INTERNATIONAL AND CROSS-BORDER CONTRACT FORMATION – ESSENTIAL CONSIDERATIONS

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CROSS-BORDER AND INTERNATIONAL AGREEMENTS

by

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1. Introduction

Over the years, I have represented Canadian clients who have expanded operations internationally primarily through strategic acquisitions. In initiating those transactions, Canadian clients are likely to consult their Canadian counsel to discuss the proposed transaction and the manner in which it can best be implemented. This paper will review the manner in which Canadian counsel can play a significant role in negotiating and settling agreements in international or cross-border transactions entered into by Canadian clients and will also review some of the principal threshold legal and regulatory issues that require consideration when embarking on a transaction in a foreign jurisdiction.

One of the challenges and opportunities facing Canadian counsel to Canadian businesses that expand internationally is how best to serve the Canadian client in jurisdictions in which the Canadian lawyer is not licensed to practice law. Canadian clients may want to continue using their Canadian counsel for a variety of reasons which will include, among others, the Canadian lawyer's familiarity with the client's business and expectations, an understanding based on experience of the legal and business risks that are within the client's realm of tolerance and personal chemistry.

*The author acknowledges the valuable assistance of Andrew Ellis, a student-at-law at Davies Ward Phillips & Vineberg LLP, in updating and supplementing this paper.

This paper will discuss the approach I have taken as a lawyer acting on behalf of Canadian clients in a variety of cross-border and international transactions.

From the perspective of a practising commercial lawyer, there are two principal challenges presented by cross-border and international transactions and the agreements related to them. One is process or practice related, i.e., how can a lawyer qualified to practice in one jurisdiction address the challenges presented by the need to draft and negotiate agreements that are affected by the laws of multiple jurisdictions. The second - and not unrelated - challenge is substantive: what kinds of legal and contractual issues are particular to, or typical of, cross-border agreements.

In addressing the challenges of negotiating and drafting agreements in an international context, this paper will use the model of negotiating and drafting private acquisition agreements – whether of assets or shares – as a paradigm. However, this discussion could relate equally to the negotiation of many other types of cross-border or international agreements, such as debt financings or other transactions that, unlike securities transactions for example, are not subject to extensive domestic regulation.

My approach here, in particular, will be to discuss, at the outset, several of the limitations and challenges involved in negotiating international and cross-border agreements and how responsibility can be properly allocated between Canadian and foreign counsel in negotiating and drafting such agreements. I will then touch on some of the key substantive threshold legal and regulatory issues that arise in entering into agreements that are designed for foreign international transactions. These substantive issues include contract formation, governing law, enforceability, jurisdiction for the adjudication of disputes, and regulatory issues.

2. Geographic Professional Limitations

A. The Restrictions on Advising Clients on Foreign Law

As Canadian lawyers qualified to practice law in specific provinces or territories we state, in qualifying each legal opinion we provide, that:

> "We are solicitors qualified to practise law in the Province of ■ and we express no opinion as to any laws, or any other matters by any laws, other than the laws of the Province of ■ and the federal laws of Canada applicable therein".

Given that cardinal limitation on our professional licences – if not competence – we must, as a starting point, be wary of requests by Canadian clients to act on their behalf in the negotiation and settlement of agreements governed by the laws of jurisdictions other than the laws of the jurisdiction in which we are licensed to practise law. Counsel for Canadian clients expanding their businesses internationally are often asked to do just that.

It is interesting to note in this regard that in 2010, LawPRO published an article specifically noting that the LawPRO Professional Liability Insurance Policy provides coverage to Ontario lawyers for the performance of professional services involving "the practice of the law of Canada, its provinces and territories". The article goes on to state the following:

> With the Internet, easy international travel and a global economy, relationships and business transactions – and legal matters and disputes – frequently cross international borders. Handling matters that involve foreign law can increase the risk that you will face a malpractice claim, and can have important malpractice insurance implications that you should keep in mind.
>
> …
>
> What will, or will not, be covered can be very fact-specific, but you should expect that you are not covered for work involving non-Canadian law.

The article also provides the following caution:

> As much as you may want to help a client, don't be tempted to give even the most basic advice with respect to foreign law, even if you know for certain that the information is correct. Just telling a client about a foreign law deadline or commenting on a few words in an agreement governed by foreign law fully exposes you to a claim.

Ontario lawyers are not covered for giving advice on non-Canadian law under the LawPRO policy.

This first part of this paper attempts to describe how, based on my personal experience, I have responded to the challenge presented by requests from Canadian clients to act on their behalf in international and cross-border transactions – and, in particular, in the negotiation and drafting of agreements made in connection with such transactions while attempting to remain within the bounds of my own professional competence and, more particularly, my professional licence, which restricts me to practising law and advising on legal matters governed by the laws of the Province of Ontario, which is the jurisdiction in which I am licensed to practise law.

B. The Intra-Canadian Model and its Challenges

Traditionally, as members of the Bar of a Canadian province or territory, we act almost without hesitation in advising clients on various commercial transactions, particularly those that are not specifically regulated such as, by way of example, the acquisitions of businesses or the making of loans, in provinces of Canada other than the province(s) in which we are licensed to practice law. In business acquisitions, for example, it is common to find Alberta lawyers advising their Alberta clients on acquisitions in British Columbia or Ontario and Ontario

lawyers advising their Ontario-based clients on acquisitions in Alberta and British Columbia. Technically, the limitations on our professional capacity in respect of these matters is as severe in extra-jurisdictional Canadian transactions as it would be in foreign transactions. Our experience in navigating the frontiers of professional competence in these "cross-border" intra-Canadian transactions can serve as a guide for how we might navigate the same limitations in foreign extra-jurisdictional transactions.

It is interesting to note, with respect to intra-Canadian "cross-border" transactions, that in the last number of years, in an attempt to eliminate the costs to issuers of obtaining provincial agents' opinions in cross-Canada securities offerings, certain Toronto law firms began developing the practice of rendering opinions on the laws of other provinces in which the securities were being offered. The practice is based on the ability of all Canadian lawyers under the 2002 National Mobility Agreement to practice on a temporary basis the laws of provinces in which they are not called. The National Mobility Agreement has been signed by all of the professional bodies governing the practice of law in Canada, and has been implemented locally by the respective Law Societies or Bar Associations in each jurisdiction other than Québec.[1] The approach that has been adopted by some law firms in the circumstances where opinions of counsel in other provinces would have otherwise been required, has been to qualify opinions as to the laws of the provinces other than Ontario in the following manner:

> "we are solicitors qualified to practise law in the Province of Ontario **and except for the opinions provided in paragraphs ■ and ■ as they relate to the Securities Laws of the provinces ■ and ■, which are provided by us pursuant to the National**

[1] Barreau du Quebec is a signatory to the National Mobility Agreement, but has not implemented it yet. The recent introduction of "Special Canadian Legal Advisors" as a restricted form of membership in the Barreau for lawyers in good standing in other Canadian jurisdictions will likely be helpful in implementing the provision for mobility in Quebec.

> **Mobility Agreement among certain members of the Federation of Law Societies of Canada,** we express no opinion as to the laws of any jurisdiction or as to any matters governed by the laws of any jurisdiction, other than the laws of the Province of ■ and the laws of Canada applicable therein in effect on the date hereof."

Apparently, the view of those firms who accept or deliver such opinions is that, in principle, there is no problem with the use of the National Mobility Agreement for straight-forward corporate opinions such as extra-provincial registrations or corporate existence or for securities opinions based on National Instruments. Based on the LawPRO release cited above, it would seem that these types of opinions would be covered by the Law Society mandatory minimum insurance.

These intra-Canadian developments are interesting to note as a reflection of the attempt to eliminate, to the extent possible, interprovincial barriers to trade and mobility. While they have no direct bearing on either the competence or insurability issues raised by the challenges of advising Canadian clients in their conduct of international or cross-border transactions, they are reflective of the overall global trend towards eliminating restrictions on trade and mobility.

3. Working with Foreign Counsel – The Acquisition Agreement Model

A. Choice of Local Counsel

The choice of local counsel in foreign – including extraprovincial – jurisdictions is often one that Canadian clients will leave up to their principal Canadian counsel. In the absence of pre-existing relationships with local counsel, referrals should be sought from other lawyers who have previously worked in the relevant jurisdiction.

B. Acquisition Agreements as a Paradigm for the Canadian/Foreign Lawyer Working Relationship

All commercial lawyers with any degree of practical experience in foreign jurisdictions will know that agreements governing negotiated purchase transactions are remarkably uniform across jurisdictional boundaries. This uniformity is driven primarily by the very nature of the subject matter of these agreements, and is reinforced by the advancements in technology that have reduced the world, in general, and the practice of commercial law, in particular, to a global village. As a practical matter, every purchase agreement must, of necessity, deal with: the subject matter of the transaction (assets or shares), including a legally accurate description of such subject matter; the consideration to be paid for the assets or shares; the manner in which the consideration is determined, quantified, adjusted and paid; the liabilities, if any, to be assumed (on an asset purchase transaction in particular); and any expenses to be allocated between the parties. The contractual provisions relating to the foregoing matters tend to be substantially identical across the jurisdictional divide as their contents are determined primarily by commercial, rather than legal, factors.

Purchase agreements will also always contain representations and warranties provided by both vendor and purchaser, generally with far more extensive representations and warranties being provided by the vendor with respect to the title, state and quality of the business and/or assets that are subject to the sale. The nature, substance and extent of the parties' representations and warranties will be driven principally by commercial considerations and will be designed primarily to address the major business risks associated with the particular assets or business being acquired, modified to reflect the relative bargaining strengths of the parties and the commercial practice and custom in the relevant jurisdiction. While partially informed by the

legal idiosyncrasies of each jurisdiction, these factors, for the reasons mentioned above – primarily the globalization of the marketplace and the uniformity of legal practice that results therefrom – play a lesser role in the determination of the scope and content of the parties' representations and warranties.

Contractual rules governing the behaviour of the parties during the hiatus between the date on which the purchase agreement is signed, and the date on which the transaction is closed, will generally be codified through covenants of both parties that will apply during that period of time. The scope and content of these covenants, like the other principal provisions of the purchase agreement, will similarly be determined primarily by commercial factors. The same consideration applies to those provisions of the purchase agreement that govern the logistics and conditions of closing.

The one element of the pre-closing covenants and closing conditions that will vary between jurisdictions will be the identity of the particular regulatory consents, approvals or filings that will be required to be obtained in each jurisdiction prior to, and as conditions of, closing. However, the subject matter of such consents, approvals and filings, such as anti-trust or competition filings or consents, securities filings or consents, registrations or filings required to perfect security interests, *etc.*, will generally be substantially similar and can generally be anticipated in principle, if not in the precise details, by experienced Canadian counsel.

Finally, the content and scope of the indemnity provisions of a negotiated purchase agreement, pursuant to which each party indemnifies the other for damages incurred as a result of the indemnitor's breach of covenant or representations and warranties or for damages resulting from pre-closing (in the case of the vendor) or post-closing (in the case of the

purchaser) conditions or events, will reflect the nature of the subject matter of the agreement, the relative bargaining strength of the parties, and only to a much lesser extent, the idiosyncrasies of local law and practice. (For example, the size of the indemnity and the extent of the "caps", thresholds and "tipping baskets" may vary slightly as a matter of practice between jurisdictions.)

Based on the foregoing summary overview of the subject matter of negotiated purchase agreements, one can begin to understand how an experienced Canadian counsel may effectively advise a Canadian client in the negotiation of such agreements, even when the agreements relate to foreign business acquisitions and are governed by foreign law. Given that the considerations which inform such negotiations are primarily commercial, the utility of a lawyer to his or her client will be driven much more by the lawyer's experience than by his or her knowledge of the local law. However, it is important that the Canadian counsel remain particularly sensitive to those contractual provisions that are more likely to be impacted by the non-Canadian law and that will require the input of foreign counsel. The ensuing portion of this section will illustrate in some more detail how Canadian and foreign counsel may interact productively and with due regard for their areas of geographic competence, in advising a Canadian client on an acquisition in a foreign jurisdiction.

C. Subject Matter

Generally speaking, the portion of a purchase agreement that deals with the subject matter of the acquisition will refer either to the assets (most of which will be described in schedules) or the relevant shares or other securities that are subject to the sale. In the case of a purchase of shares or other securities, it is always important to review carefully the description of the shares or other securities with local counsel to ensure that it accurately reflects the relevant

shares or securities, as they are described in the articles or other constating documents of the acquired corporate or other entity or in any other document that creates the relevant securities (*e.g.*, a note indenture). Moreover, the advice of local counsel should be sought with respect to any restrictions on the transferability of the shares or other securities and with respect to any other contractual, statutory, common law or other restrictions on, or conditions that apply to, the transfer of the shares or securities or that otherwise encumber the ability of the vendor to effect the transfer.

In the case of an asset purchase, local law may require certain acquired assets to be defined or described in a particular manner and it is important to ensure that local counsel has reviewed and is satisfied with the accuracy of the definition or description. For example, if intellectual property licences are to be included in the acquired assets (or assumed liabilities), it would be important for local counsel to review the description of the intellectual property licences to ensure its accuracy as well as its conformity to any aspects of local law that may impact on that description and/or other aspects of those licences, such as transferability.

D. Purchase Price

As noted above, the contents of the purchase price section of a purchase agreement are generally dictated by commercial – and not legal – considerations. However, local practice may differ from Canadian practice regarding the manner in which the purchase price may be adjusted and how the adjusting reviews or audits are to be conducted. Moreover, to the extent that the adjustment language reflects an application of accounting principles, advice should be sought from either local counsel, or perhaps more appropriately, the local office of the client's auditors (or local auditors in the event that a client is not using one of the international

auditing firms) to ensure that a description of any accounting principles or terms (*e.g.* description of inventory, goodwill, depreciable assets, *etc*.) that will impact on the price adjustment is accurately reflected in the purchase agreement and that the procedure set out in the agreement for conducting audits and valuations of the acquired assets is consistent with local practice.

In addition, to the extent that the purchase price includes shares or other securities, the advice of local counsel as to the proper description of such shares or securities and as to any issues regarding the transferability of such shares or securities will be required, just as it would be where the shares or securities are the subject matter of the acquisition.

Similarly, to the extent that the price or economic cost of the transaction involves the assumption of the vendor's obligations and/or liabilities (which may include encumbrances, governmental permits, environmental liabilities or lease obligations) such assumed obligations and liabilities may be creatures of local law and thereby affected, both in their description and substance, by the vagaries of such law. While the initial drafts of a purchase agreement prepared by Canadian counsel will more often than not "get it right", one is compelled to rely on the advice of local counsel in ensuring that no obligation or liability is improperly described and assumed and that any protection that would otherwise be available to a Canadian purchaser is not lost because of Canadian counsel's ignorance of local law and practice. This consideration is particularly relevant to the transfer of licences and government permits, the assumption of mortgages or other forms of security and the assumption of liabilities that are subject to local statutory regulation, such as environmental liabilities, or that are themselves the creatures of such regulation, such as tax liabilities.

If a Canadian business is selling assets to a foreign purchaser, the financial risk associated with any currency fluctuations that may arise can be mitigated by ensuring that payment is made in Canadian or U.S. dollars or Euros. Letters of credit can be used to reduce the risk of non-payment and risk of non-enforcement associated with international purchase agreements. The use of a letter of credit substitutes the credit of the purchaser's bank for that of the purchaser. Its usefulness in business transactions is based on the principle of the autonomy of the credit. Regardless of any subsequent dispute between the parties, the bank that issued the letter of credit to the purchaser is obliged to pay upon receipt from the vendor of the requisite documentation. The only circumstance in which a letter of credit will not be honoured is where a fraud has been perpetrated by the beneficiary of the credit and the fraud has been brought to the knowledge of the bank before payment.[2]

E. Bulk Sales Law

While most Canadian jurisdictions have discarded their bulk sales rules which require creditor consent to a "sale in bulk" asset transaction, this is not the case in many foreign jurisdictions. Accordingly, the advice of local counsel must be obtained as to the proper description of any applicable bulk sales rules and as to the conventional practice adopted by commercial parties in the relevant jurisdiction for dealing with such restrictions. (Such practices can include obtaining judicial or statutory exemptions, contractual indemnities and waivers or other mechanisms for addressing the potential liabilities created by bulk sales legislation).

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[2] *Bank of Nova Scotia v. Angelica-Whitewear Ltd.*, [1987] 1 S.C.R. 59.

F. Representations and Warranties

As noted above, most representations and warranties will reflect the risks associated with the particular assets or business being acquired. Therefore, Canadian counsel with knowledge of his or her client's business, risk tolerance and negotiating leverage, and with prior experience in acquisitions of this nature, will be in the best position to draft and negotiate the representations and warranties on behalf of the Canadian client. However, in preparing the representations and warranties, Canadian counsel will require input from local counsel as to legal matters which will have an impact on such representations and warranties, and as to conventional practice in the local jurisdiction which may inform the bargaining approach of the local party to the transaction.

(i) Status

By way of example, in an acquisition by a Canadian purchaser of the shares of a foreign corporation, local counsel's input will be important in assisting the purchaser's Canadian counsel in preparing the representations and warranties as to the due organization, existence and good standing of the foreign corporation and the appropriate representations and warranties to be obtained in connection with the qualification of the corporation to do business in the foreign jurisdictions in which it conducts its business. In both share and asset purchase transactions, the appropriate language of the title representation will be prepared or reviewed by local counsel. In my experience, as a general matter, the format used in Canadian precedents can be applied, almost without revision, in most foreign transactions, but that format may require some modification from jurisdiction to jurisdiction based on legal advice as to local practice and terminology.

(ii) Permits, Licences and Filings

Local counsel's input will be important in determining the identity, nature and proper description of any approvals, permits and licences required to be obtained, or filings required to be made, under local law to enable the transaction to be effected in the manner contemplated in the agreement, and the issues that should be addressed in any representations and warranties concerning such approvals, permits, licenses and filings.

(iii) Property and Encumbrances

The description of title to real estate and the encumbrances thereon, including the description of any encumbrances that ought to be assumed as "Permitted Encumbrances", will similarly require input from local counsel. Canadian counsel can continue to lead the negotiation as to the scope and intensity of the representations and warranties as to title, as a commercial matter, based on the purchaser's risk tolerance, the practice, the industry and the relative negotiating leverage of the parties. However, the scope and definition of the encumbrances, and the agreement as to which encumbrances should properly be assumed, will be informed by local law, custom and practice.

(iv) Employees and Employee Benefits

Canadian counsel would be well-advised to delegate totally to local counsel the area of employment benefits regulation which, especially in United States jurisdictions, is a complex area of regulated federal law practised by highly specialized counsel. This also applies to any acquisition of a business whose employees are unionized. In such a case, the negotiation of the provisions related to the assumption of collective bargaining agreements and the

associated representations and warranties should be with the exclusive purview of specialized labour counsel, subject to instruction as to business issues by the client with input of Canadian counsel only to the extent the client desires such input.

(v) Environmental/Intellectual Property

While environmental and intellectual property issues are also generally the subject of specified regulation in every jurisdiction, Canadian counsel can play a significant role in negotiating the provisions regarding these issues, because the nature of the risks, and the substance of the relevant legislation, is often virtually identical across jurisdictions. Although local input is critical in ensuring that the particular rules of the local regulatory regimes are reflected, and the relevant assets, liabilities and risks are accurately described, Canadian counsel with experience in these areas, and in acquisitions generally, will be competent to advise the Canadian client on the manner in which the risks can best be allocated on a basis acceptable to the client, based on such counsel's understanding of the legal and practical risks involved, and his or her understanding of the client's risk tolerance. However, the registration of intellectual property with the appropriate local regulator should be left to local intellectual property counsel.

G. Covenants

Generally, where an acquisition transaction involves a delay between execution of the purchase agreement and closing, there will be covenants that govern the behaviour of the parties between those two dates. These covenants may deal with, among other matters, the conduct of the business during the period, the access of the buyer to the premises of the acquired business, the treatment of employees, the obtaining of third party consents and regulatory compliance and environmental matters, such as the conduct of environmental investigations.

The manner in which these issues will be addressed will be strongly influenced by the risks associated with the conduct of the business by the vendor during a period in which the economic result of such conduct may directly accrue to the purchaser (if the effective date of the transaction precedes the closing date) or may, at the very least, have a significant effect on the acquired business from and after the closing date. As a result, the purchaser will have a strong commercial interest in monitoring, if not controlling, the conduct of the business during that interim period. This is a purely commercial concern with which Canadian counsel to the purchaser will be familiar. That counsel will therefore be best able to negotiate the terms of these interim period covenants without much substantive input from local counsel. 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, licences and approvals that must be obtained, and the filings that must be made, so that the purchaser can continue to operate the business from and after closing). In addition, local advice will be necessary in drafting and negotiating the covenants of the parties as to the allocation of liabilities that arise under any highly regulated regimes, such as tax or employee benefit legislation and regulations.

The full description of the procedure to be adopted by the parties in respect of the allocation of environmental risk (*e.g.*, the conduct of various environmental investigations and the allocation of liability to address the conditions identified by such investigations) can be negotiated primarily by Canadian environmental counsel with input from local counsel to address the particularities of local legislation.

H. Logistics and Conditions of Closing

The logistics of closing are virtually uniform in all jurisdictions and, except for the regulatory consents and filings that are particular to a given jurisdiction, will not need much input or review by local counsel and can be negotiated fully and virtually exclusively by Canadian counsel.

I. Indemnities

As a general matter the cross indemnities of vendor and purchaser are the result of a commercial negotiation that is informed, only to a minor extent, by local law and practice, such as any applicable statutes of limitation or other prescription periods that may affect the survival periods of the various indemnities. However, the fundamental deal issues associated with any indemnity, which generally concern the survival period of the indemnity, the appropriate threshold of damages that must be incurred before the indemnitee can assert a claim against the indemnitor, and the maximum aggregate liability that an indemnitor will have pursuant to its indemnity (*i.e.*, the "cap" on the indemnity) are all commercial matters. Experienced Canadian counsel, with knowledge of the business and understanding of the relative bargaining power of the parties, will be in a good position to advise the Canadian client as to such matters.

J. Summary Regarding Cross-Border Purchase Agreements

Based on the foregoing overview, Canadian counsel has a very significant – but not exclusive – role to play in advising Canadian clients who pursue business acquisitions in foreign jurisdictions. However, it would be nothing short of professional negligence for a Canadian lawyer to attempt to pursue any such acquisition in the absence of competent local

legal assistance. Most business acquisitions are driven fundamentally by commercial considerations and experienced counsel with knowledge of the client and its business will be in the best position to advise the client on acceptable risks and the appropriate resolution of risk allocation issues that arise in negotiated acquisitions transactions. However, that counsel will inevitably require the input of its foreign counterpart to ensure, at the very least, that technical aspects of the transaction governed by local law are properly addressed and that local practice is considered when negotiating otherwise "standard" provisions.

In preparing agreements in U.S. jurisdictions, it is especially helpful to resort to the model share and asset purchase agreements prepared with commentary by the Mergers and Acquisitions Committee of the American Bar Association's Business Law Section as a helpful starting point in understanding the American approach to these transactions and the suggested resolution of issues that may arise in their negotiation.

4. Threshold Issues in International and Cross-Border Agreements

A. Contract Formation

Until a formal agreement containing a choice of law clause is signed, neither party can rely on the laws of its own jurisdiction to govern issues of contract formation. Therefore, questions may arise as to whether a valid contract is formed under the laws of a particular foreign jurisdiction. In some cultures, a handshake may be sufficient to validate an agreement. Similarly, whether a "letter of intent" or "memorandum of understanding" is a binding contract or merely an agreement to negotiate depends on the rules of contract formation in the jurisdiction of the contracting parties. In most common law jurisdictions and in many civil law jurisdictions an agreement will be legally binding if both parties intended their agreement to be legally

enforceable, assent has been reached on all of the essential terms of the agreement and all statutory formalities have been satisfied.[3] Each of these requirements can vary, however, by jurisdiction.

In Canada, the test to determine whether parties intended for their agreement to be legally enforceable is objective, meaning that if the conduct of one party is reasonably viewed by the other party as an indication of an intent to be bound, a legally enforceable contract will be created. Chinese law also takes a formal approach, focusing on the parties 'declared' rather than 'genuine' intention. The test in France, on the other hand, is subjective, with French law creating a legally binding agreement only where there is evidence that the parties had a real intention to be bound by the document. Finally, Dutch law takes an intermediate position, providing that subjective intent will prevail unless one party reasonably relies on the declared intent of the other party.[4]

In Canadian common law jurisdictions the determination as to whether parties have assented to all of the essential terms of an agreement is dependent on whether any omitted terms are so important that their omission leads to the conclusion that the parties have not reached an agreement, a determination largely based on commercial context. In contrast, the essential terms of a contract are codified in certain civil law jurisdictions. For example, the Chinese Contract Law provides that a contract should contain at least eight terms, including: names and domiciles of the parties; subject matter; quantity; quality; price or remuneration; time limit for, place and method of performance; liability for breach of contract; and method for

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3 James M. Klotz, *International Sales Agreements*, 2d ed. (The Netherlands: Kluwer Law International, 2008) at 26-27.

4 Nicole Kornet, "Contracting in China: Comparative Observations on Freedom of Contract, Contract Formation, Battle of Forms and Standard Form Contracts" (2010) 14.1 E.J.C.L.

dispute resolution, although a valid contract can be formed without certain of these terms so long as the content of the contract can be ascertained.[5]

A common statutory formality that must be met is that a contract must not have an illegal cause or purpose. Under the French Civil Code, for example, a contract will be void if its cause or reasons are illegal. Similarly, Articles 1411 and 1413 of the *Civil Code of Québec* provide that a contract whose cause or object is prohibited by law or contrary to public order will be null, the result being that the contract will be deemed never to have existed. Note, however, that there can be significant variations in statutory requirements from one jurisdiction to the next. For example, a statutory requirement unique to a particular jurisdiction is the requirement under China's General Principles of Civil Law for a contract not to violate mandatory state plans.[6]

Practically speaking, the question as to whether a contract has been formed under the laws of a foreign jurisdiction will only become a significant concern to Canadian counsel if a dispute arises prior to a formal agreement with a choice of law clause being signed. If, for example, one party seeks to enforce the terms of a letter of intent on the basis that it constitutes a fully-formed contact under the laws of that party's jurisdiction, then the issue of contract formation will become an essential concern. In these situations, the expertise of local counsel is required to determine whether and to what extent a Canadian client owes contractual obligations to their foreign counterparty.

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5 *Ibid*.

6 Moussa Sékou Traore, "A Comparative Study of Contract Formation and Breach of Contract and Liability in China and Ohada (Note 1) Space Contract Laws" (2011) 4 Journal of Politics and Law 153 at 156.

B. Enforceability

Agreements entered into by Canadian clients with parties in foreign jurisdictions will be governed by the laws of the local jurisdiction or of a third jurisdiction, and the parties will often attorn to the jurisdiction of the local courts to adjudicate disputes arising out of the interpretation of the contract or the compliance by the parties with its terms. At the very least, local counsel will need to be retained to review the agreement for its enforceability and to provide any enforceability opinion that may be required on the closing of the transaction. If the Canadian business will be contracting directly using a Canadian entity, Canadian counsel will have to provide the corporate aspects of the closing legal opinion. Aside from the considerations of prudence and professional responsibility that would require Canadian counsel to retain local counsel, the practical necessity of obtaining a legal opinion at closing will provide a check on the Canadian counsel who might otherwise be tempted to act alone.

(i) Governing Law

Although some agreements entered into by Canadian clients in foreign jurisdictions will typically be governed by the laws of the foreign jurisdiction – which is particularly true in the case of acquisition agreements where the acquired business is carried on or headquartered in the foreign jurisdiction – an issue may often arise as to which law should be selected as the governing law of the contract particularly in jurisdictions where the legal system is insufficiently sophisticated to deal with complex transactional or commercial agreements. In such cases the governing law should be that of a jurisdiction with a more hospitable and a sophisticated legal system and which has a relationship to the jurisdiction in which the transaction is being conducted. For example, English law would be the appropriate law where

transactions are conducted in former colonies or possessions of the United Kingdom and United States law may be more appropriate for transactions in Central or South America.

If the governing law of the contract is not addressed expressly in the contract – which is a highly unusual circumstance in contemporary practice – it will be left to conflicts of laws rules to determine which law governs the contract. Under Ontario law, deference is given first to the contractual choice of the parties, then to the implied choice of the parties and finally to what is called the "proper law of the contract". The implied choice of the parties is inferred from various factors, including whether the contract expressly provides for a place for 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. Other factors that courts have occasionally considered are the language in which the contract was written or the currency of the contract, but these are weak factors from which no inference should be drawn.[7]

In some areas of law, the "proper law of the contract" is predetermined by fixed rules. For example, in dealings with real property, in the absence of an express choice to the contrary, the "proper law of the contract" – and therefore the governing law of the contract – will be the jurisdiction in which the real property is located. In other areas of the law, however, the test for the proper law of the contract is the "closest and most substantial connection" test articulated in *Imperial Life Assurance Co. of Canada v. Colmenares*.[8] The closest and most substantial connection is determined by looking at a number of factors including the place of the contract, the place of the performance of the contract, the place of business of the parties and the

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7 Stephen G.A. Pitel & Nicholas S. Rafferty, *Conflict of Laws* (Toronto: Irwin Law, 2010) at 274-275.

8 [1967] S.C.R. 443.

nature and subject matter of the contract. The opinion of local counsel will be required as to the validity of the choice of law clause in the foreign jurisdiction.

(ii) Jurisdiction and Enforceability of the Contract

If enforceability is at issue counsel may wish to consider use of an exclusive jurisdiction or forum selection clause. Traditionally, exclusive jurisdiction or forum selection clauses were viewed negatively by Canadian courts. However, there was a change over time in the Canadian judicial acceptance of such clauses, culminating in the Supreme Court of Canada's decision in *Z.I. Pompey Industrie v. ECU-Line N.V.*, where Justice Bastarache, writing on behalf of the Court, stated:

> [Forum selection] clauses are generally to be encouraged by the courts as they create certainty and security in transaction, derivatives of order and fairness, which are critical components of private international law … In the context of international commerce, order and fairness have been achieved at least in part by application of the "strong cause" test. This test rightly imposes the burden on the plaintiff to satisfy the court that there is good reason it should not be bound by the forum selection clause. It is essential that courts give full weight to the desirability of holding contracting parties to their agreements.[9]

Accordingly, 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.

(iii) Dispute Settlement

Although this topic will be addressed in more detail in Barry Leon's presentation this afternoon, I thought that I would lay the groundwork for that session by discussing the legal

[9] 2003 SCC 27, [2003] 1 S.C.R. 450 at para. 20.

and contractual framework that should inform the preparation and negotiation of dispute settlement provisions in cross-border and international agreements. One way to reduce the risks associated with the enforcement of a contract made in a foreign jurisdiction is to agree to submit the dispute to arbitration. Arbitration has become the preferred dispute settlement provision in international business agreements. The benefits of arbitration include the ability of the parties to customize the process, the confidentiality of the arbitration process and the 1958 New York *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, (the "Convention") signed by more than 100 States. The law in Ontario governing arbitrations is the *International Commercial Arbitration Act* (Ontario) (the "ICAA"), which incorporates the UNCITRAL Model Law on International Commercial Arbitration (the "Model Law"). To give force to an arbitration clause, there must be an express section, in writing, setting out the agreement to arbitrate either in the form of an arbitration clause or a separate arbitration agreement. The arbitration agreement is treated, pursuant to the ICAA and Model Law, as an agreement independent of the other terms of the contract and may survive if the contract is null and void, so long as there is a basis for arguing that an agreement was formed with respect to arbitration.

Article 34 of the Model Law provides limited grounds for allowing a court to overthrow or not enforce an arbitral award. An arbitral award may only be set aside if:

(a) the party making the application furnishes proof that:

(i) a party to the arbitration agreement was under some incapacity or the agreement is otherwise invalid;

(ii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceeding or was otherwise unable to present their case;

(iii) the award deals with a dispute not contemplated by the submission to arbitration or contains decisions on matters beyond the scope of the submission to arbitration; or

(iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless such agreement was in conflict with the provision of this Law from which the parties cannot derogate, or, failing such agreement, was not in accordance with this Law; or

(b) the court finds that:

(i) the subject matter of the dispute is not capable of settlement by arbitration under a law of this State, or

(ii) the award is in conflict with the public policy of the State.

However, the finality of an arbitral award depends on the jurisdiction and, accordingly, the choice of governing law will influence the enforceability of the arbitral award. In China for example, arbitration awards are not open to review whereas in other countries the courts will readily review an award for errors in law.[10] The position in Canada appears to be well captured in the following citation from *Quintette Coal Ltd. v. Nippon Steel Corp.* In

[10] Klotz, *supra* note 2 at 289.

dismissing an appeal from a judgment dismissing an application to set aside an arbitral award, Justice Gibbs of the British Columbia Court of Appeal stated:

> The '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', spoken of by Blackmun, J. [of the Supreme Court of the United States in *Mitsubishi Motors Corp. v Soler Chrysler-Plymouth Inc.*, 473 US 614 at 629 (1985)] are as compelling in this jurisdiction as they are in the United States or elsewhere.[11]

C. Regulatory Issues in International Agreements

In this Section I will focus principally on regulatory issues that are encountered in Cross-Border and International Transactions – Primary Agreements. The two most common threshold regulatory issues that have to be addressed in the early stages of an acquisition are generally competition or antitrust issues, foreign investment regulation and, when public companies – or the securities of public companies – are involved, securities law issues. We will address competition and foreign investment regulation in this paper.

(i) Competition Antitrust Issues

(a) The United States

We will start by exploring some of the applicable rules of our closest neighbour – the USA. Under the United States *Hart-Scott-Rodino-Anti-Trust Improvements Act* ("HSR"), parties or transactions that meet certain minimum thresholds must comply with the reporting requirements and wait at least 15 to 30 days before completing any asset transfer. During this

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[11] [1990] B.C.J. No. 2241 (B.C.C.A.). This case was most recently referred to in *Mexico v. Cargill, Incorporated*, [2011] O.J. No. 4320 at para. 33 (Ont. C.A.) and *Seidel v. TELUS Communications Inc.*, 2011 SCC 15, [2011] 1 S.C.R. 531 at para. 100.

period the Department of Justice's Antitrust Division will review the transaction for anti-competitive effects in the United States market. If the transaction qualifies for reporting, failure to comply may result in civil penalties of up to US$16,000 per day. Three criteria must be met for HSR to apply;

(a) first, the transaction must affect commerce in more than one state or with another country;

(b) second, one party must have total assets or annual net sales of at least US$141.8 million and the other party must have total assets or annual net sales of at least US$14.2 million; and

(c) third, as a result of the transaction, the acquiring person must hold an aggregate amount of stock and assets of the acquired person valued at more than US$70.9 million. HSR will apply regardless of the foregoing where the transaction affects commerce in more than one state or with another country and the aggregate amount of stock and assets acquired is valued at more than US$283.6 million.

(b) The European Community

In Europe, the Merger Regulation (*Council Regulation 139 of 2004*) (the "Merger Regulation") gives the European Commission the exclusive power to investigate mergers and acquisitions with a "community dimension". Two sets of thresholds are set out to establish whether a merger or an acquisition has a "community dimension":

(a) the combined aggregate worldwide turnover of all the entities concerned is more than Euro 5 billion and the community turnover of each of at least two of the entities is more than Euro 250 million; or

(b) the combined aggregate worldwide turnover of all the entities concerned is more than Euro 2.5 billion and in each of at least three member states the combined aggregate turnover of all the entities is more than Euro 100 million.

If either of these sets of thresholds is met, the European Commission must be notified for approval, unless each of the entities concerned achieves more than two-thirds of its aggregate community turnover in one and the same member state. Mergers and acquisitions below these thresholds, along with those that meet the two-thirds rule, remain in the exclusive jurisdiction of the member states.

(c) Canada

By way of comparison, in Canada, under the *Competition Act*, pre-merger notification requirements apply in respect of any merger that meets certain financial and voting interest thresholds. There are two financial thresholds, both of which must be met for the mandatory notification rules to apply. First, the transaction must be of a minimum size - $80 million in Canadian assets (book value) or gross revenues (sales in or from Canada). Second, the parties to the transaction, together with their affiliates, must have total assets in Canada or gross revenues (sales in, from or into Canada) that exceed $400 million. In addition, the transaction must result in the acquirer holding a minimum percentage of voting shares – more than 20% for public companies or 35% for private companies (or 50% if these thresholds are already exceeded).

Each party to a notifiable transaction must file certain basic information and is precluded from completing the transaction before the expiry of the statutory waiting periods (30 days with an option for additional 30 days for production of documents). The substantive merger review considers whether the proposed merger is likely to lessen or prevent competition substantially in a market in Canada and even non-notifiable transactions can be challenged on substantive grounds.

(ii) Foreign Investment Regulation

(a) Canada

While the *Competition Act* applies to all mergers in Canada, the acquisition by a non-Canadian of control of a business carried on in Canada will be either notifiable or reviewable (depending on the value of the assets) under the *Investment Canada Act*. Notification, when required, may be made within 30 days from closing and involves only very basic information for the investor and the acquired business. The thresholds for review depend on whether the investor is a WTO investor (which includes any form of business organization that is controlled by a national/permanent resident of a member of the World Trade Organization). The general thresholds are $5 million for direct acquisitions and $50 million for indirect acquisitions. For WTO investors, the threshold for review of a direct acquisition is $344 million (except for a cultural business) and indirect acquisitions are not reviewable regardless of the value of the assets, but will still be notifiable. In 2009, the Government of Canada enacted extensive changes to the *Investment Canada Act* that will progressively increase the review threshold for direct acquisitions by WTO investors to $1 billion. The amendments have received Royal Assent, but have not yet been proclaimed into force.

The substantive review under the *Investment Canada Act* considers the "net benefit to Canada" test and the potential impact of the transaction on national security. So far, there has been only one formal rejection of an investment (not involving a cultural business).[12] However, a 2010 decision by the Minister of Industry that BHP Billiton Plc's proposed acquisition of Potash Corp. did not satisfy the "net benefit to Canada" test had substantially the same effect as a formal rejection and lead to the abandonment of the bid. The proposed merger of Canada's TMX Group Inc. and London Stock Exchange Group Plc. was another controversial cross-border transaction that faced opposition from both government officials and the private sector. Ontario Finance Minister Dwight Duncan made no secret about his concerns that a "strategic asset" like the exchange would move to London.[13] The Bank of Canada Governor Mark Carney also expressed caution that if a clearing system moves offshore it would make it more difficult to regulate and control systemic risks. Some of the most powerful financial institutions in Canada were also opposed and launched a counter-bid offering both a higher price and a domestic alternative. In the end, the TSX and the LSE called off the merger plan when it became clear that they would not get the required shareholder support. However, the strong opposition that the deal faced raised some criticism that Canada is getting a reputation as being closed to foreign business. Note that while the recent acquisitions of Nexen Inc. by CNOOC Limited, a Chinese state-owned company, and of Progress Energy Resources Corp. by PETRONAS Carigali Canada Ltd., a Malaysian state-owned company, were ultimately

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12 Alliant Techsystems Inc.'s proposed takeover of MacDonald Dettwiler and Associates Ltd. in 2008.

13 Boyd Erman and Karen Howlett, "Shareholders reject proposed merger of TMX and LSE" *The Globe and Mail* (29 June 2011), online: <http://www.theglobeandmail.com/globe-investor/tmx-deal/shareholders-reject-proposed-merger-of-tmx-and-lse/article2080213/page1/>.

approved, Prime Minister Stephen Harper warned that there is a limit to how much foreign state-owned influence is acceptable in Canada.[14]

In addition to the generally applicable provisions in the *Investment Canada Act*, other statutes provide further restrictions on foreign investment and control of Canadian businesses. The *Canada Business Corporations Act* and many provincial corporate statutes require at least 25% of the directors to be Canadian residents. Other residency requirements of corporate statutes relate to the location of a corporation's registered office, corporate records and shareholder meetings.

There are also specific restrictions applying to certain industries. Under the *Telecommunications Act*, in order to be eligible to operate in Canada, a telecommunications common carrier that holds more than a 10% share of the total Canadian telecommunications market based on revenue must be incorporated or continued under the laws of Canada and at least 80% of the directors and 80% of the beneficial owners of voting shares must be Canadians. While prior approval under the *Telecommunications Act* is not required, the Canadian Radio-television and Telecommunications Commission (CRTC) has specific responsibility for ensuring compliance with foreign ownership and control rules. Under the *Broadcasting Act*, prior approval of the CRTC is required for changes of control or ownership of licensed undertakings. In October, 2012, the CRTC denied BCE Inc.'s bid to acquire control of Astral Media Inc.'s television and radio services on the basis that the acquisition was not in the public's interest. However, since the rejection, BCE Inc. and Astra Media Inc. have submitted a new proposal to CRTC, although a decision is currently outstanding. Note also that the merger notification

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[14] The Canadian Press, "Nexen, Progress Scrutiny Unlikely to Deter Foreign Firms," *CBC News* (9 December 2012), online: <http://www.cbc.ca/news/canada/story/2012/12/09/canada-investment-cnoc.html>.

requirements under the *Competition Act* apply to both telecommunications and broadcasting mergers.

(b) The United States

In the United States, the Committee on Foreign Investment in the United States (CFIUS) is an inter-agency committee delegated the authority under the Exon-Florio Amendment to review transactions that could lead a foreign person to control a U.S. business. This review is conducted in order to determine if any national security concerns will arise from the transaction. 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, alternatively, refer the matter to the President of the United States for a decision on the matter.

In September 2012, President Obama required Ralls Corporation, a Chinese-owned corporation, to divest its interest in wind farms it purchased from Terna Energy Holding USA Corp. near the Naval Weapons Systems Training Facility in Boardman, Oregon, on this basis. Note, however, that U.S. acquisitions are rarely blocked in this manner, the next most recent example being George H.W. Bush's decision to block the acquisition of MAMCO Manufacturing, Inc. by a Chinese agency in 1990.[15] Nonetheless, since 1990, almost half of the transactions that CFIUS has investigated have been terminated by the parties involved on the

[15] David Jackson, "Obama Blocks Chinese Wind Farm Purchase", *USA Today* (29 September 2012), online: <http://www.usatoday.com/story/theoval/2012/09/28/obama-blocks-chinese-wind-farm-purchase/1600745/>.

basis that they would prefer to withdraw from the transactions rather than experience a negative determination by CFIUS.[16]

Another U.S. law relevant to foreign acquisitions is the *Foreign Investment in Real Property Tax Act of 1980* (FIRPTA), which imposes withholding tax on the disposition of a U.S. real property interest by a foreign person. FIRPTA provides for the taxation of gains realized on the disposition of an interest in U.S. real property held directly by a foreign person or indirectly by a foreign person through a partnership or U.S. corporation that predominantly holds real estate. The gain is characterized as income effectively connected with the conduct of a U.S. trade or business, which subjects the foreign person to U.S. income tax on the net income derived from such gain at normal U.S. income tax rates. In general, a purchaser of an interest in U.S. real property from a foreign person is required to withhold an amount equal to 10% of the amount realized (generally the gross purchase price). The foreign seller must report the gain by filing a U.S. income tax return on which withheld amounts are credited against the liability. FIRPTA does not apply to the disposition of stock of a publicly traded U.S. corporation (provided the seller owns less than 5%), units in a real estate investment trust that is domestically controlled, stock in a non-U.S. corporation or debt instruments (unless they are convertible or otherwise participating in FIRPTA assets). In 2011, bills were introduced in the U.S. House of Representatives and Senate proposing to expand the relief from taxation under FIRPTA with the intent of encouraging foreign investment in U.S. REITs, but these bills have not been passed.

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[16] James K. Jackson, Congressional Research Service, *The Exon-Florio National Security Test for Foreign Investment* (1 October 2012) at 10, online: Federation of American Scientists <http://www.fas.org>.

(c) The European Community

Foreign investment review is conducted on a country-by-country basis for member states of the European Union, although in recent years discussions related to the establishment of a special European Union foreign investment review board have been growing.[17] There are currently foreign review requirements in a number of European states, including Germany, whose Foreign Trade Act was amended in 2009 to allow its government to block certain acquisitions by non-European Union residents that threaten public order or safety. In order to be subject to review, the acquirer must directly or indirectly hold 25 percent or more of the German target company's voting rights after the transaction. Similarly, the United Kingdom can also intervene in transactions on public interest grounds. However, intervention can generally only occur if the foreign acquisition involves national or public security or the country's media or financial system. Other European states that have foreign investment rules include Italy, France and Spain, although the specific requirements in each of these jurisdictions are beyond the scope of this paper.

5. Conclusion

In this paper, I have attempted to provide an overview of some threshold issues confronting Canadian counsel in engaging in cross-border and international transactions by (a) focusing on process issues such as the retention of foreign counsel and, using an acquisition agreement model, to illustrate how Canadian counsel can work productively with foreign counsel in dividing responsibilities in such transactions; and (b) touching on some of the substantive legal issues that arise in foreign transactions, again with an emphasis on acquisitions. The

[17] John W. Miller, "EU Mulls Board to Review Foreign Investments", *The Wall Street Journal* (14 March 2011), online: <http://online.wsj.com/article/SB10001424052748704893604576200521425783048.html>.

globalization of Canadian legal practice brings unprecedented opportunities and challenges. If handled properly, it can provide a genuinely enriching and intellectually stimulating experience for lawyers.