company* c. *Peterborough Cereal Company*, (1924) S.C.R. 120 at p. 131.
[19] Appeal Decision, *supra*, par. 63.

generally. That said, there is no Quebec prohibition or rule of public order preventing these parties from contractually modifying liability for defects in their sales of goods.

[50] Secondly, MGI argues that Texas law differs from prescription under Quebec law. Under the former, ST's expert opines that prescription begins to run from the date of delivery regardless of when the buyer acquires knowledge of the defect. No authorities have been submitted by MGI to support its argument that choosing a different law on prescription is contrary to public order or requires greater levels of consent. Moreover, MGI's counsel acknowledges that a party need not know what differences exist under foreign law before accepting to be governed by it.

[51] In addition, according to MGI, should the Court conclude that the law of Texas applies in the manner advanced by ST, then its claims for $46,059,726.51 might only be worth $47,859, approximately .0015% of its combined claims. Although understandably of great importance to MGI, it is not that potential result which dictates the application of the Ts & Cs. The decision is not to be based on equity but on the principles of Quebec civil law governing *res judicata*.

[52] The Appeal Decision already determined that MGI had tacitly consented to Clause 19. The parties discussed four (4) of MGI's five (5) Ts & Cs. They did not discuss those of ST[20]. The fact is that MGI had an unwritten internal policy not to take cognizance of and never to consider another party's Ts & Cs; MGI would not look at them, would not read them. The Appeal Decision reproduces four pages of testimony to that effect[21]. Moreover, MGI never advised ST of its policy[22].

[53] It is in that factual backdrop that MGI argues that ST has failed to establish that it unequivocally accepted the choice of law provision in Clause 19.

[54] The Appeal Decision analyzes this issue of MGI's consent to Clause 19. Inspired by other case law, the Court of Appeal concludes that there is no difference between a party that is voluntarily blind and a party that is grossly negligent[23]. Sophisticated parties, like MGI and ST, that are used to international transactions, should make the necessary verification of exchanged documents or ultimately bear the consequences[24]. The specific consequence here is that MGI has already been held to have had knowledge of ST's Clause 19 and to have accepted it.

[55] This Court is not sitting in appeal of the Appeal Decision. It is not to consider whether the Court of Appeal decided correctly or reasonably. The First Stage Trial does not constitute a proverbial second kick at the can. The Court determines that there is

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20 Appeal Decision, *supra*, par. 9, 10, 11, 12, 13, 15, 16, 17, 18, 28, 29, 35, 36.
21 Appeal Decision, *supra*, pp. 5-9.
22 Appeal Decision, *supra*, par. 20.
23 Appeal Decision, *supra*, par. 39-41.
24 Appeal Decision, *supra*, par. 42

identity of cause as regards the choice of Texas law in Clause 19 of ST's Ts & Cs. Accordingly, the test of the three identifies having been met, and subject to concluding on the following sub-questions, there is *res judicata* regarding the application of Clause 19 and the choice of Texas law.

iii) Does res judicata apply to Clauses 12(a) and 14?

[56] Does the same reasoning and conclusions expressed above apply to the limitation and exclusion of liability provisions (Clauses 12(a) and 14)?

[57] MGI argues that it does not; the Appeal Decision is silent as to Clauses 12(a) and 14. Nor does the Appeal Decision determine whether MGI gave its clear and unequivocal consent to renounce its rights under those clauses. Nor does the Appeal Decision consider Art. 1475 C.C.Q. – whereby a party who invokes notice of an exclusion or limitation of liability must prove knowledge of it existence at the time the contract is formed.

[58] MGI candidly drops its argument that limitation and exclusion of liability is a matter of public order. Nevertheless, it argues that the Court of Appeal does not analyze Clauses 12(a) and 14 and that it was not necessary to its decision; those clauses are not intimately connected to the decision on choice of forum. It argues that the same type of distinction applies here as was applied in *Burton et al* vs. *Ville de Verdun*[25], – a decision that a municipal by-law is valid does not constitute *res judicata* as regards an issue of acquired rights under that by-law.

[59] In order to determine whether the choice of forum clause applies, the Court of Appeal decided that it must first determine whether the Ts & Cs exchanged between the parties are binding. That is an essential element intimately connected to its dispositive.

[60] The Appeal Decision determines that all of ST's and MGI's Ts & Cs are consented to by the parties and are binding, so long as ST's do not contravene those of MGI. In case of contradiction, MGI's Ts & Cs would govern[26]. Accordingly, it is not necessary to reproduce clauses 12 (a) and 14 for the purposes of following this issue.

[61] It is essential to ask the following questions: Why does the Appeal Decision hold that all the Ts & Cs are binding? Why does it not simply address the issue of whether the choice of forum portion of Clause 19 excludes the Quebec courts' jurisdiction?

[62] The answer lies, at least in part, in MGI's argument to exclude all of ST's Ts & Cs on the basis of an over-riding absence of consent. Before the Superior Court, leading to the Appeal Decision, MGI wrote that one of the indisputable ("véritables")

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[25] *Burton et al* v. *Ville de Verdun*, [1998], AZ-98011720 (C.A.).
[26] Appeal Decision, *supra*, par. 69.

questions before the Court was the following: had the parties concluded a contract on the basis of ST's standard conditions[27]? Only after arguing that it had not consented to ST's Ts & Cs, did MGI argue directly on the exclusionary aspect of the choice of forum.

[63] As mentioned earlier, the Court of Appeal considered the contract formation question to be one of the key questions of the appeal.

[64] MGI's position has always been the same. It claims never to have consented to any of ST's Ts & Cs – none of them. The Court of Appeal faces that question head-on. The Appeal Decision evaluates MGI's systemic internal policy of not looking at or considering suppliers' Ts & Cs and concludes that there is no difference between voluntary blindness and gross negligence.

[65] How does that differ between consent given under Clause 19 versus consent under Clauses 12(a) and 14? It does not. This result is of MGI's making – it cannot now claim that it would prefer another. MGI could have raised additional argument against a finding of consent, and this before the Superior Court and the Court of Appeal. But not having so, it must accept that the Appeal Decision also stands as a rebuke to what it could have argued and chose not to[28]. The overriding objective is to avoid contradictory judgments.

iv) Would applying Texas law result in a violation of natural justice and the audi alteram partem principle?

[66] MGI argues that to apply *res judicata* constitutes a flagrant procedural and substantive injustice. It violates the rules of natural justice by violating the principle of *audi alteram partem*. But the reality is that MGI has had its day (actually, many days) in court on the issue of contract formation between it and ST. It has been heard at length twice previously. It has argued the issue. It has sought to convert the First Stage Trial into a process to modify that result, while acknowledging that no public order issue is at stake. The Court does not accept that the rules of natural justice have been or are being violated.

v) Are any "live issues at trial" prejudice by applying res judicata?

[67] Throughout the First Stage Trial, both in written argument and orally, MGI's counsel has adopted the position that the Court is faced with something akin to a Motion To Dismiss and a Motion To Apply Texas Law. They raise warnings about deciding issues at a preliminary stage, with an incomplete evidentiary record. They invite the Court "to defer the issues in dispute to trial", as ST is attempting to short-circuit a full debate through the use of its Stipulated Questions.

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[27] "Argument Sommaire de Matrox Graphics Inc.", ST's Book of Judgments, Proceedings and Previous Written Arguments, Book A, tab 4.

[28] *Doyon* c. *Régie des marches agricoles et alimentaires du Québec*, 2007 QCCA 542 at par. 51.

[68] But the Court is not seized of a Motion and is not deciding a preliminary matter. The Court has conducted a trial, the First Stage Trial, to respond to the Court's (not ST's) Stipulated Questions - the Court has already decided that they need to be answered.

[69] MGI underscores the potentially drastic consequences and irreparable harm to it that could result from the answers the Court decides. Its counsel state in writing that they were never in agreement with the approach of splitting the trial and having any stipulated questions; as well, they intend to adduce different evidence "at trial". Whatever may be MGI's views of the process and strategies as to proof, the Court considers that the Stipulated Questions clearly identify what issues were to be addressed during the First Stage Trial and that the parties have, once again, had the opportunity to be heard. The Stipulated Questions will be answered.

[70] That said, there are certainly "live" issues to be determined at the second phase of trial in these Court files. Liability and damages have yet to be decided. The issue of contractual relations between the parties' respective subcontractors, if any, and related companies has yet to be decided - and more particularly, what Ts & Cs apply to those various subcontractors and related companies. These issues, and perhaps others not forming part of the Stipulated Questions, will be analyzed during the next trial phase should they be lawfully raised by the parties. For now, the Stipulated Questions will be answered, based on the proof made by both parties. The "live" issues are not prejudiced.

[71] As mentioned earlier, MGI considers one of the "live" issues to be identifying the moment that ST's Ts & Cs begin to apply. The Court does not consider that to be a "live" issue between MGI and ST. There is nothing in the Appeal Decision that limits temporally the application of the Ts & Cs. They have been held to apply to all of the contractual relationship between MGI and ST.

[72] It is not now appropriate for the parties to re-open the proof so as to try and modify the presumption of *res judicata*.

[73] Accordingly, the Court decides that the Appeal Decision constitutes *res judicata* on the issues of formation of contract between MGI and ST; that the MGI and the ST Ts & Cs are binding and co-exist in the manner expressed in the Appeal Decision: in the event that ST's Ts & Cs are in contradiction with MGI's Clauses 1 to 4, then MGI's Ts & Cs govern, in accordance with MGI's Clause 5. The laws of the State of Texas govern the contractual relations between MGI and ST; the laws of Texas apply in the manner set forth in Clause 19.

[74] Having so concluded, the Court will not address MGI's private international law argument that its consent should be analyzed not under Quebec law, but rather under Texas law. That issue is moot.

[75] As regards the umbrella objection by ST during the First Stage Trial to all proof and evidence pertaining to the formation of contract between it and MGI, it is maintained; and, accordingly, the proof and evidence regarding the formation of contract between MGI and ST, which was taken under an umbrella reserve, is declared inadmissible. The absolute presumption of the final judgment on contract formation between MGI and ST, which is the Appeal Decision, is irrebuttable[29].

[76] It is unfortunate that the parties sought to repeat much of the proof previously made on that same issue of contract formation. The vast majority of the Exhibits and transcripts filed were the same proof as was made regarding the choice of forum proceedings. That is, in part, exactly what *res judicata* is intended to avoid. But, had the Court split the *res judicata* decision from proof on Texas law during the First Stage Trial, that would have created an even greater delay in the administration of justice.

[77] That said, some of the proof and evidence relating to dates and events for prescription purposes and for warranties is not excluded. They are necessary for the purposes of interpreting and applying Texas law and will be referred to later in this judgment.

[78] The Court will now proceed to Stipulated Question 3. As that question raises two (2) issues (one relating to limited warranty and remedies, and the other relating to limited liability and damages), the Court will deal with Stipulated Question 3 in two (2) separate parts.

QUESTION 3A: IS THE MATROX ACTION ILL-FOUNDED BASED ON THE LIMITED WARRANTY/REMEDIES PORTION OF CLAUSES 12(A) AND 14 OF ST'S TS & CS?

[79] The Texas law experts disagree as to whether the Direct Action is ill-founded. ST's expert, lawyer Thomas W. Craddock, opines that it is. MGI's expert, lawyer R. Bruce Hurley, opines that it is not.

[80] Much of Mr. Hurley's testimony and expert report[30], written at the request of MGI[31], addresses contract formation and whether Clauses 12 and 14 form part of the contract. That is of no assistance to the Court. *Res judicata* has been decided, and Clauses 12 (a) and 14 form part of the contractual relationship between the parties. The opinion of an expert on foreign law is intended to establish a fact, and it has no greater insulation from *res judicata* than the proof of other factual witnesses.

[81] That said, Mr. Hurley's subsidiary opinion is that Clause 12(a) must fail as a matter of law – ST's limitations on MGI's remedies "fail of their essential purpose". If

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29 Art. 2847, 2848 C.C.Q.
30 P-19.
31 D-28.

ST's limitation of remedies does fail, then Texas law allows for the general remedies provided by the Uniform Commercial Code[32].

[82] Clause 12(a) reads as follows[33]:

> "(a) **LIMITED WARRANTY**: IT IS EXPRESSLY AGREED THAT NO WARRANTY OF MERCHANTABILITY, WARRANTY OF FITNESS FOR A PARTICULAR PURPOSE, NOR ANY OTHER WARRANTY (EXPRESS, IMPLIED OR STATUTORY) IS MADE BY SELLER, EXCEPT THAT SELLER WARRANTS THE GOODS TO BE FREE FROM DEFECTS IN MATERIALS AND WORKMANSHIP IN NORMAL USE AND SERVICE. THE LIABILITY OF SELLER UNDER THIS WARRANTY IS LIMITED SOLELY TO THE REPAIR, REPLACEMENT OR ISSUANCE OF CREDIT (AT THE SOLE OPTION OF SELLER) FOR SUCH PRODUCTS THAT BECOME DEFECTIVE WITHIN SIX (6) MONTHS AFTER DELIVERY TO BUYER (THE "WARRANTY PERIOD") UNLESS (1) SELLER IS NOTIFIED IN WRITING OF SUCH DEFECTS BY BUYER PRIOR TO THE EXPIRATION OF THE WARRANTY PERIOD, (2) THE DEFECTIVE ITEMS ARE RETURNED TO SELLER, TRANSPORTATION CHARGES PREPAID BY BUYER, AND (3) SELLER'S EXAMINATION OF SUCH ITEMS DISCLOSES TO SELLER'S SATISFACTION THAT SUCH DEFECTS HAVE NOT BEEN CAUSED BY IMPROPER HANDLING, STORAGE, TESTING OR INSTALLATION, MISUSE, NEGLECT, REPAIR, ALTERATION OR ACCIDENT. SELLER WILL CHARGE BUYER WITH ALL EXPENSES INCURRED FOR THE REPAIR OF DEFECTS OR REPLACEMENT OF ITEMS NOT COVERED BY THE WARRANTY. THE REPAIR OR REPLACEMENT BY SELLER OF ANY ITEM SHALL NOT BE DEEMED TO EXTEND THE WARRANTY PERIOD OF ANY ITEM WHICH HAS BEEN REPAIRED OR REPLACED OR TO CREATE ANY NEW WARRANTY PERIOD, NOTWITHSTANDING THE FOREGOING PROVISIONS. THE WARRANTY PERIOD FOR PROCESSED SEMICONDUCTOR CHIPS AND WAFERS IS LIMITED TO THIRTY (30) DAYS FROM DATE OF SHIPMENT. IN NO EVENT SHALL SELLER BE LIABLE FOR LOSS OF PROFITS, LOSS OF USE, INCIDENTAL DAMAGES, CONSEQUENTIAL DAMAGES OR ANY LOSS, COSTS OR DAMAGES OF ANY KIND BASED UPON A CLAIM FOR DEFECTIVE PRODUCTS OR BREACH OF WARRANTY."

[83] Firstly, Clause 12(a) excludes all warranties other than one: ST warrants the E^2 to be free from defects in materials and workmanship in normal use and service. There is no disagreement between the experts that Texas law generally allows parties to exclude or modify implied and express warranties[34]. But ST's express warranty is also

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32 Texas Business and Commerce Code Ann., tit.1§ 2.719(b), referring to Title 1, Uniform Commercial Code.

33 D-27; Note: The Court uses the version found in an original document filed jointly by the parties during the Trial as D-27, and this is in response to objections on using the versions contained in P-2C, D-4 or an additional enlarged version used by counsel for MGI.

34 Texas Civil Practice & Remedies Code Ann., §. 2.316

exclusive and limited. This will be discussed further shortly. Before doing so, ST's expert raises a threshold issue.

[84] Mr. Hurley states that to exclude warranties, the exclusion must be "conspicuous[35]". He is of the opinion that Clause 12(a) is not conspicuous. He refers to a 1990 Supreme Court of Texas case[36] in which a written disclaimer was held not to be conspicuous since it was hidden from attention in a warranty text, undistinguishable in typeface, size and colour - hidden amongst language about how great the warranty was.

[85] That case is so distinguishable that it is of little assistance. The text of the disclaimer in ST's Clause 12(a) is in capital letters, although so too is the language of the warranty. However, in Clause 12(a), the introductory words "LIMITED WARRANTY" are not only capitalized, but they are also in bold. Moreover, the disclaimer is not hidden amongst favourable language - the disclaimer is the lead wording. Before knowing what there is as a warranty, the language informs the buyer that there is no warranty of merchantability or of fitness, nor other warranties, express, implied or statutory. Only then is the actual warranty stated. Moreover, whether small print or not, it is readable. It is not necessary to be enlarged to be read. Section 2.316(b) is not a cumulative test, as suggested by Mr. Hurley - the wording of the Section is clear in that regard.

[86] The Court holds that Clause 12(a) is conspicuous. Nor is MGI well-placed to claim that the clause could not be read by a reasonable purchaser, given its systemic internal policy not to read suppliers' Ts & Cs.

[87] The Court has concluded that Clause 12(a) contains an exclusive and limited expressed warranty. What does that limited warranty, in Clause 12(a), provide?

[88] The parties have advanced various methods of reading Clause 12(a). A reasonable and clear reading of the Clause demonstrates that its entire "unless" portion is intended to enable ST, after notice in writing of a defect within six (6) months, to examine the defective parts and to satisfy itself that the cause rests not with it but with MGI or others. The Court determines that the express warranty only covers defects which appear within six (6) months of delivery, and is limited solely to the repair, replacement or issuance of credit "unless" ST has been notified of a defect within six (6) months after delivery, the defective goods are returned for examination by ST and ST is satisfied that the defect has not been caused by the causes mentioned.

[89] Accordingly, if ST has been promptly notified and is satisfied after examination, that the defect is not caused by external sources, then the limited remedies (repair, replace, credit) do not apply. In that case, the general remedies provided under Title 1, the Uniform Commercial Code, would apply.

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35 Ibid, s. 2.316(b)

36 *Cate* v. *Dover Corporation*, 790 S.W.2d 559 (Tex. Sup. Ct. 1990).

[90] But what happens if a defect appears within six (6) months of delivery, notice is not given within that time, or the parts are not sent to ST for examination? Then the limited remedies (repair, replace, credit) apply to the exclusion of all other remedies. To complete the analysis, and contrary to MGI's submission, if a defect appears later than six (6) months after delivery, the exclusive limited warranty does not cover it, and no other remedy is available. That is the sense of the exclusive limited warranty and the use of the six (6) month delay even for notification of a defect. The same result occurs if ST, after examination, reasonably concludes that a problem that appears within six (6) months from delivery is not a defect attributable to it. In both cases, ST will charge the buyer the costs of repair or replacement.

[91] What then of the doctrine of failure of essential purpose? Both experts agree that the doctrine is recognized under Texas law[37]. Both also agree that under Texas law, parties are free to contractually limit the remedies available in the event of a breach of warranty[38]. Both experts also agree that if an exclusive or limited remedy fails of its essential purpose, then the warranty clause fails and the buyer has the remedies provided under the Uniform Commercial Code, which is Title 1 of the Texas Business and Commerce Code. The experts disagree, however, on whether the facts and circumstances of this case give rise to a failure of essential purpose.

[92] The failure of essential purpose referred to in s.2.719(b) is most frequently applied in limited "repair and replacement" remedies where the seller is either unable or unwilling to repair the defective goods within a reasonable period of time[39]. The essential purpose of repair and replacement thus fails, leaving the buyer with no remedy of value and no substantial value in the transaction.

[93] MGI's expert refers to a 1997 decision by the United States District Court, S.D. Texas[40], in which the five-year warranty by the manufacturer of refrigeration compressors, which repeatedly failed, could not be and were not replaced, failed of its essential purpose.

[94] ST's expert, in an attempt to add strength to the limited warranty, distinguishes the merely "replace and repair" scenarios from the actual wording of Clause 12(a). He says that it also provides a third option – "issuance of a credit". Mr. Craddock noted that Clause 12(a) does not specifically mention a credit against future purchases, unlike the Ohio case[41] cited by Mr. Hurley. The Ohio case did not support a credit against future purchases as a viable remedy when the buyer ceases to purchase vendor's goods.

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37 Texas Business and Commerce Code*, supra, note 32*, §. 2.719(b)

38 Ibid, §. 2.719(a)(c).

39 *Mercedes-Benz North America, Inc.* v. *Dickenson*, 720 S.W.2d 844, at par. [12] (Tex. App. Ct. 1986); P-19.1, Tab 15, p. 12.

40 *Metro National Corporation* v. *Dunham-Bush, Inc.*, 984 F. Supp. 538 (Tex. S.D. Ct. 1997).

41 *Sutphen Towers, Inc.* v. *PPG Industries, Inc.,* 2005 WL 3113450 (Ohio App. 10 Distr.); P-19.1, Tab 23.

Neither expert could identify one (1) Texas case that deals with failure of essential purpose where the warranty involves credit in addition to repair and replace provisions.

[95] The wording of the "credit" component of Clause 12(a) is not as clear as it could be, or as it should be. Although (unlike the Ohio case) it does not specifically refer to future sales, it most certainly does not mention price "refunds", a remedy, according to Mr. Hurley, which is mentioned and approved in other cases. It is not certain that under Texas law a "credit" could save the limited warranty from a failure of its essential purpose. Should the facts show that ST actually treated the wording as a price refund, that might in fact be sufficient to allow it to stand; the Court will come back to this point later.

[96] The Court recognizes as a fact that Texas law includes the failure of essential purpose doctrine. As well, the Court recognizes that repair, replace and price refunds can be a valid remedy limitation under Texas law. The Court also recognizes that, under Texas law, the determination of whether or not a warranty fails is based on the facts and circumstances of each case. What are the relevant facts and circumstances in this case?

[97] In the First Stage Trial, the Court is not seized with determining whether or not the E^2 are defective, or whether ST is liable for such defects. Nor is it seized with a subsequent phase of evaluating MGI's damages, if any, which may have resulted from the alleged defects. However, for the purposes of answering Stipulated Question 3, the Court assumes that all or some of the E^2 are defective, that ST is liable for those defects and that MGI has suffered damages as a result (otherwise, there is no need to even consider Clause 12(a)).

[98] MGI first orders E^2 from ST in December 1997[42]. MGI starts production of its graphic cards using E^2 in early 1998. According to Steven Dutemple of MGI, alleged problems are first seen in March-April 1998. Those problems are always on the last page of data, with "1"s being read as "0"s. Mr. Dutemple says he gave the error logs to Mark Majewski of ST. These alleged problems, no doubt, occur within six (6) months of delivery, given that MGI only begins to order from ST after qualifying samples that it received in late 1997. However, there is no proof as to the number of E^2 devices in question. There is no proof that any of the E^2 devices are submitted at that time for evaluation by ST. There is no proof that MGI requests any replacement, repair or refund; no proof that ST accepts or declines.

[99] One year later, in March-April 1999, MGI is informed that HPF has noticed an unusually high number of alleged failures in the graphic cards. Mr. Dutemple describes those alleged failures as having the same signatures as the earlier problems - "1"s being read as "0"s. MGI provides ST with one (1) of its boards for analysis. It also

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[42] D-1.

returns ninety-nine (99) allegedly failed E^2 devices to ST for testing. These are sent out in various batches: three separate shipments of 10 devices each in March-April 1999; three separate shipments of 26, 21 and 22 devices respectively in May-June 1999. Returning E^2 to ST requires desoldering the E^2 from the boards, a delicate operation to avoid damaging the pins in the microchips. ST does not request that more devices be returned for testing. At the same time, MGI is doing its own testing and notices that some E^2 devices are failing within two (2) to three (3) weeks of installation on their boards. MGI considers it to be a systemic problem. Representatives of the two parties are in regular communications, even daily, as confirmed by ST in P-4. In July 1999, after various testing on the returned E^2 devices, ST reproduces the same signature failures and issues a failure notice. ST stops production and stops shipments[43].

[100] So as to be able to order more E^2 in August 1999, MGI is required to sign a Non Conforming Product Release Form[44]. This is a short term measure, as can be seen from the date on the documents. The documents do not constitute renunciation of any failure of essential purpose.

[101] In the summer of 1999, MGI begins receiving a substitute product from another supplier, and at one point begins removing ST's E^2 devices from its boards. In that time-frame, ST begins producing a newly modified E^2.

[102] On September 17, 1999, MGI sends ST a letter of demand[45], holding ST liable for any and all damages. ST replies on September 24, 1999[46], referring generally to its Ts & Cs and particularly to the exclusion for consequential damages. This ST repeats in a letter dated September 28, 1999[47]. In neither of its two formal responses to MGI does ST respond that MGI has somehow failed to respect the specific terms of the limited warranty: ST does not deny that the alleged defects have arisen within six (6) months of delivery; it also does not argue in its replies that MGI has failed to provide enough devices for testing.

[103] Under the circumstances, and assuming for the purposes of the First Stage Trial that the E^2 are defective, the facts demonstrate that MGI substantially complied with the conditions of identifying and returning allegedly defective goods and of properly notifying ST.

[104] As well, assuming that the E^2 are defective, ST cannot reasonably conclude that it is not satisfied that the problems were not caused by MGI or others. Even its March 22, 1999 so-called Final Analysis[48], questioning overstresses on the E^2, resulted from

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43 P-16
44 Ibid.
45 P-3.
46 P-4.
47 P-5.
48 P-2d.

what appears, based on the proof, to be its own faulty testing. Once its testing method was modified, ST reproduced the signature failure[49]. Subject to the defect being proven at the next phase of trial, ST has not acted reasonably in refusing to declare itself satisfied in accordance with Clause 12(a); it maintains its position that the warranty is limited and exclusive. Yet, it does not give life to that limited warranty.

[105] ST argues that, in fact, it did provide credit to MGI in accordance with Clause 12(a). The Court does not agree. The Return Material Authorization[50], to which ST refers, only relates to extra E^2 that MGI had in inventory. They had never been used; obviously, there is no proof that they were defective or had failed. The return is unrelated to Clause 12(a). The proof does not demonstrate that ST made or offered to make a price refund. ST's conduct does not assist ST in its argument that "issuance of credit" refers to a price refund; the Court concludes that "issuance of credit" means credit against future purchases, not price refunds for past purchases.

[106] ST could not or would not respect its own contractual warranty. In late September 1999, ST's in-house counsel wrote that ST "will of course, replace the products[51]", but the proof does not establish that it did so. By then, MGI was already using a different supplier: ST had stopped producing and shipping the E^2 in question. The proof does not support ST's position that "issuance of credit" was a viable remedy in this case.

[107] The passage of years speaks clearly to the fact that ST has had more than a reasonable opportunity to give life to the limited remedy it imposed. It has not shown that it has done so. Replacing or repairing the product at this stage would be illusory. In the event the product is proven to be defective, ST's position would leave MGI with no remedy, let alone a minimum adequate remedy[52].

[108] As a result, and based solely on the proof made to date and given the presumptions mentioned above, the limited warranty, which limits MGI's remedies, fails of its essential purpose. MGI thus has general remedies available under the UCC[53] as agreed by both experts in Texas law. The Direct Action is not ill-founded by reason of the limited warranty in Clause 12(a).

[109] However, that does not fully respond to whether the Direct Action is ill-founded by virtue of Clause 12(a).

[110] Clause 12(a) also includes a statement that limits the type of damages that a buyer may claim in the event of defective goods. It is set out above – all incidental and

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49 D-7.
50 D-7 and DW-6.
51 P-4; D-8.
52 Uniform General Code, White and Summers, *supra,* p. 2.
53 Texas Business and Commerce Code, supra, §. 2.719(b).

consequential damages, loss of profits and other such damages are specifically excluded. Does that damage limitation fail when the limited warranty fails of its essential purpose?

[111] Before answering that specific question, an almost identical question needs to be asked in relation to Clause 14, a limitation of liability and damages clause. This question is relevant to both the Direct Action and the Action in Warranty.

[112] As the limited liability and damages portion of Clause 12(a) and of Clause 14 raise very similar issues, they will be treated together in the following section.

QUESTIONS 3B + 5B: ARE THE MATROX ACTION AND ACTION IN WARRANTY ILL-FOUNDED BASED ON THE LIMITED LIABILITY / DAMAGES PROVISIONS OF CLAUSES 12(A) AND 14 OF ST'S TS & CS?As previously stated, once a limited warranty/remedy provision fails of its essential purpose, Section 2.719(b) of the Texas Business and Commercial Code applies. It provides the buyer with the remedies set forth in Title 1, UCC.

[114] Does the referral by Section 2.719(b) to the general UCC remedies, therefore mean that the contractual limitation of liability and damages clauses fail as well?

[115] First, what do those limitations clauses state?

[116] Clause 12(a) states that ST is not liable for loss of profits, loss of use, incidental damages, consequential damages or any loss, costs or damages of any kind based upon a claim for defective products or breach of warranty. Essentially, this excludes a claim for any damages, of any kind resulting from defective products or breach of warranty.

[117] That portion of Clause 12(a) is even more all-encompassing than the limited liability provision in Clause 14. Clause 12(a) actually contradicts Clause 14, which does provide for at least some liability for limited damages, albeit capped. They are otherwise on all fours, however, as regards loss of profits, loss of use, incidental and consequential damages – both Clauses clearly exclude them.

[118] But Clause 14 then goes on to contradict itself. It excludes any and all damages arising from the "use" or misuse of the product. The Clause totally excludes any and all damages, as does Clause 12(a), but at the same time it limits (and therefore allows) damages up to a capped level.

[119] Neither expert addressed the contradictory wording and whether that would be sufficient to render the damage exclusion and limitation null and void. Nor did they discuss whether such a limitation/exclusion was commercially reasonable or not.

[120] How should the Court interpret the conflicting contract clauses? The UCC provisions[54] state that words which negate or limit a warranty "should be construed wherever reasonable as consistent with each other", although it does go on to say that such negation or limitation is inoperative to the extent that "such construction is unreasonable". In that context, Texas law confirms that remedies for breach of warranty can be limited with respect to damages[55] (although it must be done in accordance with Sections 2.718 and 2.719). In cases of consequential damages, they too can be limited or excluded, unless "unconscionable[56]".

[121] Clause 14 and Clause 12(a) can be construed so as to give meaning to both; although awkward in structure, the clauses are not ambiguous as to meaning. The express warranty of Clause 12(a) and the liability of ST is clearly said to be, for any type of action, limited to the "greater of $10,000 or the price specified in the sale contract for the specific product or products". All other damages, whether incidental, consequential, loss of profit or use, and the like (as specified in the Clauses) are fully negated, and MGI as buyer assumes the risks.

[122] Is such construction "unreasonable" or is the exclusion of consequential damages "unconscionable"? Generally, Texas commercial law promotes the right of the parties to contract freely, even to the point of making a bad business deal. Moreover, the Court Record contains numerous examples of limitations and negations of damages by many other semiconductor manufacturers[57] - a matter of commercial practice in the electronics industry, it seems. Nor does it appear unreasonable for a single supplier of parts, amongst many, that cost a few cents up to a couple of dollars, to seek to avoid exposure for the totality of damages that may occur further up the product chain. The results may be harsh, but the Court cannot here presume that there is bad faith or that the exclusion is unconscionable.

[123] And so, the question remains – do Clauses 12(a) and 14 as construed, continue to apply even though the Court has determined that the limited warranty fails of its essential purpose?

[124] The experts agree that the answer, under Texas law, does not illicit unanimity. There appear to be two schools of thought, as confirmed by authors and the courts of Texas. Those who consider that the limitation and negation of damages should continue to apply, and those who do not. MGI's expert refers to this as "a battle-ground". The debate centers around the interpretation of Section 2.179(b) of the Uniform Commercial Code.

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54 Texas Business and Commerce Code, supra, §. 2.316(a).
55 *Supra*, section 2.136(d), sections 2.718 and 2.719.
56 *Supra*, section 2.719(c).
57 Affidavit, Mark Majewski, August 13, 2004, Exhibits R-14 to R-30, Book of Affidavits and Exhibits Filed By ST and Matrox (Book "C"), Tabs 14-30.

[125] Those who consider that the limitation and negation provisions should continue to apply favour the view that the parties should be free to contract as they please, without intervention by the courts trying to re-write their contracts[58]. James J. White and Robert S. Summers consider this to be the majority view, while recognizing that some courts will apply the UCC remedies without applying the liability and damage limitation.

[126] The Uniform Commercial Code Comment[59], which includes comments from observers and the drafters of the Code, adds some insight as to intent of Section 2.179(b) in stating that once the clause fails "it must give way to the general remedy provisions."

[127] The issue is important to MGI, since the general remedies are such that MGI could possibly even recover consequential damages, as was acknowledged by ST's expert[60]. Moreover, it could possibly assist MGI in avoiding the stipulated cap on damages. Those caps (unlike liquidated damages) are generally considered applicable even if not a reasonable estimate of damages from a breach[61]. On the other hand, should the limitation and negation clauses apply, then, from a damage perspective, MGI would be limited to the measure of damages set forth in Section 2.714(a) and (b); that would be further subject to the cap expressed in Clause 14.

[128] The Court is of the view that Section 2.719 stipulates that the right to substitute remedies, create exclusive remedies and limit or alter damages is "subject to" the remedies under the UCC in cases where the exclusive or limited remedy fails of its essential purpose. Similarly, and completely independent of failure of essential purpose, the right to limit or exclude consequential damages is subject to the remedies under the UCC in the event the limitation or exclusion is held to be unconscionable.

[129] Unconscionability in Section 2.719(c) is a stand-alone issue; it is not inter-connected to a failure of essential purpose under sub-section (b). Consequently, the Court need not conclude on conscionability in order to conclude on the results of a failure of essential purpose.

[130] What, then, are the "remedies" provided by Title 1, UCC? Those are the remedies set forth in Subchapter G. of Title 1, being from Section 2.701 onwards, including those in Section 2.714(a)(b)(c). Of particular importance is the fact that those remedies specifically envisage incidental and consequential damages, as defined in Section 2.715.

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58 Uniform Commercial Code, supra, Chapter 10, p.4 and ff, Exhibit P-19.2, Supplemental Sources, Tab 4.

59 P-19.2, Tab 16, p. 106.

60 D-13A, page 8 of 19, Footnote 1.

61 *Global Octaces Texas L.P.* v. *BP Exploration & Oil*, *Inc.,* 154 F.3d 518 at 523 (5th Circuit 1998); Book "B", Tab 13.

[131] Is the seller, whose exclusive or limited remedy has failed under Section 2.719, entitled to avoid those incidental and consequential damages by using that same section to limit or exclude anew the damages? The Court, in the circumstances of this case, considers that it cannot.

[132] Section 2.719(a)(1) specifically refers to the limitation of a buyer's "remedies" to only return of the goods and repayment of price, or to repair and replacement, as being a means of limiting or altering "the measure of damages recoverable under this chapter." Hence, ST's limited remedy is tantamount to a limit on damages. Absent clearer language to the contrary, the Court does not consider the intent of the State Legislature to have been to allow the seller to replace one failed remedy, tantamount to a limited measure of damages, by yet another limit of damages. Had the Legislature so intended, it could have easily chosen language that would have more clearly given effect to that intent. And notwithstanding that this has developed into a "battle-ground", the language does not appear to have been modified since its passage[62] in order to settle the issue.

[133] Accordingly, neither Clause 12(a) nor Clause 14 apply to limit the remedies that MGI may have under the remedies provided in Title 1, UCC. What those specific remedies are and which ones may be available to MGI, are not to be determined by this judgment.

[134] Accordingly, the answer to Question 3B and 5b is that MGI's Direct Action and Action in Warranty are not ill-founded by reason of Clauses 12(a) and 14.

QUESTION 2: IS THE MATROX ACTION (DIRECT ACTION) TIME-BARRED, IN WHOLE OR IN PART, UNDER TEXAS LAW?

[135] Unlike Quebec law, prescription under the Texas Business and Commerce Code generally begins to run, not upon discovery of a defect, but upon tender of delivery of the goods[63]. It is a four-year limitation period. The Texas law experts for MGI and ST both agree on the general rule - that prescription begins to run from the date of delivery. Its intent is to provide sellers a uniform date beyond which they need not be concerned about stale warranty claims[64].

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62 Acts 1967, 60th Leg., p. 2343, ch. 785, Section 1, eff. Sept 1, 1967.

63 Business and Commerce Code Ann., Vernon's Texas Statutes and Codes Annotated, WestLawNext, section 2.725(a)(b), UCC. Note: In 1967, the Texas Business and Commerce Code adopted at Section 1.01 et seq., The Uniform Commercial Code, which governs all sales of goods. The UCC constitutes Title 1 of the Business and Commerce Code.

64 *PPG Indus. Inc. v. JMB/Houston Centers Partners Ltd. P'ship*, 146 S.W. 3d 79 (Tex. Sup. Ct. 2004) at par.15.

[136] However, there is an exception to that general rule. Where a warranty "explicitly" extends to future performance and discovery of the breach, then the cause of action only accrues when the breach is, or should have been, discovered.

[137] The Discovery Exception to the general rule is critical for MGI. Its Direct Action was instituted on May 28, 2003. If it is limited to the four-year general rule, MGI would only be able to claim for allegedly defective E^2 delivered subsequent to May 28, 1999.

[138] For the Discovery Exception to apply, there requires proof of a warranty that, for all intents and purposes, delays the start of the countdown on the cause of action. Does such a warranty exist in this case, sufficient to trigger the Discovery Exception?

[139] The Texas laws experts disagree as to whether such a warranty exists in this case. ST's expert, Mr. Craddock, says it does not exist. MGI's expert, Mr. Hurley says it does.

[140] Mr. Craddock does not disagree with the principle of the Discovery Exception, but he opines that the Texas Courts[65] narrowly construe the exception, focusing on the term "explicitly". He disagrees with Mr. Hurley that ST made such an explicit warranty for a specific future time.

[141] What is the warranty that MGI is relying on to trigger the Discovery Exception?

[142] A Target Specification (P-2A), also referred to as a specification data sheet, states that the E^2 has a life-cycle of forty (40) years and is designed for 100,000 erase/write cycles. Mr. Hurley considers that this constitutes a promise that the goods will last for a designated period in the future – 40 years. Hence, according to MGI, it triggers the Discovery Exception, even if it does not use the term "warranty "or" guarantee", or even if there is no intention to create a warranty[66].

[143] Mr. Craddock considers the forty (40) year life-cycle and the 100,000 erase/write cycles to be insufficient. They do not explicitly extend to future performance without defect and fail to stipulate a specific date in the future. He refers to a U.S. District Court for Texas case[67] in which a clause limiting liability to 6 months was considered insufficient – it did not provide a warranty that the gearboxes would be free from defects for 6 months.

[144] That Court based itself on two other cases. One involved an automobile warranty for certain defects reported within "1,000 hours of operation or the first six (6)

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65 To understand the Texas Court system, the experts have identified the various Court levels. The Federal Court system for Texas involves 4 Federal District Courts, the 5th Circuit Court of Appeal and the United States Supreme Court. At the State level, there are State District Courts and the State Court of Appeal. At the top of the State system is the Texas Supreme Court.

66 Texas *Business and Commerce Code*, *supra,* section 2.313(b) UCC.

67 *Hydradine Hydraulics LLC v. Power Engineering and Mfg. Ltd.*, 2011 WL 1514997 (N.D. Tex.).

months from date of shipment…[68]". In that case, the Court of Appeal of Texas concluded that there was no express promise that the goods are free of defects – to the contrary, the Court saw the language as presaging the goods will fail to perform and specifies a remedy for that eventuality. In other words, it represents an obligation to make repairs in the future rather than a warranty of "future compliance by the goods[69]".

[145] The second case referred to in the *Hydradine* case, involved a warehouse roof advertised as "bondable up to 20 years". In that case, the Supreme Court of Texas[70] stated that "implied" warranties could not be "explicit" under the Code – to be "explicit", it must be expressed - without vagueness, specific, unequivocal. The Court referred to proof that, in the roofing industry, the phrase means that the roof will not need to be replaced before 20 years. The Supreme Court of Texas did not, however, conclude that it was not sufficiently explicit. Instead, it remanded the case to the trial court for a determination of the express warranty claim.

[146] Mr. Craddock also cites another Supreme Court of Texas case[71] in which the Discovery Exception is described as "a very limited exception to statutes of limitations".

[147] Mr. Hurley cites the *PPG Indus., Inc.* case[72], in which the Supreme Court of Texas concluded that the windows manufacturer had explicitly warranted that its windows would be free of defects for five years and thus, came within the Discovery Exception ("warrants… to be free of defects and watertight for five years from April 1, 1978").

[148] What principle(s) of Texas law should the Court extract from these cases? In order to trigger the Discovery Exception, the vendor must explicitly and unequivocally express that its product will perform without defect for a specific period of time, such that it is tantamount to a warranty that no defect will be discoverable during that period. Although it is not necessary to use the words "guarantees" or "warrants", it is clear that "limitation of liability" language, even for an identified period of time, is not sufficient.

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68 *Muss v. Mercedes – Benz of North America Inc.,* 734 S.W. 2d 155, at par. [1][2][3] (Tex. App. Ct. 1987).
69 Ibid.
70 *Safeway Stores, Incorporated v. Certainteed Corporation et al.* 710 S.W.2d 544 (Tex. Sup. Ct. 1986).
71 *Wagner & Brown, Ltd. et al.* v. *Horwood*, 58 S.W.3d 732, at par. [1][2] (Tex. Sup. Ct. 2001).
72 *Supra*, par. [9].

[149] The Court must now apply these principles of Texas law to the facts. There is an absence of any introductory or surrounding language that explains the meaning of the two terms "100,000 erase/write cycles" and "40 years data retention". They appear as separate items on the first page of ST's E^2 Target Specifications[73], as part of a list of bullets, set out vertically. The list also includes items such as "single 3.0V to 3.6V supply voltage" and "64 bytes page mode"; these are not directly relevant, but are mentioned to give a clearer picture of the nature and context of the bullets listed in the Target Specifications. At the bottom of each page of the various Target Specifications, the following words appear: "This is preliminary information on a new product now in development or undergoing evaluation. Details are subject to change without notice." The right to change the specifications without notice is also repeated in Clause 10 of ST's Ts & Cs. The E^2 was a new commodity product for ST.

[150] Not surprisingly, the Target Specifications are not said to be routinely exchanged between the parties. They do not appear by specific reference on any but one (1) of MGI's purchase orders. That said, ST acknowledges that Target Specifications were given to MGI's senior engineer at the time of their initial discussions in 1996. Moreover, MGI alleges that the Target Specifications provided to it were of such importance to its decision to acquire E^2 from ST, that it considers that they form part of the Framework Contract[74]. Given the evidence, the Court adopts that position for the purposes of determining the issue of the Discovery Exception.

[151] What does "100,000 erase/write cycles" mean? According to MGI's engineer, Steven Dutemple, it is the number of times MGI can write programmes to the E^2 device. ST does not contest this, although its Director of Sales, Mark Majewski, adds that it was a target under ideal laboratory conditions; that caveat is not specifically stated in the Target Specifications.

[152] What does "40 years data retention" mean? Mr. Dutemple explains that it is the length of time the E^2 device can maintain its programming even if there is no power to the device. ST does not make proof against that assertion, although, Mr. Majewski adds the same caveat. That also is not mentioned in the Target Specifications. The proof shows that the parties did not specifically discuss the "40 years data retention" aspect.

[153] During the First Stage Trial, the Court is not seized with the issue of determining liability, but it is important (for the purposes of prescription) to determine whether either, or both, of these technical elements are related to the alleged defect at issue in the proceedings. The proof demonstrates that the nature of the defect appears to relate to the loss of memory retention in relation to the "40 years data retention" specification.

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[73] P-2A, P-14, P-15.

[74] Plaintiff's Amended Answer to Amended Defence With Respect To Certain Questions Regarding the Applicability of Texas Law (Following Splitting of Action) (Art. 182 C.C.P.), par. 54.

This is sufficient for the purposes of analyzing that specification as the possible trigger for the Discovery Exception.

[154] Under the circumstances, the question under Texas law for the Discovery Exception to apply is the following: Did ST explicitly and unequivocally express that the E^2 will perform without defect for the specific period of 40 years?

[155] No doubt it could be said that there is a specific period of time: 40 years. Even if not stated, it would start upon delivery – that would be a reasonable interpretation. As well, future performance of the E^2 could be said to be expressed through its retention of memory over the next 40 years, even without power. But the basic threshold question still remains: is the Target Specification an unequivocally expressed "warranty" in the context of the Discovery Exception. The Court concludes that it is not.

[156] The Target Specification on its face is a performance "target", pertaining to a new product; moreover, Clause 10 of ST's Ts & Cs states that the Target Specifications can be changed without notice, as does the Target Specification itself. As well, no proof was submitted as to the reason, utility or necessity for anyone to require 40 years of memory retention – this could have been useful to distinguish a performance warranty from statements of mere promotional exaggeration. This is especially true in the world of electronics, a relatively new field, where product or utility life often appears to be closer to single digit numbers. The proof shows that the parties did not even discuss the matter. And although Texas law does not require the words "warranty" or "guarantee" to be used, it is worthy of observation that the only Texas case mentioned by the experts which recognized an explicit warranty for the Discovery Exception was one where the vendor used the term "warrants[75]".

[157] The foregoing does not mean that the Target Specifications are not implicit warranties or even express warranties available to MGI for other purposes[76]. The Court nonetheless concludes that the Target Specifications is not an explicit warranty sufficient to trigger the Discovery Exception; the exception does not apply in this case. The forty-year memory retention clause is too ambiguous. It's not sufficiently clear that it is saying that the E^2 will function without any defect for forty years. Moreover, it does not clearly extend a warranty to the "discovery" of a defect over the course of forty years.

[158] MGI's Direct Action was filed on May 28, 2003. Applying the Texas four (4) year rule of prescription[77] to the facts, any of MGI's claims for E^2 delivered on or prior to May 28, 1999, are prescribed (statute barred) under the applicable law of Texas. MGI's expert recognizes this result in the absence of the Discovery Exception[78].

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75 *PPG*, *supra.*

76 This distinction was made in the cases submitted by the experts on Texas law.

77 For the purposes of this Judgement, the term prescription is used rather than the term "statute of limitations" under Texas law. The judgment treats them as having the same meaning.

78 Expert Report P-19, page 25, section H, first and second paragraphs.

[159] In any event, the facts show that prior to May 28, 1998, MGI was already aware of problems relating to the E^2. Without commenting on liability, MGI began seeing failures shortly after it started production of the graphic cards; the error was not random – "I" bit being read as a "0" bit. It was always in the same area of the E^2. MGI communicated its failure logs to ST in March-April 1998. In early 1999, HPF advised MGI of an unusual number of failures in the graphic cards[79]. MGI shipped failed devices to ST for analysis. Thereafter, more failed units were returned to ST, more new units were ordered – eventually MGI changed its supplier in 1999.

[160] The alleged defect being thus both inherently discoverable and factually discovered during the statutory four-year period (assuming for argument that MGI's defect allegations are well-founded), the Discovery Exception would not be condoned under Texas Law[80], regardless of whether an explicit warranty triggered that exception.

[161] Ultimately, there is no explanation given to explain the absence of a direct action by MGI prior to the expiry of the four-year prescription. Had it sued by early 2002, prescription would not now be an issue. It sent ST a letter of demand in September 17, 1999[81], followed by another dated October 22, 1999[82]. Others followed with details of expenses incurred and, as well, as regards the claim it had received from HPF. Then HPF sued MGI in the State of California, filed on March 23, 2001[83]. Two more years passed before MGI's Direct Action was filed.

[162] MGI's expert raises an additional argument regarding prescription ─ he opines that prescription had been tolled (suspended).

[163] Mr. Hurley refers the Court to Section 16.068 of the Texas Civil Practices and Remedies Code[84]. That section eliminates a defence based on prescription in relation to "a subsequent amendment or supplement to the pleading[85]". It requires, however, that the amendment and supplement not be based on a new, distinct or different transaction or occurrence. Accordingly, opines MGI'S expert, the Action in Warranty would have suspended prescription (tolled the statute of limitations) for the subsequent Direct Action.

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79 Exhibit D-23: Affidavit of Ed Dwyer dated May 11, 2001, before the United States District Court, Eastern District of California.

80 *Wagner & Brown, Ltd.* v. *Howood*, 58 S.W.3d 732 at par. [3][4][5] (Tex. Sup. Ct. 2001).

81 P-3;

82 Book G, Book of Enclosures, Tab 13;

83 Book G, Book of Enclosures, Tab 4;

84 Legal Authorities to the Expert Report of Bruse Hurley, Volume 2 of 2, Tab 15;

85 "*16.068: If a filed pleading relates to a cause of action, cross action, counterclaim, or defense that is not subject to a plea of limitation when the pleading is filed, a subsequent amendment or supplement to the pleading that changes the facts or grounds of liability or defense is not subject to a plea of limitation unless the amendment or supplementary is wholly based on a new, distinct, or different transaction or occurrence."*

[164] Has the Action in Warranty tolled prescription of the Direct Action under Texas law?

[165] The Court rejects MGI's argument and answers in the negative. Neither of the Texas law experts could locate one (1) decision in which Section 16.068 was applied to a separate action. The wording of that section seems to clearly refer to an amendment or a supplement within the same lawsuit: "… a subsequent amendment or supplement to the pleading…". Absent proof that Section 16.068 is applied differently under Texas law, the Court applies the clear meaning of the language in that Section – the amendment or supplement must be in the same proceeding, not a separate action.

[166] Moreover, it does not appear that the Direct Action covers exactly the same occurrence as the Action in Warranty. The latter is limited to the claim by HPF. The Direct Action is described as including damages in relation to other clients of MGI.

[167] Accordingly, the answer to Stipulated Question 2 is that the Direct Action is time barred (prescribed) under Texas law – save and except for E^2 delivered after May 28, 1999.

QUESTION 5a: IS MGI'S ACTION IN WARRANTY ILL-FOUNDED BASED ON TEXAS LAW GOVERNING CLAIMS IN WARRANTY?

[168] At issue is not whether the Action in Warranty is statue-barred (prescribed). Both experts on Texas law agree that it is not. Under Texas law, to the extent the Action in Warranty is an indemnity claim, the statute of limitations has not yet started. There has been no final judgment yet on the underlying claim between HPF and MGI.

[169] One issue raised by ST is that MGI has no cause of action against it for "contribution". In other words, MGI cannot claim that ST is a co-debtor, co-obligor or co-guarantor directly to HPF. Nor is there privity of contract between ST and HPF. As well, ST argues that they are not joint tortfeasors. All well and good, but this issue is not relevant to the Action in Warranty. MGI does not seek a conclusion that condemns ST to pay anything directly to HPF.

[170] It is, for all intents and purposes, simply an anticipatory indemnity action – an action in warranty that only seeks indemnity from ST if MGI is held to be liable to HPF. Whether or not Texas law provides for an anticipatory warranty action as a valid procedural vehicle, that is not relevant. Procedure is governed in this case by Quebec law[86]. The Action in Warranty does not fail simply because it is anticipatory.

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[86] Art. 3131 C.C.Q.

[171] ST also argues that the Action in Warranty fails by reason of: (a) MGI's failure to meet the limited warranty pre-conditions (notice and returning product for examination), and (2) the limitation on damages under Clauses 12(a) and 14. In other words, there is no real cause of action. For the reasons already expressed, the Action in Warranty does not fail for any of those grounds at this stage, as there may be a cause of action under Title 1, UCC, and damages may be recoverable.

[172] Consequently, the Action in Warranty is not ill-founded from a prescription or procedural perspective. Nor can it be declared ill-founded at this stage for want of a proper cause of action. As to whether it is well-founded in fact and in law, that is a determination to be made at the next phase of trial.

FOR THESE REASONS, THE COURT:

[173] **DECIDES AND ANSWERS** the Stipulated Questions as follows:

[174] **QUESTION 1**: Yes.

[175] **QUESTION 2**: Yes, in part.

[176] **QUESTION 3**: No.

[177] **QUESTION 4**: Yes.

[178] **QUESTION 5a**: No.

[179] **QUESTION 5b**: No.

[180] **THE WHOLE**, with costs to follow suit.

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Dates of Hearing: June 11 to June 19, 2012

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