

CORPORATE

BULLETIN

*A Report on Recent
Developments
in Corporate Law*

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17 CONTRACT PROVISIONS THAT CAN HELP GET YOU PAID

Recent events in this uncertain economy have prompted many businesses to re-examine their credit policies and risk management strategies. Legal considerations should play a prominent role in this process. The content of the printed or electronic contract that you use with your customers can make an enormous difference when it comes to collecting accounts for goods or services rendered. Although no substitute for proper credit and other risk assessment, the following contract provisions can help protect the interests of your business in the collection process:

1. TITLE RETENTION

If your business is involved in the sale of inventory or equipment, the contract should include a title retention provision. Title retention gives the seller a security interest in the goods sold, and in the proceeds from the resale or lease of the goods, until payment is received. It also provides the seller with the right to retake possession on default as a self-help remedy and may give the seller priority to the interests of other secured parties. Perfecting the security interest requires strict compliance with the *Personal Property Security Act* (Ontario).

2. CONTRACTUAL TRUST

A sales contract can also create a trust relationship. Contractual trust obligations may be useful in the supply of inventory from wholesalers to retailers or from consignors to consignees. In the event of a non-payment, the seller can make a claim against the specific trust assets, if they can be identified or traced. If the trust assets cannot be located, the seller can bring a personal claim against those directors and officers responsible for the breach of trust.

3. OVERDUE INTEREST

Suppliers will usually want to stipulate a rate of interest that is onerous enough to discourage late payment without impeding the sale or amounting to a criminal rate (*i.e.*, exceeding 60% per annum). Where interest is payable at a rate for any period less than a year, the agreement must contain an express statement of the equivalent annual rate; otherwise, the supplier is precluded from recovering any interest exceeding 5% per annum.

4. COLLECTION EXPENSES

A sales contract should provide for the recovery of the supplier's legal expenses on a solicitor-and-client basis and for the supplier's other collection costs on a full-indemnity basis. Costs incurred in court proceedings are, in Ontario, at the discretion of the court. However, the Ontario Court of Appeal has given effect to

a contractual provision entitling one party to solicitor-and-client costs, the highest level of reimbursement available.

5. DEPOSIT

At the time of receiving a purchase order, a supplier may require a deposit to secure future performance and hedge the risk of default. A modest deposit may be forfeited even though the supplier suffers no loss from the default.

6. LIQUIDATED DAMAGES

A supplier may also want to consider using a carefully drafted liquidated-damages provision as a genuine pre-estimate of damages for breach of contract. Ideally, this provision will spare the supplier the necessity of proving that the contract was breached and substantiating the damages.

7. EXCULPATORY AND DISCLAIMER CLAUSES

Exculpatory and disclaimer clauses are used to limit potential excuses by the customer for non-payment or slow payment. The supplier can generally disclaim all warranties, conditions, covenants and representations, express or implied, except those expressly set forth in the contract. The supplier can also limit the potential heads of damages, such as direct, indirect, special, consequential, exemplary or punitive damages. Finally, a warranty as to delivery date should be resisted and damages resulting from late delivery should be expressly excluded since delay in delivery is often raised as an excuse for slow or non-payment.

8. WAIVER OF IMPLIED CONDITIONS AND WARRANTIES

Except in consumer transactions, a commercial seller of goods may also exclude, by express agreement, the implied conditions and warranties of fitness for purpose and merchantable quality under the *Sale of Goods Act* (Ontario). Exclusion of implied warranties alone will not be a sufficient waiver of the implied conditions. For this reason, if the sales contract is developed in the U.S. (where waiver of warranties alone is sufficient), it should be modified for use in the Canadian marketplace.

9. WAIVER OF SET-OFF BY CUSTOMER

The sales contract should expressly exclude any right of set-off that the customer may have. This provision will help minimize the opportunity for a customer to claim set-off of damages it may allege to have suffered against the purchase price, and may enhance the ability of the supplier to assign or factor the receivable.

10. SET-OFF IN FAVOUR OF SUPPLIER

If, however, the relationship between the supplier and the customer may give rise to refunds, rebates, returns and other payment obligations owing by the supplier, then the contract should grant the supplier the right to expressly set off any such claims against the customer's indebtedness so as to net the cross-claims before the claims of third parties against the customer intercede. In the absence of a set-off, the supplier may find itself in the ironic situation that the trustee in bankruptcy of its customer can demand payment of the customer's full claim while the supplier's claim against the customer goes unpaid. However, the supplier has to prove mutuality, including that the cross-debts arose out of the same transaction. These difficult issues are best avoided by an express provision.

11. APPLICABLE LAW

A supplier will usually want to state that the law of its home jurisdiction governs the contract to preclude the customer from raising fanciful defences based on the laws of an unfamiliar jurisdiction.

12. EXCLUSION OF VIENNA SALES CONVENTION

The *United Nations Convention on the International Sales of Goods* (the "Vienna Sales Convention") will apply to most international sales of goods. Both Canada and the U.S. are parties to the Vienna Sales Convention. Thus, unless expressly excluded in the contract, the Vienna Sales Convention will apply to cross-border sales of goods. The Vienna Sales Convention contains surprises for unwary parties, such as requirements to keep offers open for acceptance for a reasonable time; to give reasonable notice before terminating a contract for non-performance; and relaxation of the perfect tender rule

(thereby, allowing the buyer to reduce the price for allegedly deficient work). Canadian and U.S. sale of goods and contract law generally provide otherwise.

13. JURISDICTION

The supplier will usually want to have the customer expressly submit to the non-exclusive jurisdiction of the court in the supplier's jurisdiction. The supplier can then obtain judgment in its home jurisdiction and have the judgment recognized and enforced in the customer's jurisdiction.

14. WAIVER OF JURY TRIAL

While jury trials in commercial cases in Canada are rare, a supplier may wish to provide for a waiver of trial by jury in the sales contract. In the U.S., the combination of jury trials, punitive damages and contingency fees has placed upward pressure on damage awards.

15. INTEGRATION CLAUSE

A supplier should also consider including an integration or entire agreement clause. This provision will help prevent the customer from justifying a refusal to pay on the basis of representations, warranties or covenants that are not contained in the written agreement.

16. ARBITRATION

The parties to a commercial contract may want to specify that any disputes that arise are to be determined exclusively by arbitration and that the decision of the arbitrator is final and binding. The parties must assess whether arbitration is appropriate in the circumstances.

17. THIRD PARTY GUARANTEE

It is often to the seller's advantage to insist on a personal guarantee from one or more of the customer's shareholders. Obtaining a personal guarantee from a shareholder neutralizes any incentive to stockpile inventory and equipment to satisfy debts owing to a secured creditor at the expense of unsecured creditors.

CONCLUSION

While none of the foregoing provisions is a substitute for a prudent and disciplined credit policy, careful consideration of legal drafting issues can form an integral part of a comprehensive plan for minimizing exposure to bad debts and ensuring that unpaid accounts remain collectable.

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