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The Drafting and Enforcement of Canada/United States Contracts: A Canadian Lawyer's Perspective

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I. Introduction

Canadian/United States negotiations have unique characteristics which deserve special treatment. Frequently, transborder negotiations suffer from the same affliction as heads-of-state meetings involving the two countries—fulsome talk of similarities of outlook, hands across the border and the longest undefended border in the world—but little meaningful analysis of differences.[1] The reason for this is plain: the similarity in business practices of the two countries conveys the impression that the business law of both sides is also similar. Unfortunately, this is not always the case, and such an assumption may lead to surprises and mistakes. Alternatively, even when the substantive legal results on a particular issue between the two countries are similar, the means of enforcement and other procedural considerations may differ.

This article is a survey of issues to be considered by the lawyer who is drafting and negotiating commercial agreements between private Canadian and United States parties. It takes the perspective of a Canadian business lawyer and should be of particular interest to United States lawyers with little transborder experience. The discussion addresses: the letter of intent as a prelude to a binding contractual agreement; methods of securing

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1. In the eternal ebb and flow of Canada/U.S. relations we appear to be at the high water mark, as represented by the 1985 Mulroney/Reagan Quebec City summit meeting (one of the few to actually occur on a summit). For a business lawyer, the nadir of the Canada/U.S. relationship was the 1911 Conservative Party rallying cry: "No truck nor trade with Yankees!" (COLOMBO'S CANADIAN QUOTATIONS, 200 J. R. Colombo, ed. 1974).

payment (specifically, the letter of credit and secured transactions in personal property); contractual limitations on liability, and alternative dispute resolution. The discussion in this article deals with the context of the negotiation of any one of a series of common business transactions, *e.g.*, a territorial franchise agreement, the purchase and sale of a business, a venture capital investment, a technology transfer agreement, an exclusive distributorship, or a long-term supply agreement.

II. The Letter of Intent and the Uncertainty Problem[2]

A. Transactional and Relational Contracts

Just as in the United States, the Canadian letter of intent can be a useful, although occasionally dangerous tool in the negotiation of a commercial agreement. Traditionally, the model for the discussion of commercial agreements has been the simple "one-shot" sale-of-goods contract. This classic transactional contract was analyzed as though the seller and buyer had not previously, and would not in the future, contract with one another. If, as frequently happens, the seller and buyer enter into further transactions, any problems relating to the formation and enforcement of the contractual relationship are treated as though the parties had entered into a series of discrete sale-of-goods contracts. This is in contrast with a relational contract through which the parties embark on a relationship extending over time. Usually, the relational contracts involve a substantial degree of mutual dependence and trust, regardless of whether this is specifically acknowledged by the parties. Typical examples of these "trust" contracts are the partnership agreement, or the distributorship, franchise or license agreement.

The international sales community is increasingly utilizing these relational contracts. What were once simpler, transactional contracts have become relational in nature. Often this merely evidences the sellers' recognition of the advantages in having their products distributed centrally from the importing country. At other times, this shows the growth of the countertrade phenomenon, even between two industrialized countries like Canada and the United States. Frequently, what once would have been a sale now involves parallel and offsetting commitments for assembly and other invest-

2. The March Hare (as lawyer):
You should say what you mean.
Alice (as client):
I do, at least I mean what I say—that's the same thing, you know.
The King (as judge):
If there's no meaning in it, that saves a world of trouble, you know, as we needn't try to find any.
L. Carroll, Alice in Wonderland, 74 and 155 (Penguin, 1973).

ment in the importing country. There are also situations where the supply of components is so vital to the buyer that he insists on making an equity investment in the seller to ensure some further measure of control over his source of supply.

Because the relational contract is usually broader in scope and more complex than the traditional transactional contract, its negotiation is often a more lengthy process, the parties frequently want written evidence that the proposed transaction will indeed go forward, and this evidence is needed in advance of a formal signed contract. A letter of intent is often seen as satisfying this need. It may be used for the parties' "internal" purposes to demonstrate their good faith and intention to proceed with the proposed transaction, or it may be used for the "external" purposes of convincing a third party financier that it ought to make a loan commitment or to demonstrate to a government agency the parties' serious commitment to the proposed transaction. For whatever reasons, letters of intent are frequently used in connection with international commercial transactions. Their use, however, involves risk when the proposed transaction does not materialize.

B. Risks of the Letter of Intent

What are the risks in using a letter of intent? Ironically, although the underlying reason for using this tool is to reduce uncertainty, its careless use can *increase* uncertainty. Clients involved in negotiations for long-term exclusive distributorship for a territory encompassing an entire country should not draft or execute formal agreements without the benefit of legal advice. Otherwise, they may exchange correspondence or sign a document intended to be a "letter of intent," and later find that they have entered into a binding agreement.

Nevertheless, business people may have quite the opposite intention. That is, they might have agreed, or thought they had, on the essential elements of the proposed transaction and wish to record their agreement to these principles in a "temporary" document. They enter into a letter agreement but later, for whatever reason, fail to enter into a formal agreement. Meanwhile, a dispute develops over a basic term not dealt with in the letter agreement. Is there a binding agreement in effect, and, if so, what are its terms? These hypothetical fact situations illustrate an abstract area of contract law—uncertainty. Not all bargains will be recognized by Canadian Courts as enforceable contracts. Agreements which are sufficiently uncertain or indefinite will not be enforced.[3]

3. For a more intensive analysis of the Canadian case law on uncertainty, *see* Potter, *Contract Formation: The Problem of Uncertainty and the Utility of Arbitration Clauses as Alternative Enforcement Mechanisms*, Special Lectures of the Law Society of Upper Canada—Law in Transition: Contracts, 13 (1984).

Turning from theory to practice, risks exist in this area involving penalties for miscalculation. The purported letter of intent may be found legally enforceable, and one party could therefore be liable in damages for breach.[4] Alternatively, if the contract is not legally enforceable, the party inducing a mistaken belief of enforceability may still be found liable for expenses induced in reliance on the belief.[5] It would appear that Canadian Courts have recently relaxed slightly the certainty standards required to convert a letter of intent into an enforceable agreement.[6]

Avoiding miscalculation, however, is relatively easy. The parties should clearly identify preliminary letters as letters of intent and include a provision denying the enforceability of the obligations unless, of course, one is trying to "have his cake and eat it too." Such a party would undoubtedly adopt with enthusiasm the definition of a "gentleman's agreement" attributed by Professor Waddams to the English judge, Mr. Justice Vaisey: "A gentleman's agreement is an agreement which is not an agreement entered into between two persons, neither of whom is a gentleman, with each expecting the other to be strictly bound, while he himself has no intention of being bound at all."[7] While this is a perceptive comment and often reflects the initial intention of a party, the challenge for the commercial lawyer is to change the client into a gentleman and, eventually, the letter of intent into a binding agreement.

III. Methods of Securing Payment

Beyond enforcing promises to pay as a simple unsecured creditor, many grantors, vendors and other unpaid parties will want to attain a stronger position as against other general creditors. Two common methods are the letter of credit and the personal property security interest.

A. Letters of Credit[8]

Broadly speaking, letters of credit may be of two types: the documentary credit and the standby credit. The documentary credit is a payment mechanism, classically used in international commerce to effect payment for the sale of goods. At the request of the buyer, the buyer's bank issues a letter of

4. *See* Canada Square Corporation v. VS Services Ltd. [1981] 15 B.L.R. 89 (Ont. C.A.), 34 O.R. 350.
5. Brewer Street Investments Ltd. v. Barclays Woolen Co. [1954] 1 Q.B. 428 (Eng. C.A.).
6. Canada Square Corporation v. VS Services Ltd. [1981] 15 B.L.R. 89 (Ont. C.A.).
7. S. Waddams, The Law of Contracts 114 (2d ed., 1984).
8. The two most recent discussions in Canadian legal literature are: Graham and Geva, *Standby Credits in Canada*, 9 Can. Bus. L.J. 180 (1984) and Van Houten, *Letters of Credit and Fraud: A Revisionist View*, 62 Can. B. Rev. 371 (1984). *See also* Sarna, Letters of Credit: The Law and Current Practice (1984).

credit to the seller who may draw upon the credit by presenting the documents (*e.g.*, a draft and documents of title specified in the letter of credit) to the seller's bank.[9] Lately, the classic documentary letter of credit, originally developed as a payment device, has evolved into a variant—a security device known as a "standby credit." Here, the underlying contract between the parties is typically a "relational" or ongoing one rather than the discrete "transactional" contract of purchase and sale which underlies the classic documentary letter of credit.[10] If the underlying relational contract is properly performed, the standby credit will never be presented; if there is a default, however, the holder is free to present a document to the issuer's bank, thereby triggering payment to the holder. By thus securing performance of the issuer's non-monetary obligations, the function of the standby credit approximates that of a performance bond.[11]

Why would one prefer a letter-of-credit-as-security device over the more traditional personal property security interest? Frequently, other lenders effectively preclude the taking of a security interest of value. There may also be cases where the costs of realization on the security would be prohibitive in relation to the amount being secured.

In the United States, the Uniform Commercial Code (the UCC) contains provisions dealing with both letters of credit (art. 5) and personal property security (art. 9). Although several Canadian Provinces have adopted or are considering adoption of the UCC-type personal property security statutes, there is no federal or provincial legislation in Canada on the subject of letters of credit. Frequently, however, in both international and domestic transactions, Canadian letters of credit will be expressed to be subject to the Uniform Customs and Practice for Documentary Credits (UCP) of the International Chamber of Commerce (ICC).[12] Graham and Geva offer the view that, according to Prof. Goode, it is probably true in Canada as in England that the UCP is simply a set of standard rules having no legal force

9. The seller's bank (also, usually, the "advising bank") may act as a "confirming bank" and give its own undertaking to honor the credit, establishing a "confirmed credit"; otherwise, only the buyer's bank undertaking is given, in which case the credit is an "unconfirmed credit."

10. Such a relational contract could be a long-term joint venture agreement, a construction contract, a franchise or licensing agreement or an agreement for the supply of services. Theoretically, both types of credit, documentary and standby, could be involved in the same transaction, *e.g.*, a contract for the purchase and sale of personal property in which a documentary credit would act as a mechanism for the payment of the purchase price and the performance of the seller's warranties in the future would be secured by the issue of a standby letter of credit.

11. A true performance bond, however, is a surety contract with a third-party insurer which responds only to the beneficiary's actual damages and is subject to the equities between the parties to the underlying contract.

12. Uniform Customs and Practice for Documentary Credits, International Chamber of Commerce (Pub. No. 400, June, 1983).

except so far as specifically incorporated by reference into the contract.[13] The UCP has only very recently been revised[14] and now expressly applies to standby credits, as well as documentary credits. So far as the status of the UCP in the United States is concerned, it is of interest that New York permits the parties to a letter of credit to exclude the application of UCC art. 5 in favor of the UCP.[15]

Faced with these overlapping and non-statutory provisions, what considerations should be foremost when using a letter of credit in a United States/Canada transaction? If the letter of credit is a standard form document, there will be the usual pressures to use it unamended, regardless of its relevance to the specific transaction at hand. Canadian bank standard form documents generally specify governance by the UCP. If the parties are willing, a non-standard form (or, as referred to in Canada, a "one-off" document) should be drafted to suit the circumstances. This will increase the likelihood that the documents presented will be congruent with those required.[16] If it can be enforced in the U.S. party's state, as is possible in New York, it would be highly desirable for reasons of likely uniformity of interpretation, to elect to have the credit governed by the UCP. If this is not feasible, then a choice of law should govern the document. Frequently, it is assumed that the credit will be governed by the laws which govern the underlying transaction, but that may not follow automatically if an "unusual" choice has been made for the underlying transaction; *e.g.*, the law of a jurisdiction other than that of either party. Since there will probably be no startling differences in application of substantive principles between the two countries, and since the payment rather than the creation of the document will more likely be the subject of dispute, it may be appropriate to choose the law of the paying bank's forum.

Before leaving this subject, it may be useful to briefly touch on the most topical substantive issue in Canada on letters of credit, *viz.*, its autonomy from the underlying transaction. As stated in art. 4 of the UCP, "all parties concerned deal in documents, and not goods, services and/or other performances to which the documents may relate."[17] A long-established exception to this principle is fraud. Graham and Geva have analyzed English and Canadian case law, concluding that "compared to their English counterparts, Canadian Courts have been less hesitant to invoke the fraud excep-

13. Graham and Geva, *supra* note 8, at 187.
14. *See* Eberth, *The New Uniform Customs and Practice for Documentary Credits: A Legal Analysis*, INT'L BANKING L., Nov. 1984, at 74; Kozolchyk, *The 1983 UCP Revision, Trade Practices and Court Decisions: A Plea for a Closer Relationship*, CAN. BUS. L.J. 214 (1984).
15. N.Y. Uniform Commercial Code, 5-102(4) (McKinney, 1964).
16. *See* Michael Doyle & Associates Limited, v. Bank of Montreal, [1984] 5 W.W.R. 193.
17. *See supra* note 12, at art. 4.

tion" and the UCC art. 5 test as to fraud is "illusory."[18] Van Houten argues that the English position as confirmed in the recent *United City Merchants* case[19] shows a strictness of autonomy which is more apparent than real and, in doing so, takes comfort from the comments of Stephenson L.J. in the English Court of Appeal in this case when he praises "the flexible standard" of the UCC.[20] Notwithstanding this praise, the House of Lords allowed the appeal and Van Houten admits that the case "is not by any means supportive of the liberal view."[21]

The result probably leaves Canada where it has always been, metaphorically speaking, somewhere in the mid-Atlantic. Our most amusing contribution to the literature has been a case in which the plaintiff applied his knowledge of business to his personal life with unfortunate results.[22] In the course of negotiating a cohabitation agreement, the plaintiff said that he would issue a letter of credit to his co-habitee on the condition that she would draw on the letter of credit only if she commenced residing with him and he failed to marry her within one year. Only a few days after receiving the letter of credit and without fulfilling the condition, the defendant attempted to gain the funds through her Texas bank. Although in this case the Supreme Court of Ontario enjoined the payment, this is hardly a significant retreat from the more traditional approach of autonomy. The case was not a trial, merely a motion to continue an injunction, and, in any event, the defendant tendered no evidence. The Court therefore was left with only the plaintiff's uncontradicted evidence that the letter of credit was subject to a collateral oral agreement.

Is love indeed nonnegotiable?

B. Personal Property Security Legislation in Canada[23]

In Canada, legislative jurisdiction over secured transactions is provincial, while banking, bankruptcy and insolvency legislation is exclusively within federal competence. Since 1967, four Canadian jurisdictions, Ontario,

18. Graham and Geva, *supra* note 8, at 201, 204. *See also* Kimball and Sanders, *Preventive Wrongful Payment of Guaranty Letters of Credit—Lessons from Iran*, 37 Bus. Law. 417 (1984); Schivank, *Use and Abuse of Documentary Credits*, Int'l, Cont. L. and Fin. Rev., May 1981, at 332; O'Connor, *Payment and Financing Mechanisms in International Trade* and Graham, *Performance and Bid Bonds, etc.* in New Dimensions in Int'l Trade L., 58 (J. Ziegel & W. Graham eds. 1980).

19. United City Merchants (Investments) Ltd. v. Royal Bank [1983] 1 A.C. 168 (H.L.).

20. Van Houten, *supra* note 8, at 381.

21. Van Houten, *supra* note 8, at 383.

22. Rosen V. Pullen (1981), 16 B.L.R. 18 (Ont. H.C.J.).

23. The most recent and comprehensive discussions in Canadian legal literature are: Ziegel, *Recent and Prospective Developments in the Personal Property Security Law Area*, 10 Can.

Manitoba, Saskatchewan and the Yukon Territory, have adopted comprehensive personal property security legislation (herein referred to generically as PPS legislation), conceptually based on art. 9 provisions of the UCC.[24] Some progress has been made in three other Provinces towards adoption of PPS legislation; to date, however, only four of Canada's twelve jurisdictions (ten provinces and two territories) have formally eliminated that "multiplicity of common law, equitable, and statutory security devices, each with its own complex of arcane rules and many dark and unillumined corners"[25] which characterizes pre-PPS legislation.

The progress in other jurisdictions consists of 1978 draft legislation in both Alberta and British Columbia, a lapsed bill in the Alberta legislature in 1980 and continued work on the revision of the Quebec Civil Code.[26] For a common law practitioner, it is fair to say that Quebec's civil law treatment of PPS is confusing, even more than the existing pre-PPS law in the common law Provinces, which is usually founded on separate statutes dealing with chattel mortgages, conditional sales, bills of sale and "corporate securities." "Debentures" and similar instruments issued by corporations securing tangible personal property and book debts have traditionally been a popular means of secured indebtedness, by way of either a fixed or floating charge. When Ontario enacted its PPS legislation in 1967, it unwisely left its corporate securities statutes intact. Manitoba and Saskatchewan learned from Ontario's error and dispensed with this confusing archaism.

Generally speaking, the existing Canadian PPS legislation displays many differences from art. 9 of the UCC; however, none of these could be termed fundamental. Many concepts are similar, even if their scope is different: security interest, perfection, attachment, proceeds, etc. As aptly stated by Professors Ziegel and Cuming, "If the weather is discounted, a U.S. commercial lawyer would feel very much at home in any Canadian jurisdiction which has adopted a Personal Property Security Act once he has become accustomed to the Canadian legislative drafting style."[27] Three areas of

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BUS. L.J. 131 (1985); Cuming, *Comments on the Report of the Ministers Advisory Committee on the Personal Property Security Act (Ontario)*, 10 CAN. BUS. L.J. 168 (1985); and MacDonald, *Modernization of Personal Property Security Law: A Quebec Perspective*, 10 CAN. BUS. L.J. 182 (1985). *See also* Ziegel and Cuming, *The Modernization of Canadian Personal Property Security Law*, 31 and Cuming, *The Modernization of Canadian Personal Property Security Law*, 31 U. TORONTO L.J. 249 (1981).

24. Personal Property Security Act, ONT. REV. STAT. ch. 375 (1980); Personal Property Security Act, MAN. REV. STAT. ch. P-35 (1973); Personal Property Security Act, SASK. REV. STAT. ch. P-61 (1980); The Personal Property Security Ordinance, O.Y.T. 1980 (2nd), c.20.

25. Ziegel and Cuming, *supra* note 23, at 250.

26. Ziegel and Cuming, *supra* note 23, at 249; Ziegel, *supra* note 23; Zoellner, UCC art. Nine and Secured Transactions in Canada and Civil Law Jurisdictions, 29 CHITTY'S L.J. 260 (1981); Civil Code Revision Office, *Report on the Quebec Civil Code*, Vol. II, 346–372 (1977).

27. Ziegel and Cuming, *supra* note 23, at 253. *See also* Semple, *The Legal Incidents of*

difference, however, due largely to Canadian legal history and differences of established commercial practice, are the specific recognition accorded in Canadian PPS legislation to floating charges, a greater scope for registration as opposed to perfection by possession in Canada, and greater codification of the parties' rights and remedies on default.

Probably the most significant recent development in Canada is what may be a new enthusiasm for uniformity. Unlike the relative uniformity in the United States which art. 9 has produced, there are significant differences among the four existing Canadian statutes; however, there are several seemingly unrelated developments regarding reform and uniformity which bode well for the future. Firstly, the Uniform Law Conference of Canada and the Canadian Bar Association have formed a Joint Committee and approved a draft Uniform Personal Property Security Act.[28] This new Joint Committee will act in much the same way as does the Permanent Editorial Committee of the UCC. Secondly, now that the Ontario statute has been in operation for nearly nine years and close to two hundred reported decisions are available from the three principal PPS jurisdictions, Ontario has moved to substantially redraft its statute, rather than merely tinker with it. Most significantly, the proposed revision incorporates many of the features of the Uniform Personal Property Security Act.[29] Thirdly, as reported by the Joint Committee, Manitoba is actively considering revision of its statute, and there is a substantial possibility that Manitoba will adopt the Uniform Personal Property Security Act rather than make piecemeal amendments. This would be an event of considerable significance—the first full Canadian adoption of a model PPS statute.

Unfortunately, federal laws in the banking and insolvency fields which bear on PPS legislation seem quite out of harmony with the provincial law, especially in relation to the all-important question of priorities. No early resolution of this particular federal provincial conflict appears on the horizon.

For a United States party taking security in Canada, if the property is in the Yukon, Saskatchewan, Manitoba or Ontario, his lawyer will have little trouble assimilating the advice he receives from Canadian counsel. He may even be able to indulge in a limited amount of off-shore planning, as, for

Computer Software and Its Use as Collateral in Security Transactions, 7 CAN. BUS. L.J. 450 (1983); Shanker, *The Past, Present and Future of True Leases and Disguised Security Agreements: An Old Problem in Modern Apparel*, 7 CAN. BUS. L.J. 288 (1983).

28. For the text of the Uniform Personal Property Security Act, *see* Uniform Law Conference of Canada, PROCEEDINGS OF THE SIXTY-FOURTH ANNUAL MEETING, 359 (1982).

29. Joint Committee on the Uniform Personal Property Security Act, 1982, FIRST ANNUAL REPORTS, 2 (1984). The report continues: "Nevertheless, our Committee is of the view that in the interest of uniformity greater harmonization should be brought between the proposed new Ontario Act and the Uniform Act."

instance, in proposing a U.S.-style "floor plan" financing of inventory. If, however, the transaction involves any other Canadian jurisdiction, the U.S. party will need a short course in legal history to begin to understand the system and, in Quebec, the uncertainty level is so high that he will also need a great deal of faith.

C. Contractual Exemption Clauses and "Fundamental Breach"— An Unconscionable Muddle[30]

Although there is no uniform sale-of-goods law across Canada, in the common law Provinces there is an unintegrated collection of sale-of-goods statutes, all generally modeled on the English statute of 1893,[31] together with a variety of consumer protection and business practices legislation.

Against this background of the sale-of-goods statute law, which applies only to goods, and the consumer protection legislation which, generally speaking, applies only to sales to consumers or practices involving consumer sales, there is a rather significant area of commercial sales transactions largely unregulated by statute. Despite this, or perhaps because of this, the courts have been willing to develop common law principles to deal with the perceived unfairness, especially in consumer transactions, of clauses excluding or limiting liability. For example, there is the time-worn *contra proferentem* rule of construction,[32] *i.e.*, that exemption clauses ought to be construed "strictly" and, on balance, against the interest of the party who drew the document. The legal draftsman has reacted to this in a variety of ways: by clarifying and making explicit his peculiar intention or purpose in framing an exemption clause,[33] or by having his client receive an acknowledgement that the other party was given an opportunity to obtain legal or other professioal advice in connection with the transaction. Recently, the English House of Lords reaffirmed the propriety of an exclusion clause, even though construed *contra proferentem*, but held that limitation clauses were less offensive than exclusionary clauses. This could lead to the curious result that when the parties have apparently expressed the intention that no liability whatever attach, the courts will respect the parties' intention only after

30. *See* Fridman, Sale of Goods in Canada (2d ed., 1979) and for the most current discussion, *McTavish, Exemption Clauses: Are Couriers Fair Game?* in Special Lectures of the Law Society of Upper Canada, *supra* note 3, at 69.

31. The Sale of Goods Act (1893) 56 & 57 Vict., c.71.

32. S. Waddams, *supra* note 7, at 348.

33. For example, one finds this clause in a typical franchise agreement: "This agreement is entered into between the parties hereto with the full knowledge of its nature and extent, the Franchisee hereby acknowledging that the qualifications for a franchise are special, unique and extraordinary, and that this agreement would not be entered into except on condition that such restrictive covenants be included herein."

applying a negative presumption. On the other hand, no such presumption will be applied when the parties have apparently expressed the intention that some limited level of liability should attach. If this sounds curious in principle, the application of such a blunt instrument as *contra proferentem* can produce an even more curious result. In one of the *Purolator Courier Ltd.* cases,[34] the Ontario Court of Appeal held that the exculpatory words "any reason whatever including delay" did not include non-delivery!

In addition to the *contra proferentem* rule, Canadian courts have adopted and further refined the English concept of "fundamental breach." In doing so, Canadian judges have worked away assiduously on the rather futile exercise of determining whether fundamental breach is a rule of law or a rule of construction. If the former, then the rule would operate regardless of the parties' intentions, and if the term to be excluded by the exculpatory clause were a "fundamental" term, then the exculpatory clause, even if it appeared to express the wishes of the parties, would be inoperative. On the other hand, if the rule were merely a rule of construction, then the contract as a whole would be analyzed to determine the parties' intentions. This sterile exercise of classification was brought to a halt in England in 1980 by the *Photo Production Ltd.* case,[35] where the House of Lords held that the rule is merely a rule of construction. Although the Supreme Court of Canada has professed to follow the *Photo Production Ltd.* case,[36] it is unclear how committed the court is to this new perspective.[37]

What has led to this absurdity is the lack of a generalized Canadian concept of unconscionability such as exists in art. 2-302 of the UCC or under the United Kingdom Unfair Contract Terms Act, 1977. The Ontario Law Reform Commission reviewed the question thoroughly in its 1982 Report on Sale of Goods and recommended the adoption of such a generalized concept for insertion in a revised Sales of Goods Act for Ontario.[38] Its recommended version incorporates features of both the United Kingdom and United States legislation.

Unless the Canadian courts suddenly embrace the *Photo Productions Ltd.* case or, even more unlikely, adopt the Ontario Law Reform Commission recommendations, Canadian lawyers in the common law Provinces will simply have to "muddle through" by drafting broad exculpatory clauses which also include self-serving language of the acknowledged fairness of the clause. In addition, the exculpatory clause must be readable, *i.e.*, it must not

34. Cathcart Inspection Services Ltd. v. Purolator Courier Ltd. (1982), 139 D.L.R. (3d) 371 (Ont. C.A.).

35. Photo Production Ltd. v. Securicor Transport Ltd., [1980] A.C. 827 (H.L.).

36. Beaufort Realties (1964) Inc. and Belcourt Construction (Ottawa) Ltd. v. Chomedy Aluminum Co. [1980] 2 S.C.R. 718.

37. S. WADDAMS, *supra* note 7, at 356; McTavish, *supra* note 30, at 69.

38. Ontario Law Reform Commission, 1 REPORT ON SALE OF GOODS 153 (1982).

catch the other party by surprise. Finally, the chances of successfully upholding such clauses will be greatly increased if the other party is given an element of choice, *e.g.*, complete exemption from liability with rate structure A or partial exemption (*i.e.*, limited liability) with rate structure B.

D. Alternative Dispute Resolution in Canada/United States Private Agreements[39]

There is a wealth of literature on alternative dispute resolution (ADR) in the United States' context, both domestic[40] and international,[41] and a growing literature in the Canadian context, again both domestic[42] and international.[43] However, there is very little writing on ADR in the specific context of Canada/U.S. private commercial agreements.

I will discuss the subject from the point of view of the business lawyer considering the use of ADR in a typical Canada/U.S. commercial agreement. Initially, the discussion will be in terms of arbitration, with later references to conciliation/mediation and the mini-trial.

Frequently, lawyers face the drafting issue in these simple terms: will the parties agree to arbitrate some or all classes of disputes or will they rely on conventional litigation to settle disputes? Traditionally, the comparative advantages of the arbitral process over the judicial process is thought to lie in the factors of cost, speed, confidentiality, informality and efficacy. As for informality (both as to the conduct of proceedings and the discretionary reception of evidence) and confidentiality, little need be said because the arbitral process usually justifies the parties' expectations. However, the factors of cost and speed do not universally favor arbitration. Because arbitrators, unlike judges, must be paid by the parties for their services, unless special factors are involved, the parties should be encouraged to provide for only one arbitrator. Again, unless one can readily forecast reasons for a contrary view, he should give the arbitrator power to demand those elements of civil procedure which shorten the litigation process and dispense with those elements which can unnecessarily lengthen it. In this regard, a Canadian arbitration should use institutional rules of conduct[44] to

39. *See* R. McLaren & E. Palmer, The Law and Practice of Commercial Arbitration [in Canada] (1982).

40. Needle, *The Nuts and Bolts of Arbitration*, excerpts quoted in 8 The Info. Franchise Newsletter (1985).

41. Higgins and Brown, *Pitfalls in International Commercial Arbitration*, 35 Bus. Law. 1035 (1980).

42. Davidson, *Dispute Settlement in Commercial Law Matters*, 7 Can. Bus. L.J. 197 (1982).

43. Graham, *International Enforcement of Arbitral Awards: The Case of Canada*, International Commercial Arbitration (Can. Council, I.C.C., 1982).

44. *Rules for the Conduct of Arbitrations*, Arbitrator's Institute of Canada, Inc. *See also* Stein and Watson, *International Commercial Arbitration in the 1980's: A Comparison of the Major Arbitral Systems and Rules*, 38 Bus. Law. 1685 (1983).

supplement, or where applicable and possible, replace those implied by the relevant Provincial arbitration statutes. Because of the rental costs of suitable premises, travel costs, solicitors' and experts' fees, arbitrators' fees, the cost of transcription of evidence where applicable, the cost of management time and other ancillary expenses, arbitration can be costly. Indeed, if either party acts in an obstructionist manner, it may even be lengthy.

Further, because arbitrators, under Ontario law, are unable to grant an injunction, an order for the preservation of property or similar interim relief,[45] a party seeking such relief may be frustrated and prefer relief in the courts. Therefore, if a privative clause (*i.e.*, court-excluding clause) is present, the arbitration clause should be drafted so that the privative clause does not prevent resort to the courts for such interim or supplemental relief.

This catalogue of considerations should not be thought to reflect a general bias against arbitration as an ADR mechanism. On the contrary, I have argued strongly for a wider and much more creative use of the process.[46] Such broad use is only possible, however, after careful analysis of the advantages and disadvantages of arbitration in each commercial situation, followed by a tailoring of arbitration provisions to suit any special circumstances.

Arbitration is of great value, particularly in negotiations of international relational contracts. Firstly, there is no provision as effective in promoting a healthy atmosphere for substantive negotiation as a well thought-out arbitration clause. Advocacy of the use of an arbitration clause in this situation is usually interpreted by the other party as a signal of a genuine interest in the creation of a long-term and stable contractual relationship. Secondly, arbitration can be used to introduce the necessary element of certainty into what might otherwise be a contract void for uncertainty, as in a twenty-year franchise agreement when the parties are able to agree on a royalty rate for the first five years, but not beyond.[47] Thirdly, the ability to choose in advance the identity of the arbitrator, the scope of the questions to be arbitrated, and the arbitration procedure itself fosters stability. Finally, in the event that legislation intervenes and interferes with the relationship (*e.g.*, by barring a party from exporting a product for national security reasons), an arbitrator would probably be able to reflect the "true" intention of the parties better than a court, which tends to reflect national policy considerations rather than commercial realities.

In Canada, if the parties wish to exclude court supervision to the max-

45. Cosman, *Attachments and Other Interim Court Remedies in Support of Arbitration*, 10 CAN. ARBITRATION J., 2 (1985).

46. Potter, *supra* note 3.

47. RUSSELL ON THE LAW ARBITRATION, 25 (A. Walton & M. Vitoria eds. 20th ed. 1982): "Since an arbitrator can be given such powers as the parties wish, he can be authorized to make a new contract between the parties."

imum extent possible, in order to ensure that their intentions are carried out, a so-called *Scott* v. *Avery* clause such as the following must be included:

> Except as otherwise permitted hereunder, it shall be a condition precedent to the commencement of any legal proceedings arising out of the negotiation, validity, interpretation, performance and effect of this agreement that the arbitration procedures provided for herein shall have been completed. The award made in accordance with these provisions shall be final and binding and not subject to appeal, provided, however, that judgment may be entered to enforce the award in any Court of competent jurisdiction and the party against whom such award is made waives all rights of objection to such enforcement.[48]

Under Canadian law this should ensure that a court will allow the arbitration proceedings to go forward without interference unless, of course, the issues raised in any parallel litigation are non-contractual in nature or unless the parties are different. Without such a clause, a common law Canadian court has discretion over whether to stay the conflicting legal proceedings.[49] The clause also permits the parties to invoke the assistance of the court for interim remedies, if elsewhere specified, and for enforcement.

If the transaction involves multiple documents or if any are standard form documents, great care must be taken to prevent dissimilar arbitration or litigation procedures arising from different parts of what is essentially an integrated transaction or relationship. For example, to revert to the letter of credit as a payment or security device, frequently a bank's standard form document is used which contains reference to a specific institutional arbitration procedure. However, if the letter of credit is collateral to an underlying contract between the non-bank parties, and if there is a confirming bank, there will be other contractual relationships created. If a dispute arises, it will presumably be desirable to have all parties before the same tribunal. If the proposed relationship is a short-term transactional one, in reality it will probably be impractical to attempt to properly sort out all the overlapping relationships. If, however, a relational arrangement is contemplated, all parties should be urged to agree to a common ADR mechanism.

Any Canadian lawyer writing on the subject of international arbitration cannot avoid a matter of intense embarrassment—the fact that Canada is not a signatory to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).[50] Fortunately,

48. This clause is not intended to be comprehensive, since it does not deal with procedural rules, but it represents a necessary part of any arbitration clause which is designed to give the arbitrator exclusive jurisdiction. *See* Scott v. Avery (1856), 10 E.R. 1121 (H.L.), approved by the Supreme Court of Canada in Deuterium of Canada Ltd. v. Burns & Roe, Inc., [1975] 2 S.C.R. 124.

49. For example, *see* Re Rootes Motors (Canada) Ltd., (1952) O.W.N. 553 (Ont. H.C.J.).

50. New York Convention on the Recognition and Enforcement of Arbitration Awards of 1958. June 10, 1958, 21 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 38.

however, there are recent signs of a thaw in federal/provincial relations generally that may produce the necessary consensus to allow accession to this vital cornerstone of international commerce.[51] Until Canada's accession to the New York Convention, one method of coping is to provide for arbitration in the defendant's forum. Having to move one's dispute across the border can have a very salutary effect on settlement discussions, but if settlement fails, enforcement will be carried out in the same jurisdiction as the arbitration, thus it is hoped, avoiding the effect of the gap in the reciprocal recognition provided by the New York Convention.

Until recently, mediation and conciliation have found much greater favor in the international arena than they had in the domestic commercial context; however, now that the mini-trial is becoming fashionable, these two traditionally under-utilized methods may reappear in both domestic and international contracts. Conciliation may be used effectively as a prelude to arbitration. This functions best when the identity of the conciliator is known in advance or he is chosen from a pre-agreed panel. This increases the likelihood of acceptance by both sides. If the conciliation is unsuccessful after a very short period, such as ten to fifteen days, the conciliator becomes an arbitrator and, after a hearing, imposes a settlement. With this structure, the parties know that a solution suggested by the conciliator is likely to be the one imposed and the incentive to proceed with an adversarial hearing is reduced or eliminated, especially if the conciliator-turned-arbitrator can penalize the parties in costs.

A reading of the recent literature on mini-trials[52] leads one to believe that seldom is this novel but effective method acquiesced to in advance in the same way that arbitration or conciliation frequently is.

ADR mechanisms are powerful tools to bring the law to serve practical commercial needs, but they cannot achieve maximum effectiveness if used blindly. If at the end of arduous negotiations on the substance of a commercial transaction the parties fail to spend adequate time on the arbitration clause, they seriously weaken the structure on which their negotiations stand.

IV. Conclusion

In negotiating and drafting private commercial agreements between Canadian and United States parties, a broad range of issues may arise which contain a strong policy element: trade, investment, tax, anti-trust, etc. Frequently, however, more practical issues are critical to the success of the

51. It is the writer's understanding that the Canadian federal government and all provincial governments have indicated their willingness to adopt the Convention.

52. Gorske, *Mini-Trial Dispute Resolution*, 19 LES NOUVELLES 146 (1984); Gallo, *Alternative Dispute Resolution*, 20 LES NOUVELLES 60 (1985).

commercial transaction: how does A get paid and what security can B give, or what if the widgets don't work? If the draftsman responds to these questions by simply pressing the "print" button on his word processor without analyzing how transborder transactions can generate an entirely different set of problems, he may become part of the problem instead of being the key to its solution.