REFERENCE GUIDE

Commercial Contract Terms

Prepared by

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Canada

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Introduction & Disclaimer

Exporters operate in a highly competitive, global marketplace. It is important that the underlying commercial contract terms and conditions clearly reflect the negotiated terms and conditions agreed to by both parties. A poorly drafted contract increases the risk of misunderstanding and commercial disputes which may give rise to payment delays, contract performance delays, warranty disputes, and/or calls on any performance security instruments (e.g. bank letters of credit, surety bonds) that may have to be issued. It is important that exporters appreciate and understand the structural elements and risks inherent in clauses comprising the commercial contract.

This Guide examines the key terms and risks that should be kept in mind by exporters when negotiating a commercial contract.

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Basic Commercial Contract Principles

The terms and conditions of a commercial contract should be clear and unambiguous.

A poorly drafted contract increases the risk of misunderstanding and commercial disputes which may lead to a refusal to pay or to a call on performance instruments (letters of credit, letters of guarantee or surety bonds).

The following general principles should be applied in the development of commercial contract wording:

- Generally, contracts should be in writing, signed and dated by both parties. There may be other formalities, such as witnesses, notarization, etc., required by the laws of a particular jurisdiction to create a binding contract. Exporters are encouraged to seek legal advice to ensure they have taken all necessary steps to ensure that their contract is legally binding.
- It is important to ensure ALL exhibits, schedules, appendices, annexes, are referenced appropriately throughout the contract document.
- Any changes to the original contract should be agreed to in writing by way of a formal signed contract amendment.
- If external financing is required, it is important to ensure that the contract includes provisions that such arrangements must be in place and in force as a prerequisite to the contract becoming valid and enforceable.

Typical Clauses

The following represents some clauses typically found in export contracts:

A) Parties and Contract Purposes

The commercial contract should clearly identify the parties to the contract and the full legal names of all the parties should be used in the signature line and elsewhere in the contract (not the trade names).

The commercial contract should include a clear statement of obligation for the buyer to buy (and pay for) and for the seller (exporter) to sell (and deliver) the goods/services. This provision establishes the underlying provisions for the rest of the contract and usually includes a detailed description of the goods/services involved in the context of a purchase and sale transaction or in respect of a specific project. Specifically, the contract statement of obligation should clearly reflect how limited or extensive is the scope of a party's obligations – i.e. design, supply, installation, commissioning, warranty, training, services.

B) Contract Price

The contract should clearly reflect the negotiated total payment details between buyer and seller (exporter). The following considerations may be taken into account in developing this clause:

- Is the contract price clearly stated?
- Is the price fixed or adjustable?
- Is there a breakdown related to the components of the scope of the work to be contracted for? For example, are there specific amounts for design, goods, training, etc.?
- Currency and basis of price – Is there one currency or are there multiple currencies?

C) Terms of Payment

The following considerations may be taken into account in developing this clause:

- Does the contract clearly state how and when payment(s) will be made?
- What is the credit period? Within 30 days of receipt of documentation? Immediately?
- Are there partial payments due on milestones, e.g. final design, partial delivery, installation, and final acceptance? Are these due dates clear?
- Are there any contract conditions "suspending" the payment obligation?
- Is specific documentation required to trigger a payment obligation?
- Are approvals/acceptance required from the buyer in order to trigger payment obligations? (Is there a deemed approval/acceptance date?)
- What are the mechanisms for payment? : Irrevocable Letter of Credit (ILC), open account, outside financing (EDC or alternative sources of financing)?
- Are payment terms linked to performance instruments (i.e. bank ILC or surety bond)? If there is a downpayment, advance payment or milestone payment made to the exporter, the contract may require the issuance by the exporter to the buyer of an advance payment or performance guarantee/bond as a condition of payment. If the contract provides for a holdback, the contract may provide for the issuance of a warranty/retention guarantee/bond on the exporter's behalf by their bank or surety. In most cases, these payments are only 'payable' upon issuance by the exporter of the relevant performance instrument.
- Does the contract provide for holdback payments?: If so, most holdbacks are payable after final acceptance by the buyer. Should the buyer never accept, the end result is that there may be no obligation for payment of that portion of the contract price. Without a "deemed approval" or "no later than" date, the exporter may have no legal recourse to the buyer under the terms of the contract.

D) Delivery Schedule and Terms of Delivery

The contract should include clear delivery terms. The following considerations may be taken into account in developing this clause:

- Are the delivery terms in accordance with Incoterms[1]? (e.g. Ex works?, FOB?, CIF?)
- If Incoterms are not specified, are the obligations of each party in respect of costs during shipment, transfer of title and loss/damage risks clear?
  - Who is responsible for costs during shipment?
  - When does title transfer? Upon certain actions or events taking place? Should title pass prior to the exporter being paid, the exporter may have no right to take back the goods for either salvage or resale.
  - Who is responsible for paying for damages or loss of goods during shipment?
- Are there any particular delivery limitations? (e.g. formal release from the buyer?)
- Can the exporter realistically meet the delivery schedule? Is the delivery schedule, as set out in the contract, consistent with the exporter's capabilities and corporate work schedule?
- Does the delivery schedule match the payment obligations of the buyer or does the delivery and payment schedule put the exporter in a cash negative position throughout the contract? The relevance for the exporter is that the timing of delivery and number of shipments feed into the anticipated project cash flows.

E) Penalties and Liquidated Damages

The penalties and liquidated damages clause identifies possible financial obligations of the exporter and, in some cases, the buyer in the event of exporter non-compliance with certain contract performance obligations. In that regard, the exporter may want to:

- Review the guarantee/bond wording to ensure the performance instrument is not used as the mechanism for payment of contract penalties or liquidated damages.
- Consider how a demand by the buyer for the payment of a penalty or for liquidated damages might affect the buyer's payment obligations for contract amounts owing as well as the exporter's contract performance obligations and capabilities.

The following should be taken into consideration in developing this clause:

- Are the penalties for late delivery reasonable in relation to the value of the goods and the damages that the buyer might incur as a result of late delivery?
- Penalties are normally calculated as a percentage of the contract price or the value of the delayed goods/services for a specific period of time. In EDC's experience, the total amount of penalties payable should not exceed 100% of the contract price.
- Can the penalties be deducted from contract payment amounts owing to the exporter?

[1] Incoterms is the abbreviation for "International Commercial Terms" which have been developed by the International Chamber of Commerce to establish agreed conventions as to the obligations and responsibilities of the buyer and seller during the contract life with respect to costs (expenses) incurred during shipment, ownership/title transfer control and liability in the event of loss or damage.

- While circumstances may vary from contract to contract, in the event the exporter is required to issue bank letters of guarantee or surety bonds in support of contract performance obligations, it has been EDC's experience that it is helpful if the contract clearly specifies whether or not payment of penalties are taken from these instruments issued as security. The exporter should be aware that if the buyer is in fact able to call the letter of guarantee or the bond in order to obtain payment of penalties or liquidated damages, the buyer can use the instruments as a payment mechanism to cover such penalties and liquidated damages detailed in the contract. In EDC's experience, this is not the normal intent of such bank letters of guarantee or surety bonds.

F) Force Majeure Clause

The force majeure clause generally identifies or lists events which the parties agree will cause excusable or justified delays in the performance of the buyer's or seller's obligations or excuse performance altogether.

The following considerations may be taken into account in developing this clause:
- Does the clause specify which events will constitute a force majeure?
- What is the impact of a force majeure on the performance of the contract?
- Will a force majeure suspend a party's performance (and for how long) or excuse the party's non-performance?
- Does a force majeure result in an automatic extension of time for performance? What are the steps required to resolve the "excusable" delay?
- What are the options available to the buyer and the exporter in the event of a force majeure? i.e. termination, delays, modification of scope.

In EDC's experience, in the event of a force majeure, the options made available to the contractual parties should be balanced and reasonable. Neither party should benefit from such a situation.

G) Arbitration or Court Proceeding for Dispute Resolution

The dispute resolution clause in a contract usually details the agreed procedures in settling any contract disputes. Dispute resolution through an arbitration process, which is typically subject to international law, where disputes can be settled by independent third parties, is often preferable to resolution through the courts of the buyer's country.

The following considerations may be taken into account when developing this clause:
- What is the process for settling disputes or issues arising under the contract?
- Does the contract specify governing law and a forum for dispute settlement?
- If the contract contains an arbitration provision, are the rules, the location and the language of the arbitration specified? Can the arbitral decision be appealed to the courts? Who pays for the costs of the arbitration?
- Does the contract allow time for the parties to seek an amicable resolution prior to initiating court or arbitral proceedings?

H) Contract Effectiveness

The contract effectiveness clause establishes the parameters under which the contract will come into force. There is sometimes a distinction in the contract between the date the contract was signed and the date of contract effectiveness. Contract effectiveness normally starts the "clock ticking" for all terms and conditions – delivery, payment, issuance of performance instruments, etc. Contract effectiveness impacts on the contract schedule and obligations of the exporter. There may be events outside the contract terms which "suspend" effectiveness of the contract to a later date than the date of signature by the parties (e.g. contract effectiveness may be conditional upon external financing being in place and operational).

The following considerations may be taken into account in developing this clause:

- Does the contract come into effect upon the occurrence of certain events or upon signature by the parties or both?
- If the contract is effective upon the occurrence of certain events, is the ultimate contract effectiveness date clear? If all of the events do not occur by a certain date, can the contract be terminated? Is there a deemed contract effectiveness date if the events do not occur within a certain period of time?
- Are the contract effectiveness conditions acceptable?
- Must the exporter start work prior to contract effectiveness?

I) Cancellation, Suspension, Termination and Settlement of Accounts

The following considerations may be taken into account in developing this clause:

- Are the relevant contract termination provisions clearly stated?
- Which party has a right to terminate?
- Under what conditions can the termination right be exercised?
- If termination occurs, who owes what to whom?

The termination clause may also provide a process to settle differences. Payment and performance obligations should be outlined for each party upon termination of the contract.

In the case of services contracts, it is especially important that the exporter has the ability to terminate the contract – or at a minimum, suspend services – in circumstances where the buyer has refused to make payments. Otherwise, the exporter may be in a situation where it may be contractually bound to continue services without payment.

J) Issuance of Performance Instruments

The contract may require the exporter to issue bank letters of guarantee, letters of credit or surety bonds (collectively, a "Bond") to secure their performance obligations. Such clause should clearly identify the financial obligations covered by such instruments relating to the exporter's performance.

The following should be taken into consideration in developing this clause:

- When is the Bond issued? What is reason for issuance? Is the Bond issued on milestones?
- Validity period – What are the triggers for expiry of the Bond? Exporters should ensure there is a specific expiry date for the Bond.
- Are there mechanisms to increase/decrease the amount of the Bond?
- Is specimen wording for the Bond included in the contract?
- Does the Bond, if in the form of a bank letter of credit or letter of guarantee, conform to the International Chamber of Commerce's (ICC) Uniform Customs and Practices (UCP) rules for Documentary Credits? Does the Bond, if in the form of a surety bond, conform to a recognized standard surety bond form (e.g. American Institute of Architects (AIA)?

It is important that the performance instrument corresponds to and reflects contractual requirements. The starting and ending dates should match those outlined in the contract clauses, describing the issuance and expiry of the instrument.

K) Governing Law and Language

A governing law clause in a contract expresses the parties' choice of legal system under which the provisions of the contract are to be interpreted. In the event of any dispute between the parties as to the meaning of the contract, it is intended that the specified governing law will be applied in interpreting the relevant provisions. In the absence of a governing law clause, the parties won't know which laws may ultimately be invoked in construing or enforcing the contract. Exporters should consult appropriate legal counsel as to how the absence of a governing law clause may affect the interpretation and enforcement of the contract in the relevant jurisdiction.

It is often the case that, unless otherwise stated, the applicable language will normally be the language in which the contract has been written. If the contract has been written in a language other than an official language of the exporter (i.e English or French in Canada), the exporter should ensure that a suitable contract translation be obtained to ensure that it understands the contract terms. If a translation must be acquired, legal advice should be obtained to determine which version, i.e. the original or the translation, will prevail if a dispute arises. There may also be additional formal validity requirements in order to validate the translated copy of the contract, such as notarization, that are jurisdiction-specific and which should be addressed in advance with legal counsel.

L) Required Documentation and Events

The contract should specify the documents and procedures for each event in the contract: e.g. effectiveness, payment, delivery, installation, testing, commissioning, performance, and acceptance.

For example:

- What documents are required for delivery? (the contract should outline procedures for each event i.e. payment, packing, delivery)
- What technical documentation is required? (It may be appropriate to list in specific appendices to the contract.)

These contract provisions will enable the exporter to flag/determine any documentation risks that may be assumed by the exporter. Specifically for payment, buyer approvals may be required. For bank letters of guarantee or surety bonds, other documentation may be required upon issuance of the instruments in order to make them effective or to trigger expiration.

M) Boycott Clause

The Government of Canada's policy on International Economic Boycotts (located on the Foreign Affairs and International Trade Canada website at **www.international.gc.ca/sanctions/boycott-boycottage.aspx**) calls for the denial of government support and assistance with respect to transactions where the parties have agreed to accept boycott provisions in contravention of this policy. Therefore, in order to be eligible for any EDC support, the exporter must ensure that the contract does not contain any boycott provisions.

Specifically the exporter must ensure that such boycott clause does not contractually require a Canadian firm or individual to:

a) engage in discrimination based on the race, national or ethnic origin or religion of any Canadian firm or individual;
b) refuse to purchase from or sell to any other Canadian firm or individual;
c) refuse to sell Canadian goods and services to, or buy any goods or services from, any country (except that a buyer may specify that goods and services of non-Canadian origin that are being provided by the Canadian must originate from a particular country);
d) restrict commercial investment or other economic activity in any country;
e) produce any document (sometimes called a "negative certificate of origin") which provides that particular goods or services have not originated from specific firms or places; or
f) make a statement that it does not deal with a named country (unless it is clear that there is no intention to restrict the Canadian's right to deal with the named country)?

Conclusion

This Guide is intended to inform and assist exporters in structuring sound commercial export contracts. With the proper structuring of a contract and the proper development of the relevent clauses outlined in this Guide, the exporter will have a better appreciation of both their and their buyer's rights and obligations as well as certain contractual risks inherent in any export transaction.

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