International and Cross-Border Contract Formation – Essential Considerations

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DAVIES

International and Cross-Border Contract Formation

- Geographic Professional Limitations
- Working with Foreign Counsel – the Acquisition Agreement Model
  - Allocation of Legal Responsibilities between Canadian and Foreign Counsel
- Subject Matter of Negotiated Acquisition Agreements
- Threshold Issues in International and Cross-Border Agreements

International and Cross-Border Contract Formation

- Geographic Professional Limitations
  - Canadian lawyers are only qualified to practice law in specific provinces or territories of Canada
  - Increasing demand of Canadian clients that their lawyers advise them in their international business transactions
  - LawPRO caution regarding insurability of such advice given by Ontario lawyers
  - How to address the challenge?

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- The Intra-Canadian Model
- Canadian lawyers regularly provide extra-jurisdictional advice by advising on laws of provinces/territories other than the laws of the jurisdictions in which they are licensed to practice
- The 2002 National Mobility Agreement provides Canadian lawyers with the ability to practice on a temporary basis the laws of provinces in which they are not called
  - Used for straightforward corporate opinions or securities opinions based on National Instruments

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- Working with foreign counsel
  - Canadian clients often leave the choice of local counsel up to their principal Canadian counsel
  - In the absence of pre-existing working relationships with local counsel, referrals should be sought from other lawyers who have previously worked with counsel in the relevant jurisdiction

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- Use of Acquisition agreements as a model for illustrating how Canadian lawyers can advise on negotiating and drafting cross-border and international agreements
- Remarkably uniform across jurisdictions
  - Driven primarily by very nature of subject matter
- Representations and warranties
  - Driven primarily by commercial factors
  - Globalization and the uniformity of legal practice
- Pre-Closing Covenants and Closing Conditions
  - Driven primarily by commercial factors
  - Variation of regulatory consents, approvals or filings
- Indemnity Provisions
  - Content and scope primarily reflect nature of subject matter and bargaining strength of parties

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- Subject Matter of the Acquisition Agreement
  - Share purchase agreements require review of shares or other securities with local counsel to confirm relevancy and transferability
  - Asset purchase agreements require review by local counsel if law requires assets to be defined or described in a particular manner

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- Purchase Price
  - Price adjustments require advice of local counsel or local auditors regarding accounting principles
  - Shares or securities in purchase price require advice of local counsel for description and transferability
  - Assumption of vendor's obligations and liabilities may be affected by local law and require local counsel to consider their description and substance
  - Currency fluctuations in sales of Canadian assets to foreign purchasers can be mitigated by ensuring payment in Canadian or U.S. dollars or Euros
  - Letters of credit address the risk of non-payment and non-enforcement

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- Bulk Sales Law
  - Bulk sales law rules requiring creditor consent to "sale in bulk" asset transaction have been discarded in most Canadian jurisdictions
  - However, this is not the case in many foreign jurisdictions
  - Advice of local counsel is required in respect of any local bulk sales rules

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- Negotiation of representations and warranties
  - Knowledge of client's business, risk tolerance and negotiating leverage
  - Input from local counsel as to:
    - Legal matters that will have an impact on such representations and warranties
    - Conventional bargaining approaches of the local party

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- Representations and warranties
  - Status – representations and warranties as to due organization, existence and good standing of the foreign corporation
  - Appropriate language of title representation
  - Approvals, Permits, Licences and Filings – issues to be addressed in representations and warranties concerning identity, nature and proper description of approvals, permits, licenses or filings

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- Property and encumbrances – description of title to real estate and encumbrances thereon requires input from local counsel
- Employee benefits regulation – highly specialized area that should be delegated to local counsel
- Environmental and intellectual property issues – Canadian counsel can play a significant role in negotiating provisions regarding these issues. However, the input of local counsel is critical in ensuring that the local regulatory regime is followed

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- Covenants
  - Negotiation affected by risks associated in conduct of business between execution of purchase agreement and closing
  - Local counsel's input will be necessary to advise on any particular regulatory compliances which must be addressed during the interim period (e.g. the consents, permits, licenses, approvals and filings to be addressed so the purchaser can continue the business after closing)
  - Local advice will be necessary in drafting covenants regarding allocation of liability under tax or employee benefit legislation or regulation

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- Logistics and Conditions of Closing
  - Virtually uniform in all jurisdictions except for regulatory consents and filings
- Indemnities
  - Survival period of the indemnity, appropriate threshold of damages that must be incurred and the maximum aggregate liability are commercial matters where experienced counsel can advise Canadian clients

International and Cross-Border Contract Formation

- Threshold Issues in Cross-Border Agreements
  - Contract Formation
    - Choice of law clause to govern issues and contract validity
    - Many different rules of contract formation across borders
  - Enforceability of the Contract
    - Review of agreement for enforceability, the enforceability opinion
    - Dispute settlement
  - Regulatory Issues in International Agreements
    - Competition/anti-trust law and foreign investment review

International and Cross-Border Contract Formation

- Contract Formation
  - Until a formal agreement with a choice of law clause is signed questions may arise as to whether a valid contract has been formed in a foreign jurisdiction
  - In most common law and civil law jurisdictions a valid contract is formed if both parties intended for their agreement to be enforceable, assent has been reached on all essential terms and all statutory requirements have been satisfied.
  - However, each of these requirements can vary by jurisdiction

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- Intent of the parties

In most jurisdictions the test to determine if a party intended to be bound by a contract is objective, although exceptions include France and the Netherlands

- Essential terms of the contract

These are codified in certain civil law jurisdictions, including China

- Statutory formalities

A common requirement is that a contract must not have an illegal cause or object (Articles 1411 and 1413 of the *Civil Code of Québec*)

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- Enforceability of the Contract
  - Governing Law of Agreement
    - Local jurisdiction of vendor or a more hospitable legal system
    - Conflict of law rules determine governing law if the choice is not addressed
      - Deference is given first to contractual choice of parties, second to implied choice of the parties and third to proper law of the contract

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- Implied choice of the parties
  - This is inferred from various factors, including whether the contract expressly provides for a place of dispute arbitration, whether it includes a forum selection clause or whether it is related to, or similar to, other contracts entered into between the parties that contain an express choice of governing law
- Proper law of the contract
  - Proper law is predetermined in dealings with real property
  - In others, “closest and most substantial connection” test from *Imperial Life Assurance Co. of Canada v. Colmenares*
- Opinion of local counsel regarding choice of laws clause

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- Jurisdiction of the Contract
  - Exclusive jurisdiction or forum selection clauses are given more deference since the decision by the Supreme Court of Canada in *Z.I. Pompey Industrie v. ECU-Line N.V.*
  - Canadian courts will generally give effect to exclusive jurisdiction or forum selection clauses unless the party challenging the clause can show “strong cause” for not doing so

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- Dispute Settlement
  - Arbitration is preferred in international business agreements since benefits include
    - Ability to customize the process
    - Confidentiality of the arbitration process
    - 1958 New York *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*
  - An arbitration clause or agreement must be expressly set out and the agreement is treated by Ontario's *International Commercial Arbitration Act* (the "ICAA") as independent of other terms of the contract

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- Article 34 of UNCITRAL Model Law on International Commercial Law, incorporated into the ICAA, provides limited reasons when a court may grant recourse against an arbitral award
- The British Columbia Court of Appeal dismissed an application for review of an arbitral award in *Quintette Coal Ltd. v. Nippon Steel Corp.*, citing reasons from a U.S. Supreme Court judgment
  - "concerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes"

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- Regulatory Issues in International Agreements
  - 1. Competition and Anti-Trust Regime
  - Under the U.S. *Hart-Scott-Rodino Anti-Trust Improvements Act* ("HSR") parties have reporting requirements and must wait 15 to 30 days before completing an asset transfer if certain thresholds are met:
    - the transaction affects commerce in more than one state or country
    - the total assets/annual net sales of one party are at least US$141.8 million and of the other party at least US$14.2 million
    - as a result of the transaction, the acquirer must hold stock and assets of the target valued at more than US$70.9 million
    - HSR will apply regardless of the foregoing to transactions valued in excess of US$283.6 million

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- European Merger Regulations
  - Merger Regulation of 2004 is the European Commission's exclusive power to investigate mergers and acquisitions with a "community dimension"
  - Thresholds for such determination are:
    - combined aggregate worldwide turnover of entities more than €E5 billion and community turnover of each of at least two entities more than €250 million
    - combined aggregate worldwide turnover of all entitles more than €2.5 billion and in each of three member states combined aggregate turnover of all entities more than €100 million

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- Canadian *Competition Act*
  - Under the *Competition Act* (Canada) there are financial and voting pre-merger notification thresholds:
    - Financial – size of deal exceeds $80 million and total assets/revenue of all parties exceeds $400 million
    - Voting – deal results in acquirer holding 20% (public companies) or 35% (private companies) of the voting shares

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- 2. Foreign Investment Review
  - *Investment Canada Act*
    - Under the *Investment Canada Act* thresholds for review are:
      - $5 million (direct acquisition) and $50 million (indirect)
      - For WTO investors - $344 million (direct acquisitions only)
      - Substantive review includes "net benefit to Canada" test and national security issues
      - Controversy around failed deals for Potash Corp. and TSX and recent acquisitions of Nexen Inc. and Progress Energy Resources Corp.
    - Further restrictions imposed by corporate statutes, the *Telecommunications Act* and the *Broadcasting Act*

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- Committee on Foreign Investment in the United States (CFIUS)
  - CFIUS has authority under the Exon-Florio Amendment to review transactions that may lead to foreign control of a U.S. business
  - If CFIUS is of the view that a transaction poses a national security risk it may enter into an agreement with parties to the transaction, impose conditions on the parties or refer the matter to the President of the United States
  - President Obama recently required Ralls Corporation, a Chinese-owned entity, to divest of Oregon wind farms on this basis
  - While Presidential intervention is rare, nearly half of the transactions reviewed by CFIUS are terminated by the parties involved

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- U.S. *Foreign Investment in Real Property Tax Act of 1980* (FIRPTA)

  - FIRPTA imposes withholding tax on the disposition of an interest in U.S. real property held by a foreign person

  - A gain on the disposition of an interest in real property is characterized as income effectively connected with a U.S. trade or business and a general withholding rate of 10% is applied

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- Foreign Investment Review in Europe
  - Conducted on a country-by-country basis, although talk of establishing a special EU review board for foreign investment has grown in recent years
  - For example, Germany can block acquisitions by non-EU persons that threaten public order or safety, so long as 25% of the German target company's shares are acquired
  - Other European countries that have foreign investment rules include the United Kingdom, Italy, France and Spain