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**CANADIAN CONFLICT OF LAWS**

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## CHAPTER 3

# CHARACTERIZATION AND THE INCIDENTAL QUESTION

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### §3.1 THE ROLE OF CHARACTERIZATION IN CHOICE OF LAW ANALYSIS

In an action involving legally relevant foreign elements, a court might be asked to apply foreign law.<sup>1</sup> To decide whether to do so, the court must ascertain the legal nature of the questions or issues that require adjudication and then apply its appropriate conflict of laws rules to them. For instance, do the facts raise a question of succession or of matrimonial property, or a question of capacity or of form? This analytical process is called characterization or classification. Its purpose is to enable the court to find legal categories with which the forum is familiar.<sup>2</sup> In other words, the court must allocate each question or issue to the appropriate legal category. The application of the forum's conflict of laws rule to each legal question or issue will indicate which legal system governs that question or issue. That legal system is called the *lex causae*.

Once the court has characterized the issue, it will consider the connecting factor—a fact or element connecting a legal question or issue with a particular legal system. Finally, the court will apply the law identified as the governing law. In doing so it must separate the rules of substance from the rules of procedure of the legal systems involved, because questions of procedure are governed by the *lex fori*.<sup>3</sup>

If the fact situation includes at least one foreign place element as, for example, the domicile of a person, the place of making of a contract, or the *situs* of a thing, a problem of conflict of laws may arise. The court must decide whether it should apply its own domestic law or whether by reason of the existence of the foreign place element, it should apply rules of the law of that place, or even whether, as regards different aspects of the case, resort should be had to the various foreign laws of the places in which various elements are respectively localized.

A conflict of laws rule is usually stated in the form of an abstract proposition, such as “capacity to convey land is governed by the law of the *situs* of the land,” or “the formalities of a contract are governed by the law of the place of contracting,” or “succession to movables (as distinguished from administration) is governed by the law of the last domicile of the deceased person.” A proposition of this kind is equivalent to saying that, as regards a particular kind of legal question or issue, a particular element (*situs*, place of contracting or domicile, as the case may be) is the one which should be used as the appropriate connecting factor, that is, the element that connects the factual situation or legal question or issue with the governing law. In a simple case, governed by a settled conflict of laws rule of the forum, the selection of the connecting factor may seem to be at best the use of a convenient mechanical device, and at worst the interjection of an unnecessary step, in the selection of the proper law. But in a doubtful or difficult case the deliberate consideration of the significance of various elements in the factual situation

may assist in the analysis of the problem presented to the court, and may afford a useful approach to the selection of the proper law, involving sometimes the application by analogy of an existing conflict of laws rule or sometimes the formulation of a new conflict of laws rule appropriate to a new situation.

Logically, the selection of the connecting factor and the consequent selection of the proper law must be preceded by the *characterization of the question or issue*, followed by the application of the proper law. In substance, the enquiry proceeds in three stages:

*First*, the court characterizes, or defines, the juridical nature of the question or issue upon which its adjudication is required (other words are also used to describe this process, *e.g.*, qualification, classification). As mentioned above, rules of the conflict of laws are often expressed in terms of legal concepts combined with facts or elements, and the legal question or issue involved in a given factual situation must be at least provisionally determined before a particular conflict of laws rule of the forum can be used. There may even be different aspects of the factual situation giving rise to different legal questions or issues governed by different conflict of laws rules. If a provision of a given foreign law is the governing law on some characterization of the question or issue or one of the questions or issues, that provision should be characterized, in its context in the foreign law, during the process of characterizing the legal question or issue.

*Second*, the court should select one of the place elements as being the connecting factor appropriate to the question or issue, or to each of the questions or issues, as already characterized, and consequently select the proper law or laws to which resort should be had. For instance, if the factual situation has been characterized as raising a question of succession to movables, the court will apply its conflict of laws rule for this legal question: succession to movables is governed by the law of the last domicile of the deceased. The connecting factor, which in this case is domicile, is the place element which connects the legal question with the law of a particular place. Where was the last domicile of the deceased? The answer to this question will result in application of the law of a particular legal unit as the law governing the legal question.

*Third*, to answer the question, or each of the questions, the court applies the law selected for each question to the facts of the case. That is, the court applies the domestic rules of the law of the forum, or rules similar to or identical with the domestic rules of the law of the foreign legal unit as the case may be, to the factual situation as it exists, except that the place elements are hypothetically situated in the legal unit to the law of which resort is had as regards each particular question or issue.

In a variety of circumstances there may arise what may be called a conflict of conflict of laws rules, that is, a difference between the conflict of laws rules of the laws of two legal units connected with a single situation, as distinguished from a difference between the domestic rules of the laws of the two legal units.

There may be a patent conflict of conflict of laws rules resulting from the fact that the conflict of laws rules of two legal units are different in terms, because as regards the same legal question or issue they use different connecting factors. For example, a conflict of laws rule of X may say that the *lex domicilii* governs a given legal question or issue,

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## CHAPTER 30

# FOREIGN CORPORATIONS

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### §30.1 STATUS, POWERS, DOMICILE, RESIDENCE AND NATIONALITY

Corporations and other legal persons or juridical entities duly created in foreign states or in other provinces or territories, are recognized and permitted to sue and be sued<sup>1</sup> in Canada in their corporate capacity<sup>2</sup> subject, in certain cases,<sup>3</sup> to registering or obtaining a local licence.<sup>4</sup> However, a foreign corporation's failure to obtain a provincial licence does not immunize it against suits brought against it in any of the provinces or territories nor does it affect its corporate existence.<sup>5</sup>

Questions concerning the status of a foreign corporation, especially whether it possesses the attributes of legal personality, are, on the analogy of natural persons, governed by the law of the domicile of the corporation.<sup>5.1</sup> This domicile is in the state, province or territory of incorporation or organization and it cannot be changed during the corporation's existence even if the corporation carries on business elsewhere.<sup>6</sup>

The law of the state, province or territory under which a corporation has been incorporated or organized determines whether it has come into existence, its corporate powers and capacity to enter into any legal transaction,<sup>7</sup> the persons entitled to act on its behalf<sup>8</sup> including the extent of their liability for the corporation's debts,<sup>9</sup> and the rights of its shareholders.<sup>10</sup> Furthermore, the instrument of incorporation and the laws of a corporation's domicile govern not only its creation and continuing existence, but also all matters of internal management, the creation of share capital and related matters.<sup>11</sup> The issues governed by the law of the corporation's domicile include its capacity to sue, the authority of directors, who may be appointed a director, its power to make contracts, the validity of conveyances of corporate property, the corporation's right to issue stock, and the validity of transfers of its stock.<sup>12</sup>

While the state, province or territory in which the foreign corporation intends to carry on business has the right to prescribe the extent to which the corporation may exercise its corporate powers and capacity, this does not mean that proceedings may be taken in this jurisdiction to affect its status as a corporation.<sup>13</sup> However an important exception to this exists in respect of a foreign partnership formed solely for the purposes of creating a tax loss in the forum and not for doing business. The existence of such a partnership will be determined by the law of the forum.<sup>14</sup>

There is some controversy over which law determines the liability of a corporation for the obligations of a foreign subsidiary. Since the personality and status of the subsidiary is called into question, it would seem that the law applicable to the status and capacity of the subsidiary should determine whether its corporate veil can be pierced. Alternatively, under the technique of *depeçage* the court could apply the *lex fori* to jurisdiction as a matter of procedure in order to determine the identity of the true defendant but this would encourage forum shopping for the jurisdiction most favourable to piercing the corporate veil. For other matters, the law governing the contract or tort that

gives rise to the litigation against the foreign subsidiary would determine whether its corporate veil should be pierced since, arguably, piercing the corporate veil should be characterized as a function of the dispute and not of the status of the corporation.

In Quebec, according to article 307 of the *Civil Code*, the domicile of a legal person is at the place and address of its head office, which is generally where it has been incorporated. However, article 3083 of the *Civil Code* makes it clear that: "The status and capacity of a legal person are governed by the law of the country under which it was formed subject, with respect to its activities, to the law of the place where they are carried on." The law of the place of incorporation prevails.

A corporation may have more than one residence<sup>15</sup> for different purposes, as for instance, for liability to taxation,<sup>16</sup> liability to suit,<sup>17</sup> security for costs,<sup>18</sup> and enemy character.<sup>19</sup> Each case depends upon its own facts and on the purpose and wording of the relevant statute or rule.<sup>20</sup> For purposes of international law, a corporation has the nationality of the state under the law of which it has been organized, that is, the place of incorporation and the place of the registered office.<sup>21</sup> For the purposes of the conflict of laws, many legal systems subject a corporation to the law of its nationality, which depends upon the place where its head office is located.<sup>22</sup>

Where an association is incorporated simultaneously in two or more jurisdictions or reincorporated in another jurisdiction, it has more than one legal personality and domicile but "there is in reality only one association, and a body incorporated by two or more states must not be treated as though it were a partnership of two or more associations. The same association is the subject of the various incorporations. There is but one entity in existence, but one organization. To treat the association as a number of separate though closely united bodies would be to disregard the actual situation and invert the view of the business world."<sup>23</sup> This is particularly true where the association, although incorporated in several places, has its central management located in one place and has only one board of directors.

Canadian courts should recognize multiple incorporations or reincorporations if permitted by the law of the jurisdictions in which each incorporation or reincorporation took place. Therefore, depending upon the issue, any act done by the association should be recognized and given effect in Canada, if it is valid by the law of the relevant place of incorporation or reincorporation. In case of conflict among the requirements of the laws of the places of incorporation or reincorporation, the law of the place of incorporation or reincorporation most closely connected with the issue should prevail. Where the association is recognized as one entity by the legal system where it is incorporated or reincorporated, it should be recognized in Canada. In other words, the association must be permitted to exist at one time as a single entity under all legal systems where it is incorporated or reincorporated.

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<sup>1</sup> *Browning-Ferris Industries Inc. v. Browning-Ferris Industries Inc.*, Remple, [1976] B.C.J. No. 12, [1976] 3 W.W.R. 759 (S.C.); *Canadian Stock Breeders Service Ltd. v. Reimer and Reimer*, [1976] B.C.J. No. 31, [1976] 3 W.W.R. 448 (S.C.), revd on other grounds [1976] B.C.J. No. 9, [1976] 5 W.W.R. 405 (C.A.); *International Assn. of Science and Technology for Development v. Hamza*, [1995] A.J. No. 87, 122 D.L.R. (4th) 92 (C.A.) (The right of a foreign litigant to sue is governed by the *lex fori*, including its rules relating to private international law applicable to foreign litigants.



in a particular country may be seen as an implicit selection of that country's law as the proper law.<sup>55</sup> Even if, objectively, the contract is more closely connected with another jurisdiction, the selection of the place of arbitration may amount to an implied agreement as to choice of law.<sup>56</sup> The same inference may be drawn if the form of the arbitration agreement itself complies with the law of the place of arbitration but not with the other possible governing law.<sup>57</sup>

However, the inference was not drawn in a case in which the parties and the performance of the contract were all connected with two foreign legal systems whilst the arbitration was in a third country. The foreign connections outweighed the significance of the place of arbitration and the proper law had to be selected on the basis of the other connections.<sup>58</sup> Irrespective of the proper law of the contract as such, the parties will usually be taken to have intended that the law of the place of arbitration will govern issues relating to the arbitration procedure.<sup>59</sup>

An agreed selection of a judicial forum in a particular country is a strong indication that the parties intended the law of that country to apply to the contract.<sup>60</sup> It is a stronger indication than an arbitration agreement because a court, unlike an arbitrator, is bound to apply the law of the country in which it sits unless that country's choice of law rules authorize it to apply foreign law. By contrast, an arbitral tribunal has no *a priori* legal obligation to apply the law of the country in which the arbitration takes place or, for that matter, any specific other law, since its powers derive, not from a national law, but from the parties' agreement.<sup>61</sup>

Rome I includes in its preamble a statement that says that an exclusive choice of forum in favour of the courts or tribunals of a member state "should be one of the factors to be taken into account in determining whether a choice of law has been clearly demonstrated [for the purposes of article 3, paragraph 1, the provision giving the parties freedom of choice]".<sup>62</sup> The OAS Convention puts it negatively: "Selection of a certain forum by the parties does not necessarily entail selection of the applicable law."<sup>63</sup>

### c. Proper Law Objectively Determined

#### i. *The Closest and Most Real Connection Test*

If the parties have not agreed on the proper law of their contract, the proper law depends on the "objective" test first treated as definitive in the *Bonython* case,<sup>64</sup> namely, "the system of law by reference to which the contract was made or that with which the transaction has its closest and most real connection".<sup>65</sup> The *Bonython* test, which (like the "proper law" label) derives from Westlake,<sup>66</sup> superseded the earlier habit of referring to the proper law, even where the parties had not agreed on one, as being a matter of the parties' intention. As noted earlier,<sup>67</sup> this approach failed to mark the distinction between cases in which the parties' agreement on a proper law, though not express, could still legitimately be inferred from the contract's terms, and those in which the parties had simply not agreed on the proper law. In the latter case the intention could only be imputed. Treating it as if it were inferred from the terms of the agreement was a fiction.

The *Bonython* "closest and most real connection" test makes it clear that the process required, when construction of the contract has not yielded an express or implied choice of law by the parties, is a choice of law by the court. The same distinction is reflected in

the European Rome I Regulation.<sup>68</sup> Article 3 reads, "A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to part only of the contract." Article 4 then specifies a set of tests for determining the governing law "[t]o the extent that the law applicable to the contract has not been chosen in accordance with Article 3". The OAS Convention similarly distinguishes between an express or implied agreement on the governing law, and an objective determination of the governing law based on the state with which the contract "has the closest ties".<sup>69</sup>

## ii. *Factors Considered*

All the circumstances relating to the parties and to the contract are potentially relevant in determining the proper law using the *Bonython* test. Some significance has been attached to the distinction between a connection with a "system of law" and a connection with a "country". The former might suggest that legal factors such as the style of drafting of the contract, which relate more to the "system of law", are predominant over merely geographic factors such as the place where the contract was made or was to be performed, which relate more to the "country". It is clear, however that the test embraces both kinds of factors without giving more weight, *a priori*, to one than the other.<sup>70</sup>

Although the proper law is now determined according to an "objective" test and not by imputing a fictitious intention as to the governing law,<sup>71</sup> it is still important to take into account the parties' intentions, not as to the governing law (which, *ex hypothesi*, they did not have), but as to how their contract is to operate. Supporting those intentions was the main orientation of the imputed intention test, and it is no less so in respect of the "closest and most real connection" test.<sup>72</sup> Courts have generally assumed that the system of law that is chosen by means of this test should, if possible, be one that will enable, rather than weaken or negate, the contemplated operation of the contract.<sup>73</sup> This assumption underlies the often decisive weight given to the agreement's being drafted in a form or with legal concepts that are used in one jurisdiction but not another.<sup>74</sup> It also underlies the weight sometimes given to the fact that the contract is valid according to one system of law but invalid according to another.<sup>75</sup>

However, there are limits to the logic that the choice of governing law should respect the parties' interests. The proposition makes sense if the issue is the "fit" of the agreement with the general rules for contracts; it is appropriate to take into account the fact that the contract functions better under one law than another.<sup>76</sup> On the other hand, the proposition is inapposite if the issue is the application of a regulatory statute. Such a law is meant to override the parties' interests rather than give effect to them, and so the mere fact that the parties' interests are harmed is no reason for tilting the choice-of-law scales against that system of law.<sup>77</sup>

The place the contract is concluded has no *a priori* centrality in the "closest connection" analysis, although it is a relevant factor.<sup>78</sup> In the nature of things, its weight in the analysis is greatest when the parties are both resident in the country where the contract is made,<sup>79</sup> and least if the parties are from different jurisdictions and the place of contracting is just the outcome of a rule about whether an acceptance takes effect when (and therefore where) it is sent or when it is received.<sup>80</sup>

Other factors that have been regarded as relevant to the "closest and most real

connection” analysis include the form and legal concepts in accordance with which the contract is drafted;<sup>81</sup> the language in which it is written;<sup>82</sup> the fact that the agreement is supplementary to another agreement governed by a particular law;<sup>83</sup> the fact that one party sought out the other in the latter’s home country to make the contract;<sup>84</sup> the fact that the contract was negotiated in a particular place;<sup>85</sup> the location of the property that is the subject matter of the contract;<sup>86</sup> the place where property securing the payment of a debt instrument is located;<sup>87</sup> the flag of the ship on which a contract of carriage is to be performed;<sup>88</sup> the location of the office at which an account is to be operated;<sup>89</sup> the place where delivery of goods or provision of services is to take place;<sup>90</sup> the place where a loan or debt instrument is to be repaid;<sup>91</sup> the office at which decisions as to issuing an insurance policy were made;<sup>92</sup> the place where the services under a contract of employment are to be performed;<sup>93</sup> the place where a company insuring itself against risks in multiple jurisdictions<sup>94</sup> or hiring employees of multiple nationalities<sup>95</sup> was based; and the currency in which obligations are to be paid.<sup>96</sup>

The proper law must be determined as of the time the contract was made, which means that connections that emerge subsequently cannot be factored into the analysis.<sup>97</sup>

See further the discussion of particular types of contract, below.<sup>98</sup>

### **iii. Presumptions**

Although at one time the common law choice of law rules made some use of presumptions,<sup>99</sup> the case law of the last few decades has abandoned them altogether. This contrasts with the choice of law rules in the *Civil Code of Québec* and the European Rome I Regulation for cases in which the parties have not agreed on a governing law. As noted below,<sup>100</sup> both of these pieces of legislation take as their starting point that the contract is governed by the law of the country in which the party that is to provide the “characteristic performance” is resident or, in a commercial contract, has its place of business. The Quebec *Civil Code* refers to this as a presumption, Rome I more strongly expresses it as a rule to be displaced only if the contract is manifestly more clearly connected with another jurisdiction.

Many of the common law decisions are consistent with the “characteristic performance” criterion, in that the most closely connected law was found to be that of the country of residence or the place of business of the party rendering the characteristic performance, which generally means the party who is selling or supplying the subject matter of the contract, whether property or services. But other cases have held that another law is the most closely connected law. For instance, there are sale of goods cases in which (especially where installation or after-sales technical assistance was part of the contract) the proper law was found to be the law of the purchaser’s jurisdiction, not the seller’s.<sup>101</sup>

### **iv. More than One Proper Law**

It is possible for the closest connection test to result in a contract being governed by one system of law as to one part, and by another system of law as to another, severable part.<sup>102</sup> The OAS Convention caters expressly to this possibility.<sup>103</sup> An English court found this to be the case, in relation to a contract with a bank that provided for the operation of two accounts, one in London and the other in New York. The relations between banker and customer were held governed by English law as to the former account and by New York law as to the latter.<sup>104</sup>