

# Modern Law for Global Commerce

Proceedings of the Congress of the  
United Nations Commission on International Trade Law  
Held on the Occasion of the Fortieth Session  
of the Commission



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# Contents

	<i>Page</i>
<b>I. Opening address and welcoming remarks .....</b>	<b>1</b>
<i>Nicolas Michel</i>	
<i>Under-Secretary-General for Legal Affairs, Legal Counsel, United Nations .....</i>	<i>1</i>
<i>Thomas Stelzer</i>	
<i>Permanent Representative of Austria to the United Nations (Vienna) .....</i>	<i>3</i>
<b>II. Process and value of uniform commercial law .....</b>	<b>5</b>
<b>A. Process and methods of international rule-making .....</b>	<b>5</b>
<i>Chair: Dobrosav Mitrović</i>	
<i>Chairman of the fortieth session of the United Nations Commission on International Trade Law .....</i>	<i>5</i>
<b>1. Keynote address .....</b>	<b>5</b>
<i>Ambassador Didier Operti Badán</i>	
<i>Secretary-General, Latin American Integration Association.....</i>	<i>5</i>
<b>2. Round table .....</b>	<b>18</b>
<i>Jernej Sekolec</i>	
<i>Secretary of the United Nations Commission on International Trade Law .....</i>	<i>18</i>
<i>Hans van Loon</i>	
<i>Secretary-General, Hague Conference on Private International Law....</i>	<i>19</i>
<i>Herbert Kronke</i>	
<i>Secretary-General, International Institute for the Unification of Private Law .....</i>	<i>22</i>
<i>Khalil Hamdani</i>	
<i>Director, Division on Investment, Technology and Enterprise Development, United Nations Conference on Trade and Development.....</i>	<i>25</i>
<i>Vijay S. Tata</i>	
<i>Chief Counsel, Finance, Private Sector and Infrastructure, Legal Vice Presidency, World Bank.....</i>	<i>27</i>
<b>3. Allocation of work among formulating agencies .....</b>	<b>29</b>
<i>Chair: Jeffrey Chan Wah-Teck</i>	
<i>Principal Senior State Counsel, Head, Civil Division, Attorney-General's Chambers, Singapore .....</i>	<i>29</i>

	<i>Page</i>
<b>4. Coordination of domestic positions in international forums .....</b>	<b>35</b>
<i>Kathryn Sabo</i>	
<i>General Counsel, Department of Justice, Canada.....</i>	<i>35</i>
<b>5. Comments, evaluation and discussion .....</b>	<b>38</b>
<i>Majeed H. al-Anbaki</i>	
<i>Permanent Mission of Iraq to the United Nations (Geneva).....</i>	<i>38</i>
<b>B. Harmonization of commercial law: practical importance and economic value .....</b>	<b>38</b>
<i>Chair: Kazuaki Sono</i>	
<i>Hokkaido University, Japan; and Secretary of the United Nations Commission on International Trade Law, 1980-1985 .....</i>	<i>38</i>
<b>1. Transaction costs, choice of law and uniform contract law .....</b>	<b>39</b>
<i>Gerhard Wagner</i>	
<i>University of Bonn, Germany.....</i>	<i>39</i>
<i>Kazuaki Sono, Chair .....</i>	<i>45</i>
<b>2. Economic arguments in the harmonization debate: the practical importance of harmonization of commercial contract law .....</b>	<b>46</b>
<i>Jan Smits</i>	
<i>University of Maastricht, Netherlands.....</i>	<i>46</i>
<i>Kazuaki Sono, Chair .....</i>	<i>52</i>
<b>3. Costs of legal uncertainty: is harmonization of law a good solution? .....</b>	<b>53</b>
<i>Helmut Wagner</i>	
<i>University of Hagen, Germany; and Visiting Professor, Princeton University, United States of America .....</i>	<i>53</i>
<b>4. Comments, evaluation and discussion .....</b>	<b>61</b>
<i>Seward M. Cooper</i>	
<i>Chief Counsel, Good Governance, Office of the General Counsel, African Development Bank .....</i>	<i>61</i>
<i>Paul Marca Paco</i>	
<i>Permanent Mission of Bolivia to the United Nations (Vienna).....</i>	<i>61</i>
<i>Gerhard Wagner</i>	
<i>University of Bonn, Germany.....</i>	<i>61</i>
<i>Michael Joachim Bonell</i>	
<i>University of Rome I “La Sapienza”, Italy.....</i>	<i>62</i>
<i>Kazuaki Sono, Chair .....</i>	<i>62</i>

	<i>Page</i>
<i>Jorge Sánchez Cordero</i> <i>Director, Mexican Center of Uniform Law, Mexico</i> .....	62
<i>Herbert Kronke</i> <i>Secretary-General, International Institute for the Unification of</i> <i>Private Law</i> .....	63
<i>Eric Loquin</i> <i>Director, Centre for Research on Procurement Law and International</i> <i>Investments (CREDIMI), University of Bourgogne, France</i> .....	63
<i>Beate Czerwenka</i> <i>Federal Ministry of Justice, Germany</i> .....	64
<i>Jan Smits</i> <i>University of Maastricht, Netherlands</i> .....	64
<i>Gerhard Wagner</i> <i>University of Bonn, Germany</i> .....	64
<i>Arie Reich</i> <i>Vice Dean, Bar Ilan University, Israel</i> .....	64
<i>Gerhard Wagner</i> <i>University of Bonn, Germany</i> .....	65
<i>Didier Operti Badán</i> <i>Secretary General, Latin American Integration Association</i> .....	65
<b>C. Commercial law development and technical legal assistance: goals and stakeholders</b> .....	66
<i>Chair: William T. Loris</i> <i>Director General, International Development Law Organization</i> .....	66
<b>1. Multilateral organizations and legal technical assistance: learning from experience</b> .....	66
<i>Gerard Sanders</i> <i>Deputy General Counsel, European Bank for Reconstruction</i> <i>and Development</i> .....	66
<i>William T. Loris, Chair</i> .....	74
<b>2. Commercial law harmonization and bilateral assistance</b> .....	74
<i>Charles A. Schwartz</i> <i>Senior Commercial Law Reform Adviser, United States Agency</i> <i>for International Development</i> .....	74
<i>William T. Loris, Chair</i> .....	79
<i>Charles A. Schwartz</i> <i>Senior Commercial Law Reform Adviser, United States Agency</i> <i>for International Development</i> .....	79
<i>William T. Loris, Chair</i> .....	79

	<i>Page</i>
<b>3. Managing complexity: experience of the International Trade Centre UNCTAD/WTO in trade law technical assistance .....</b>	<b>80</b>
<i>Jean-François Bourque</i> <i>Senior Legal Adviser, International Trade Centre</i> <i>UNCTAD/WTO.....</i>	   80
<i>William T. Loris, Chair .....</i>	86
<b>4. Training needs for judges and arbitrators .....</b>	<b>86</b>
<i>Judge Rosa María Maggi Ducommun</i> <i>Court of Appeals, Chile.....</i>	  86
<i>William T. Loris, Chair .....</i>	91
<b>5. Legal harmonization in practice: teaching and learning uniform commercial law .....</b>	<b>91</b>
<i>Chiara Giovannucci Orlandi</i> <i>University of Bologna, Italy.....</i>	  91
<i>William T. Loris, Chair .....</i>	95
<b>6. Comments, evaluation and discussion .....</b>	<b>95</b>
<i>William T. Loris, Chair .....</i>	95
<i>Charles A. Schwartz</i> <i>Senior Commercial Law Reform Adviser, United States Agency</i> <i>for International Development.....</i>	   95
<i>William T. Loris, Chair .....</i>	95
<i>Jean-François Bourque</i> <i>Senior Legal Adviser, International Trade Centre UNCTAD/WTO .....</i>	  96
<i>Zafar Iqbal Gondal</i> <i>International Development Law Organization, Afghanistan.....</i>	  96
<i>Gerard Sanders</i> <i>Deputy General Counsel, European Bank for Reconstruction and</i> <i>Development.....</i>	   96
<i>Innocent Fetze Kamdem</i> <i>University of Ottawa, Canada .....</i>	  97
<i>Ibrahim Hassan al Mulla al Mansouri</i> <i>Emirates International Law Centre, United Arab Emirates .....</i>	  97
<b>III. Secured transactions, company and insolvency law .....</b>	<b>99</b>
<b>A. Economic and social development through enhanced access to credit .....</b>	<b>99</b>
<i>Chair: Cynthia Licul</i> <i>Acting General Counsel, International Fund for Agricultural</i> <i>Development .....</i>	   99

	<i>Page</i>
<b>1. Legal mechanisms to empower informal businesses .....</b>	<b>100</b>
<i>Muhammad Medhat Hassanein</i>	
<i>American University, Egypt .....</i>	<i>100</i>
<b>2. Comments, evaluation and discussion .....</b>	<b>109</b>
<i>Zafar Iqbal Gondal</i>	
<i>International Development Law Organization, Afghanistan .....</i>	<i>109</i>
<i>Muhammad Medhat Hassanein</i>	
<i>American University, Egypt .....</i>	<i>109</i>
<i>Majeed H. al-Anbaki</i>	
<i>Permanent Mission of Iraq to the United Nations (Geneva).....</i>	<i>110</i>
<i>Muhammad Medhat Hassanein</i>	
<i>American University, Egypt .....</i>	<i>110</i>
<i>Said Ihrari</i>	
<i>Rector, University of Rabat, Morocco.....</i>	<i>110</i>
<i>Muhammad Medhat Hassanein</i>	
<i>American University, Egypt .....</i>	<i>110</i>
<i>Cynthia Licul, Chair .....</i>	<i>111</i>
<b>3. The role of secured transactions in mobilizing credit and the need for modernizing the law .....</b>	<b>111</b>
<i>Madhukar R. Umarji</i>	
<i>Chief Adviser, Legal, Indian Banks' Association.....</i>	<i>111</i>
<i>Cynthia Licul, Chair .....</i>	<i>116</i>
<b>4. The role of multilateral financing agencies in promoting modern standards for secured transactions .....</b>	<b>117</b>
<i>Vijay S. Tata</i>	
<i>Chief Counsel, Private Sector Development, Finance and Infrastructure, Legal Vice Presidency, World Bank.....</i>	<i>117</i>
<b>5. Promoting the implementation of the United Nations Convention on the Assignment of Receivables in International Trade and the United Nations Commission on International Trade Law Legislative Guide on Secured Transactions.....</b>	<b>120</b>
<i>Richard M. Kohn</i>	
<i>Commercial Finance Association, United States of America .....</i>	<i>120</i>
<b>6. Legal mechanisms to empower informal businesses: banking-related aspects of the UNCITRAL Legislative Guide on Secured Transactions.....</b>	<b>124</b>
<i>Georges Affaki</i>	
<i>Vice-Chair, International Chamber of Commerce, Banking Commission; Head of Legal, Energy, Commodities, Export and Projects, BNP Paribas; and Adjunct Professor of Law, University of Paris II, France .....</i>	<i>124</i>

	<i>Page</i>
<b>7. Comments, evaluation and discussion .....</b>	<b>134</b>
<i>Yuejiao Zhang</i>	
<i>Shantou University, China .....</i>	<i>134</i>
<i>Madhukar R. Umarji</i>	
<i>Chief Adviser, Legal, Indian Banks' Association.....</i>	<i>135</i>
<i>Vijay S. Tata</i>	
<i>Chief Counsel, Private Sector Development, Finance and</i>	
<i>Infrastructure, Legal Vice-Presidency, World Bank .....</i>	<i>135</i>
<b>B. New horizons for secured transactions .....</b>	<b>135</b>
<i>Chair: Kathryn Sabo</i>	
<i>General Counsel, Department of Justice, Canada.....</i>	<i>135</i>
<b>1. Practical problems of integrating various international</b>	
<b>standards of secured transactions .....</b>	<b>136</b>
<i>Neil Cohen</i>	
<i>Brooklyn Law School, United States of America .....</i>	<i>136</i>
<b>2. Security interests in intellectual property rights .....</b>	<b>140</b>
<i>Oscar Alcantara</i>	
<i>Goldberg Kohn, United States of America.....</i>	<i>140</i>
<b>3. Open issues in the field of secured transactions.....</b>	<b>143</b>
<i>Ulrich Drobnig</i>	
<i>Max Planck Institute for Comparative and International Private</i>	
<i>Law, Germany .....</i>	<i>143</i>
<i>Kathryn Sabo, Chair .....</i>	<i>144</i>
<b>4. Comments, evaluation and discussion .....</b>	<b>144</b>
<i>Neil Cohen</i>	
<i>Brooklyn Law School, United States of America .....</i>	<i>144</i>
<i>Oscar Alcantara</i>	
<i>Goldberg Kohn, United States of America.....</i>	<i>145</i>
<i>Don Wallace, Jr.</i>	
<i>Chairman, International Law Institute, United States of America .....</i>	<i>145</i>
<i>Ulrich Drobnig</i>	
<i>Max Planck Institute for Comparative and International Private</i>	
<i>Law, Germany .....</i>	<i>145</i>
<i>Aboubacar Fall</i>	
<i>Executive Secretary, African Law Institute .....</i>	<i>146</i>
<i>Kathryn Sabo, Chair .....</i>	<i>146</i>

	<i>Page</i>
<i>Madhukar R. Umarji</i> <i>Chief Adviser, Legal, Indian Banks' Association.....</i>	146
<i>Ulrich Drobnig</i> <i>Max Planck Institute for Comparative and International Private</i> <i>Law, Germany.....</i>	147
<i>Kwang-Hyeon Seo</i> <i>Ministry of Foreign Affairs and Trade, Republic of Korea.....</i>	147
<i>Oscar Alcantara</i> <i>Goldberg Kohn, United States of America.....</i>	147
<i>Yuejiao Zhang</i> <i>Shantou University, China.....</i>	147
<i>Oscar Alcantara</i> <i>Goldberg Kohn, United States of America.....</i>	148
<i>Charles A. Schwartz</i> <i>Senior Commercial Law Reform Adviser, United States Agency</i> <i>for International Development.....</i>	148
<i>Mary Hiscock</i> <i>Bond University, Australia.....</i>	148
<i>Andrej Dolinšek</i> <i>Ministry of Finance, Slovenia.....</i>	149
<i>Oscar Alcantara</i> <i>Goldberg Kohn, United States of America.....</i>	149
<i>Paul Marca Paco</i> <i>Permanent Mission of Bolivia to the United Nations (Vienna).....</i>	149
<i>Oscar Alcantara</i> <i>Goldberg Kohn, United States of America.....</i>	150
<i>Majeed H. al-Anbaki</i> <i>Permanent Mission of Iraq to the United Nations (Geneva).....</i>	150
<i>Oscar Alcantara</i> <i>Goldberg Kohn, United States of America.....</i>	150
<b>C. Legal issues on corporate governance.....</b>	<b>151</b>
<i>Chair: Eric Bergsten</i> <i>Pace University School of Law, United States of America; and Secretary</i> <i>of the United Nations Commission on International Trade Law, 1985-1991 .</i>	151
<b>1. Corporate governance in developing countries: shortcomings,</b> <b>challenges and impact on access to credit.....</b>	<b>152</b>
<i>Seward M. Cooper</i> <i>Chief Counsel, Good Governance, Office of the General Counsel,</i> <i>African Development Bank.....</i>	152
<i>Eric Bergsten, Chair.....</i>	159

	<i>Page</i>
<b>2. Responsible investing in weak governance zones.....</b>	<b>159</b>
<i>Kathryn Gordon</i>	
<i>Senior Economist, Investment Division, Organization for Economic</i>	
<i>Cooperation and Development .....</i>	<i>159</i>
<i>Eric Bergsten, Chair .....</i>	<i>163</i>
<b>3. Company restructuring and accountability .....</b>	<b>163</b>
<i>Peter Doralt</i>	
<i>Chairman, Takeover Commission, Austria.....</i>	<i>163</i>
<b>4. Comments, evaluation and discussion .....</b>	<b>168</b>
<i>Andrés Ortiz</i>	
<i>University of Guayaquil, Ecuador .....</i>	<i>168</i>
<i>Seward M. Cooper</i>	
<i>Chief Counsel, Good Governance, Office of the General Counsel,</i>	
<i>African Development Bank .....</i>	<i>168</i>
<i>Kathryn Gordon</i>	
<i>Senior Economist, Investment Division, Organization for Economic</i>	
<i>Cooperation and Development .....</i>	<i>168</i>
<i>Peter Doralt</i>	
<i>Takeover Commission, Austria.....</i>	<i>169</i>
<i>Philip Newman</i>	
<i>Chambers of Philip Newman, London, United Kingdom of Great</i>	
<i>Britain and Northern Ireland.....</i>	<i>170</i>
<i>Seward M. Cooper</i>	
<i>Chief Counsel, Good Governance, Office of the General Counsel,</i>	
<i>African Development Bank .....</i>	<i>170</i>
<i>Kathryn Gordon</i>	
<i>Senior Economist, Investment Division, Organization for Economic</i>	
<i>Cooperation and Development .....</i>	<i>170</i>
<b>D. Round table: Developing effective and efficient insolvency regimes .....</b>	<b>171</b>
<i>Chair: Wisit Wisitsora-At</i>	
<i>Director-General, Office of Justice Affairs, Ministry of Justice, Thailand ..</i>	<i>171</i>
<b>1. Discussion of a hypothetical reorganization of a cross-border</b>	
<b>corporate conglomerate that includes insurance and financial</b>	
<b>institutions whose restructuring will involve secured</b>	
<b>transactions and conflicts of laws issues: how are these issues</b>	
<b>currently treated; what major problems exist; and what further</b>	
<b>work on harmonization would assist in achieving effective and</b>	
<b>efficient insolvency regimes?.....</b>	<b>172</b>
<i>Sumant Batra</i>	
<i>Kesar Dass B and Associates, India .....</i>	<i>172</i>

	<i>Page</i>
<i>Neil Cooper</i>	
<i>Kroll, United Kingdom of Great Britain and Northern Ireland</i> .....	172
<i>Eva Hüpkens</i>	
<i>Swiss Federal Banking Commission, Switzerland</i> .....	172
<i>Irit Mevorach</i>	
<i>Lecturer, School of Law, University of Nottingham, United Kingdom</i> <i>of Great Britain and Northern Ireland</i> .....	172
<b>2. Comments, evaluation and discussion</b> .....	<b>185</b>
<i>Christopher Redmond</i>	
<i>American Bar Association, United States of America</i> .....	185
<i>Neil Cooper</i>	
<i>Kroll, United Kingdom of Great Britain and Northern Ireland</i> .....	185
<i>Majeed H. al-Anbaki</i>	
<i>Permanent Mission of Iraq to the United Nations (Geneva)</i> .....	186
<i>Wisit Wisitsora-At, Chair</i> .....	186
<i>Sumant Batra</i>	
<i>Kesar Dass B and Associates, India</i> .....	186
<i>Neil Cooper</i>	
<i>Kroll, United Kingdom of Great Britain and Northern Ireland</i> .....	186
<i>Wisit Wisitsora-At, Chair</i> .....	187
<i>Yuejiao Zhang</i>	
<i>Shantou University, China</i> .....	187
<i>Majeed H. al-Anbaki</i>	
<i>Permanent Mission of Iraq to the United Nations (Geneva)</i> .....	187
<i>Neil Cooper</i>	
<i>Kroll, United Kingdom of Great Britain and Northern Ireland</i> .....	187
<i>Wisit Wisitsora-At, Chair</i> .....	188
<b>IV. Sale of goods, transport law and electronic commerce</b> .....	<b>189</b>
<b>A. The future of contract law harmonization</b> .....	<b>189</b>
<i>Chair: Ole Lando</i>	
<i>Copenhagen Business School, Denmark</i> .....	189
<b>1. The European Contract Law Project</b> .....	<b>189</b>
<i>Diana Wallis</i>	
<i>European Parliament, Member for the United Kingdom of Great</i> <i>Britain and Northern Ireland</i> .....	189
<i>Ole Lando, Chair</i> .....	192
<i>Diana Wallis</i>	
<i>European Parliament, Member for the United Kingdom of Great</i> <i>Britain and Northern Ireland</i> .....	192

	<i>Page</i>
<b>2. Contract law at the national, regional and global levels .....</b>	<b>193</b>
<i>Jean-Paul Béraudo</i>	
<i>Honorary Counsel, Court of Cassation, France; Vice-President, International Court of Arbitration, International Chamber of Commerce; and Associate Professor, University of Paris I (Panthéon-Sorbonne, France).....</i>	
	193
<i>Ole Lando, Chair .....</i>	203
<b>3. Global and regional harmonization: the Russian perspective.....</b>	<b>203</b>
<i>Sergei N. Lebedev</i>	
<i>Chairman, Maritime Arbitration Commission, Russian Chamber of Commerce and Industry; and Professor, Moscow State Institute of International Relations, Russian Federation .....</i>	
	203
<i>Ole Lando, Chair .....</i>	205
<b>4. Global and regional harmonization: the Chinese perspective.....</b>	<b>206</b>
<i>Yuejiao Zhang</i>	
<i>Shantou University, China .....</i>	
	206
<b>5. Comments, evaluation and discussion .....</b>	<b>219</b>
<i>Jorge Sánchez Cordero</i>	
<i>Director, Mexican Center of Uniform Law, Mexico.....</i>	
	219
<i>Jean-Paul Béraudo</i>	
<i>Honorary Counsel, Court of Cassation, France; Vice-President, the International Court of Arbitration, International Chamber of Commerce; and Associate Professor, University of Paris I (Panthéon-Sorbonne), France .....</i>	
	219
<i>Diana Wallis</i>	
<i>European Parliament, Member for the United Kingdom of Great Britain and Northern Ireland.....</i>	
	219
<i>Didier Operti Badán</i>	
<i>Secretary General, Latin American Integration Association.....</i>	
	220
<i>Diana Wallis</i>	
<i>European Parliament, Member for the United Kingdom of Great Britain and Northern Ireland.....</i>	
	221
<i>Eckart J. Brödermann</i>	
<i>Brödermann &amp; Jahn, Germany.....</i>	
	221
<i>Patrice Lyons</i>	
<i>Law Offices of Patrice Lyons, United States of America.....</i>	
	221
<i>Diana Wallis</i>	
<i>European Parliament, Member for the United Kingdom of Great Britain and Northern Ireland.....</i>	
	222

	<i>Page</i>
<i>Dmitry Davydenko</i> <i>Director, Institute of Private International and Comparative Law,</i> <i>Russian Federation .....</i>	222
<i>Sergei N. Lebedev</i> <i>Chairman, Maritime Arbitration Commission, Russian Chamber of</i> <i>Commerce and Industry; and Professor, Moscow State Institute of</i> <i>International Relations, Russian Federation .....</i>	222
<b>B. Uniform contract law in practice.....</b>	<b>223</b>
<i>Chair: Manuel Olivencia Ruiz</i> <i>University of Seville, Spain.....</i>	223
<b>1. Choice of law, contract terms and uniform law in practice.....</b>	<b>224</b>
<i>Henry D. Gabriel</i> <i>De Van Daggett Professor of Law, Loyola University Law School,</i> <i>United States of America.....</i>	224
<i>Manuel Olivencia Ruiz, Chair .....</i>	229
<b>2. Towards a legislative codification of the Unidroit Principles?.....</b>	<b>230</b>
<i>Michael Joachim Bonell</i> <i>Professor of Law, University of Rome I “La Sapienza”; Italy; and</i> <i>Chairman of the Working Group for the Preparation of the Unidroit</i> <i>Principles of International Commercial Contracts.....</i>	230
<i>Manuel Olivencia Ruiz, Chair .....</i>	239
<b>3. Contract law harmonization and third countries: the case of the</b> <b>United Nations Sales Convention .....</b>	<b>239</b>
<i>Hiroo Sono</i> <i>Counsellor, Civil Affairs Bureau, Ministry of Justice, Japan; and</i> <i>Visiting Professor of Law, Hokkaido University, Japan.....</i>	239
<b>4. The practice of excluding the United Nations Sales Convention:</b> <b>time for change?.....</b>	<b>245</b>
<i>Eckart J. Brödermann</i> <i>Brödermann &amp; Jahn, Germany.....</i>	245
<b>5. Changing the opt-out tradition in the United States .....</b>	<b>249</b>
<i>Harry Flechtner</i> <i>University of Pittsburgh School of Law, United States of America.....</i>	249
<b>6. Comments, evaluation and discussion .....</b>	<b>252</b>
<i>Aboubacar Fall</i> <i>Executive Secretary, African Law Institute .....</i>	252

	<i>Page</i>
<i>Henry D. Gabriel</i> <i>De Van Daggett Professor of Law, Loyola University Law School,</i> <i>United States of America.....</i>	253
<i>Jernej Sekolec</i> <i>Secretary of UNCITRAL .....</i>	253
<i>Michael Joachim Bonell</i> <i>University of Rome I “La Sapienza”, Italy.....</i>	254
<i>Harold S. Burman</i> <i>Department of State, United States of America .....</i>	254
<i>Jean-Michel Jacquet</i> <i>Institut de hautes études internationales, Switzerland.....</i>	255
<i>Michael Joachim Bonell</i> <i>University of Rome I “La Sapienza”, Italy.....</i>	255
<i>Eric Loquin</i> <i>Director, Centre for Research on Procurement Law and International</i> <i>Investments (CREDIMI), University of Bourgogne, France .....</i>	255
<i>Eckart J. Brödermann</i> <i>Brödermann &amp; Jahn, Germany.....</i>	256
<b>C. Carriage of goods in the twenty-first century.....</b>	<b>256</b>
<i>Chair: Rafael Illescas</i> <i>University Carlos III, Spain.....</i>	256
<b>1. Freight forwarder law .....</b>	<b>257</b>
<i>Jan Ramberg</i> <i>University of Stockholm, Sweden.....</i>	257
<b>2. Sea carriage goes ashore: relationship between multimodal</b> <b>conventions and domestic unimodal rules .....</b>	<b>267</b>
<i>Michael F. Sturley</i> <i>University of Texas at Austin, United States of America.....</i>	267
<b>3. Transfer of rights and transport documents.....</b>	<b>270</b>
<i>Alexander von Ziegler</i> <i>Schellenberg Wittmer, Switzerland.....</i>	270
<b>4. Comments, evaluation and discussion .....</b>	<b>275</b>
<i>Patrice Lyons</i> <i>Law Offices of Patrice Lyons, United States of America.....</i>	275
<i>Alexander von Ziegler</i> <i>Schellenberg Wittmer, Switzerland.....</i>	276
<i>Michael F. Sturley</i> <i>University of Texas at Austin, United States of America.....</i>	276

	<i>Page</i>
<i>Ibrahim Hassan al-Mulla al-Mansouri</i> <i>Emirates International Law Centre, United Arab Emirates .....</i>	277
<i>Alexander von Ziegler</i> <i>Schellenberg Wittmer, Switzerland.....</i>	277
<i>Michael F. Sturley</i> <i>University of Texas at Austin, United States of America.....</i>	278
<i>Rafael Illescas, Chair.....</i>	278
<i>Innocent Fetze Kamdem</i> <i>University of Ottawa, Canada .....</i>	279
<i>Jan Ramberg</i> <i>University of Stockholm, Sweden .....</i>	279
<i>Alexander von Ziegler</i> <i>Schellenberg Wittmer, Switzerland.....</i>	279
<i>Michael F. Sturley</i> <i>University of Texas at Austin, United States of America.....</i>	280
<i>Emmanuel Kofi Mbiah</i> <i>Chief Executive Officer, Ghana Shippers Council .....</i>	281
<i>Michael F. Sturley</i> <i>University of Texas at Austin, United States of America.....</i>	281
<i>Zafar Iqbal Gondal</i> <i>International Development Law Organization, Afghanistan .....</i>	282
<i>Rafael Illescas, Chair.....</i>	282
<i>Zafar Iqbal Gondal</i> <i>International Development Law Organization, Afghanistan .....</i>	283
<i>Michael F. Sturley</i> <i>University of Texas at Austin, United States of America.....</i>	283
<i>Lauri Railas</i> <i>Krogerus Attorneys Ltd., Finland.....</i>	283
<i>Alexander von Ziegler</i> <i>Schellenberg Wittmer, Switzerland.....</i>	284
<i>Didier Opertti Badán</i> <i>Secretary General, Latin American Integration Association .....</i>	284
<i>Jan Ramberg</i> <i>University of Stockholm, Sweden .....</i>	285
<i>Michael F. Sturley</i> <i>University of Texas at Austin, United States of America.....</i>	285
<b>D. Electronic commerce: going beyond functional equivalence .....</b>	<b>286</b>
<i>Chair: Jeffrey Chan Wah-Teck</i> <i>Principal Senior State Counsel, Head, Civil Division, Attorney-General's</i> <i>Chambers, Singapore.....</i>	286

	<i>Page</i>
<i>José Angelo Estrella Faria</i> <i>United Nations Commission on International Trade Law</i> .....	286
<i>Jeffrey Chan Wah-Teck, Chair</i> .....	286
<b>1. Cybercrime and commercial fraud: a Nigerian perspective</b> .....	287
<i>Mal Nuhu Ribadu</i> <i>Executive Chairman, Economic and Financial Crimes Commission,</i> <i>Nigeria</i> .....	287
<i>Presented by MKG Ibrahim</i> <i>Head, Information and Communication Technology, Economic and</i> <i>Financial Crimes Commission, Nigeria</i> .....	287
<i>Jeffrey Chan Wah-Teck, Chair</i> .....	291
<b>2. Developing single windows for foreign trade</b> .....	291
<i>Bart W. Schermer</i> <i>Chair a.i., United Nations Centre for Trade Facilitation and Electronic</i> <i>Business Legal Group</i> .....	291
<i>Jeffrey Chan Wah-Teck, Chair</i> .....	300
<b>3. Becoming operational: electronic registries and transfer of rights</b> .....	301
<i>Amelia H. Boss</i> <i>Temple University School of Law, United States of America; and</i> <i>Director, Institute for International Law and Public Policy,</i> <i>United States of America</i> .....	301
<b>4. Comments, evaluation and discussion</b> .....	308
<i>Patrice Lyons</i> <i>Law Offices of Patrice Lyons, United States of America</i> .....	308
<i>Amelia H. Boss</i> <i>Temple University School of Law, United States of America; and</i> <i>Director, Institute for International Law and Public Policy,</i> <i>United States of America</i> .....	308
<i>Patrice Lyons</i> <i>Law Offices of Patrice Lyons, United States of America</i> .....	309
<i>José Angelo Estrella Faria</i> <i>United Nations Commission on International Trade Law</i> .....	309
<i>Amelia H. Boss</i> <i>Temple University School of Law, United States of America; and</i> <i>Director, Institute for International Law and Public Policy,</i> <i>United States of America</i> .....	310

	<i>Page</i>
<i>Ibrahim Hassan al-Mulla al-Mansouri</i> <i>Emirates International Law Centre, United Arab Emirates</i> .....	310
<i>Bart W. Schermer</i> <i>Chair a.i., United Nations Centre for Trade Facilitation and</i> <i>Electronic Business Legal Group</i> .....	310
<i>Jeffrey Chan Wah-Teck, Chair</i> .....	311
<i>Amelia H. Boss</i> <i>Temple University School of Law, United States of America; and</i> <i>Director, Institute for International Law and Public Policy,</i> <i>United States of America</i> .....	311
<i>Lauri Railas</i> <i>Krogerus Attorneys, Ltd., Finland</i> .....	311
<i>Agustín Madrid Parra</i> <i>University of Seville, Spain</i> .....	312
<i>Seward M. Cooper</i> <i>Chief Counsel, Good Governance, Office of the General Counsel,</i> <i>African Development Bank</i> .....	312
<i>Madhukar R. Umarji</i> <i>Chief Adviser, Legal, Indian Banks' Association</i> .....	312
<i>M.K.G Ibrahim</i> <i>Head, Information and Communication Technology, Economic and</i> <i>Financial Crimes Commission, Nigeria</i> .....	312
<i>Bart W. Schermer</i> <i>Chair a.i., United Nations Centre for Trade Facilitation and</i> <i>Electronic Business Legal Group</i> .....	313
<i>Amelia H. Boss</i> <i>Temple University School of Law, United States of America; and</i> <i>Director, Institute for International Law and Public Policy,</i> <i>United States of America</i> .....	313
<b>V. Government contracts and dispute settlement</b> .....	315
<b>A. New procurement techniques and current issues on government</b> <b>procurement</b> .....	315
<i>Chair: Tore Wiwen-Nilsson</i> <i>Partner, Mannheimer Swartling Advokatbyrå, Sweden</i> .....	315
<b>1. Modern public procurement techniques: benefits, concerns and</b> <b>regulation (with emphasis on theoretical issues)</b> .....	315
<i>Steven L. Schooner</i> <i>George Washington University School of Law, United States of</i> <i>America</i> .....	315
<i>Tore Wiwen-Nilsson, Chair</i> .....	319

	<i>Page</i>
<b>2. Modern public procurement techniques: benefits, concerns and regulation (with emphasis on practical issues).....</b>	320
<i>Knut Leipold</i>	
<i>Senior Procurement Specialist, Procurement Policy and Services Group, World Bank.....</i>	320
<i>Tore Wiwen-Nilsson, Chair .....</i>	326
<b>3. Achieving socio-economic goals through public procurement: what is at stake? .....</b>	326
<i>Robert Hunja</i>	
<i>Interim Director-General, Public Procurement Oversight Authority, Kenya .....</i>	326
<i>Tore Wiwen-Nilsson, Chair .....</i>	330
<b>4. Comments, evaluation and discussion .....</b>	331
<i>Steven L. Schooner</i>	
<i>George Washington University School of Law, United States of America .....</i>	331
<i>Michael E. Schneider</i>	
<i>Lalive Avocats, Switzerland .....</i>	332
<i>Don Wallace, Jr.</i>	
<i>Chairman, International Law Institute, United States of America .....</i>	332
<i>Yuejiao Zhang</i>	
<i>Shantou University, China .....</i>	333
<i>Arie Reich</i>	
<i>Vice-Dean, Bar Ilan University, Israel.....</i>	334
<i>Tore Wiwen-Nilsson, Chair .....</i>	334
<i>Knut Leipold</i>	
<i>Senior Procurement Specialist, Procurement Policy and Services Group, World Bank.....</i>	334
<i>Steven L. Schooner</i>	
<i>George Washington University School of Law, United States of America.....</i>	336
<i>Tore Wiwen-Nilsson, Chair .....</i>	337
<i>Robert Hunja</i>	
<i>Interim Director-General, Public Procurement Oversight Authority, Kenya .....</i>	337
<b>B. Long-term government contracts and private investment .....</b>	338
<i>Chair: Gerold Herrmann</i>	
<i>Secretary of UNCITRAL, 1991-2001 .....</i>	338

	<i>Page</i>
<b>1. Key issues on creating a legal framework for infrastructure concessions.....</b>	<b>338</b>
<i>Alexei Zverev</i>	
<i>Senior Counsel, European Bank for Reconstruction and Development.....</i>	<i>338</i>
<i>Gerold Herrmann, Chair .....</i>	<i>345</i>
<b>2. The impact of public procurement and rules of government contracting on public spending and attracting private infrastructure investment.....</b>	<b>345</b>
<i>Hector A. Mairal</i>	
<i>Partner, Marval, O'Farrell &amp; Mairal, Argentina.....</i>	<i>345</i>
<i>Gerold Herrmann, Chair .....</i>	<i>351</i>
<b>3. Public procurement, long-term government contracts and dispute settlement: the need for national systems to prevent and resolve disputes between regulators and private operators of infrastructure and providers of public services.....</b>	<b>351</b>
<i>Don Wallace, Jr.</i>	
<i>Chairman, International Law Institute, United States of America .....</i>	<i>351</i>
<b>4. Comments, evaluation and discussion .....</b>	<b>358</b>
<i>Anthony Colman</i>	
<i>Royal Courts of Justice, United Kingdom of Great Britain and Northern Ireland .....</i>	<i>358</i>
<i>Alexei Zverev</i>	
<i>Senior Counsel, European Bank for Reconstruction and Development.....</i>	<i>359</i>
<i>Dmitry Davydenko</i>	
<i>Director, Institute of Private International and Comparative Law, Russian Federation .....</i>	<i>359</i>
<i>Don Wallace, Jr.</i>	
<i>Chairman, International Law Institute, United States of America .....</i>	<i>360</i>
<i>Chair: Jeffrey Chan Wah-Teck</i>	
<i>Principal Senior State Counsel, Head, Civil Division, Attorney-General's Chambers, Singapore .....</i>	<i>360</i>
<i>Yuejiao Zhang</i>	
<i>Shantou University, China .....</i>	<i>361</i>
<i>Jernej Sekolec</i>	
<i>Secretary of UNCITRAL .....</i>	<i>362</i>
<i>Don Wallace, Jr.</i>	
<i>Chairman, International Law Institute, United States of America .....</i>	<i>362</i>

	<i>Page</i>
<b>C. Steps to ensure a stable framework for the settlement of commercial disputes</b> .....	363
<i>Chair: Michael E. Schneider</i>	
<i>Lalive Avocats, Switzerland</i> .....	363
<b>1. How to promote a uniform interpretation of public policy</b> .....	364
<i>Cecil Abraham</i>	
<i>Managing Partner, Shearn Delamore &amp; Co., Malaysia</i> .....	364
<i>Michael E. Schneider, Chair</i> .....	370
<b>2. The question of appeals in international arbitration</b> .....	371
<i>Anthony Colman</i>	
<i>Royal Courts of Justice, United Kingdom of Great Britain and Northern Ireland</i> .....	371
<i>Michael E. Schneider, Chair</i> .....	380
<b>3. Does ad hoc arbitration require more support?</b> .....	380
<i>Jan Paulsson</i>	
<i>Freshfields Bruckhaus Deringer, France; and President, London Court of International Arbitration</i> .....	380
<i>(Presented by Georgios Petrochilos</i>	
<i>Freshfields Bruckhaus Deringer, France)</i> .....	380
<b>4. Comments, evaluation and discussion</b> .....	390
<i>Zack A. Clement</i>	
<i>Committee on International Insolvency Arbitration, International Insolvency Institute, United States of America</i> .....	390
<i>Ibrahim Hassan al-Mulla al-Mansouri</i>	
<i>Emirates International Law Centre, United Arab Emirates</i> .....	391
<i>Eric Loquin</i>	
<i>Director, Centre for Research on Procurement Law and International Investments (CREDIMI), University of Bourgogne, France</i> .....	391
<i>Majeed H. al-Anbaki</i>	
<i>Permanent Mission of Iraq to the United Nations (Geneva)</i> .....	391
<i>Cecil Abraham</i>	
<i>Managing Partner, Shearn Delamore &amp; Co., Malaysia</i> .....	392
<i>Anthony Colman</i>	
<i>Royal Courts of Justice, United Kingdom of Great Britain and Northern Ireland</i> .....	392
<i>Georgios Petrochilos</i>	
<i>Freshfields Bruckhaus Deringer, France</i> .....	392
<i>Mahmoud Ababneh</i>	
<i>Ministry of Industry and Trade, Jordan</i> .....	392

	<i>Page</i>
<i>Stephen Bouwhuis</i> <i>Attorney-General's Department, Australia</i> .....	392
<b>D. Commercial dispute settlement: issues for the future</b> .....	393
<i>Chair: Dobrosav Mitrović</i> <i>Chairman of the fortieth session of UNCITRAL</i> .....	393
<b>1. The possible role of arbitration in insolvency</b> .....	393
<i>Zack A. Clement</i> <i>Committee on International Insolvency Arbitration, International</i> <i>Insolvency Institute, United States of America</i> .....	393
<b>2. Reducing time and costs on international arbitration</b> .....	400
<i>José María Abascal Zamora</i> <i>Counsel and Arbitrator, Abascal &amp; Asociados, Mexico</i> .....	400
<b>3. Conciliation: enforcement of settlement agreements</b> .....	407
<i>Tore Wiwen-Nilsson</i> <i>Partner, Mannheimer Swartling Advokatbyrå, Sweden</i> .....	407
<b>4. Unresolved issues in investment arbitration</b> .....	416
<i>Yas Banifatemi</i> <i>Partner, Shearman &amp; Sterling, France</i> .....	416
<b>5. Comments, evaluation and discussion</b> .....	431
<i>Don Wallace, Jr.</i> <i>Chairman, International Law Institute, United States of America</i> .....	431
<i>Yas Banifatemi</i> <i>Partner, Shearman &amp; Sterling, France</i> .....	432
<i>Danny McFadden</i> <i>Director, Centre for Effective Dispute Resolution, United Kingdom</i> <i>of Great Britain and Northern Ireland</i> .....	433
<i>José María Abascal Zamora</i> <i>Counsel and Arbitrator, Abascal &amp; Asociados, Mexico</i> .....	433
<i>Tore Wiwen-Nilsson</i> <i>Partner, Mannheimer Swartling Advokatbyrå, Sweden</i> .....	433
<i>Omar M. H. Aljazy</i> <i>Managing Partner, Aljazy &amp; Co. Advocates, Jordan</i> .....	433
<i>Tore Wiwen-Nilsson</i> <i>Partner, Mannheimer Swartling Advokatbyrå, Sweden</i> .....	433
<i>Omar M. H. Aljazy</i> <i>Managing Partner, Aljazy &amp; Co. Advocates, Jordan</i> .....	434
<i>Horacio Bazoberry</i> <i>Permanent Representative of Bolivia to the United Nations (Vienna)</i> ...	434

	<i>Page</i>
<i>Yas Banifatemi</i>	
<i>Partner, Shearman &amp; Sterling, France</i> .....	434
<b>VI. Closing Remarks</b> .....	435
<i>Dobrosav Mitrović</i>	
<i>Chairman of the fortieth session of UNCITRAL</i> .....	435
<i>Jernej Sekolec</i>	
<i>Secretary of UNCITRAL</i> .....	436
<b>Annexes</b>	
<b>I. LegaCarta countries</b> .....	437
<b>II. Resolutions of disputes between the regulator and operators in the Nigerian telecommunications sector</b> .....	443

## Explanatory notes

AAA	American Arbitration Association
ADB	Asian Development Bank
ADR	alternative dispute resolution
ALADI	Latin American Integration Association
ASEAN	Association of Southeast Asian Nations
CAFTA	Central American Free Trade Agreement
CEELI	Central European and Eurasian Law Initiative
CIDIP	Inter-American Specialized Conference on Private International Law
CIETAC	China International Economic and Trade Arbitration Commission
CIS	Commonwealth of Independent States
CISG	United Nations Convention on Contracts for the International Sale of Goods (1980) (United Nations Sales Convention)
CLIR	commercial legal and institutional reform
CLOUT	case law on UNCITRAL texts
CMR	Convention on the Contract for the International Carriage of Goods by Road (1956)
CNRI	Corporation for National Research Initiatives
EBRD	European Bank for Reconstruction and Development
FIDIC	International Federation of Consulting Engineers
IBA	International Bar Association
ICC	International Chamber of Commerce
ICSID	International Centre for Settlement of Investment Disputes
IDLO	International Development Law Organization
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
Incoterms	International Commercial Terms
ITC	International Trade Centre UNCTAD/WTO
ITU	International Telecommunication Union
LCIA	London Court of International Arbitration

MERCOSUR	Common Market of the South
NAFTA	North American Free Trade Agreement
NEPAD	New Partnership for Africa's Development
OAS	Organization of American States
OECD	Organisation for Economic Co-operation and Development
OHADA	Organization for the Harmonization of Business Law in Africa
PCA	Permanent Court of Arbitration
PPP	public-private partnerships
SCC	Stockholm Chamber of Commerce
SFBC	Swiss Federal Banking Commission
UN/CEFACT	United Nations Centre for Trade Facilitation and Electronic Business
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
Unidroit	International Institute for the Unification of Private Law
USAID	United States Agency for International Development
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

## **I. Opening address and welcoming remarks**

*Nicolas Michel*

*Under-Secretary-General for Legal Affairs, Legal Counsel, United Nations*

I am delighted to welcome you to the Congress held on the occasion of the fortieth session of the United Nations Commission on International Trade Law (UNCITRAL). While the Congress has been designed as a conference to consider current legal issues of commercial law, it is also an occasion to evoke the significance of UNCITRAL in the United Nations system and point out some of the circumstances that have contributed to the success of UNCITRAL and that continue to be critical for its future.

During the early years of the United Nations, trade law was outside the centre of attention of the Organization, which in the legal field was largely concentrated on the codification and progressive development of public international law. However, it soon became clear that, if the United Nations wished to promote harmonious relations among nations, reduce poverty and foster the economic well-being of the peoples of the world, it was not enough for the Organization to limit itself to matters of peace and security, including the promotion of the rule of law among nations. The promotion of trade was also to be considered an indispensable element of international peace and stability. It was therefore necessary to give all countries of the world—and in particular developing countries—the legal tools to engage in productive international and domestic trade. For such trade to thrive, countries must have laws that allow modern contract practices and guarantee the rule of law and contract discipline in business transactions.

One of the first highly visible efforts of the United Nations in the area of trade law was the negotiation in 1958, on the initiative of the International Chamber of Commerce, of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards. That Convention has since become one of the most successful and influential legal texts in the history of commercial law. We will celebrate its fiftieth anniversary next year.

A few years later, by the early 1960s, United Nations Member States—including newly independent countries, many of which were developing countries—became more and more aware that the formulation of rules governing international trade must be a universal process that benefits from the various contributions of countries with different legal, social and economic systems. The outcome of that increasing awareness was the establishment of UNCITRAL. Since that time, UNCITRAL has become, as is repeatedly stated in resolutions of the General Assembly, “the core legal body within the United Nations system in the field of international trade law”.

The ongoing need and demand for the work of UNCITRAL continues to be at the root of its continued relevance. However, to put the successful achievements of UNCITRAL during the last four decades in the right perspective, I would like to point out that the need for its work would not, in itself, have been sufficient to ensure the growth of UNCITRAL

into a vigorous organization indispensable for the international community. In fact, other international organizations have also enjoyed widespread support at their beginning, but subsequently saw their support diminish and their mandates modified.

It is therefore appropriate, on this occasion, to try to identify factors that have contributed to the success of UNCITRAL. In my view, four of them have made a crucial difference. They deserve to be mentioned because they could not be taken for granted.

First, I want to underline the supportive attitude of Governments towards UNCITRAL during these four decades. They recognized that harmonization and unification of international trade law requires a high level of professional skills and involves arduous negotiations. It is to their credit that they have sent to the meetings of UNCITRAL experts of the highest professional calibre who have achieved practical and widely acceptable results.

Second, UNCITRAL has had the wisdom to welcome international non-governmental organizations with relevant experience and expertise and has benefited from their advice at each stage of the negotiations. As much as UNCITRAL is an intergovernmental entity, I think that at the core of the success of UNCITRAL has been the willingness of Governments to include practitioners, academics and future users of its texts in their negotiations. Thanks to that fortunate combination of governmental leadership and inclusiveness, the name of UNCITRAL has become a synonym for high professional quality in international legal work.

Third, it is striking to see the extent to which UNCITRAL documents attract attention beyond the governmental circles for which they were primarily intended. They are the subject of many conferences of practitioners, they are frequently cited in professional publications and academic works, and they inspire international transactional practice. Perhaps the most telling reflection of the influence of UNCITRAL texts has been the frequency with which academic and other educational institutions plan their curricula around the UNCITRAL agenda and its texts.

Fourth, UNCITRAL has never lost sight of the call of the General Assembly expressed in the 1966 founding resolution that “the Commission shall bear in mind the interests of all peoples, and particularly those of developing countries.” Putting this principle into practice has required wise judgement in deciding on the issues to be placed on the agenda of UNCITRAL and in negotiating the substance of the rules adopted. As a result, UNCITRAL enjoys a high reputation in all parts of the world.

I set out these characteristics of the work of UNCITRAL, not only to pay tribute to the Governments participating in the work of UNCITRAL, but also to invite them to continue to pay attention to representation in UNCITRAL. While I direct this appeal to all Governments, I would like to lay special emphasis on the need for a broad presence of developing countries in UNCITRAL. I have no doubt that they are aware of the importance of the Commission’s work. I hope that budgetary constraints, which are particularly serious in developing countries, will not prevent participation in the Commission’s work.

My remarks about the factors that have contributed to the success of the work of UNCITRAL would not be complete if I failed to mention the continued and unflinching

support of the host country. Since the UNCITRAL secretariat moved from New York to Vienna, in 1979, we have been pleased to have the Government of Austria, not only as a constant member of UNCITRAL, but also as an engaged supporter of its work.

Ladies and gentlemen, after paying homage to member States, delegates and observers who have contributed so much to the success of UNCITRAL, I would like to turn to the programme of this Congress. Its main purpose is to bring together governmental officials and a broad spectrum of practitioners, academics, judges and arbitrators and give them the opportunity to assess the current state of affairs in the field of the law of international trade and to consider ideas for the future. In the next few days, you will hear about open issues, unresolved problems and developing questions in international commercial law. Our wish is that after the four days of the Congress all of us will have a broader overview of pending issues, a better understanding of questions to be addressed and interesting suggestions for the future. We also hope that the considerations at the Congress will be useful inspiration for other rule-formulating bodies and bodies involved in providing technical assistance to law reform in various parts of the world.

The speakers' list is impressive in its diversity and expertise. It is very promising. I note also that time has been reserved for discussions and contributions from the floor. In order to preserve the content of the discussions for later reference and for the benefit of those who are not able to be present these days, we plan to publish the proceedings of the Congress.

With this, I would like to thank the speakers and participants, as well as the organizers. Enjoy the stimulation of the Congress. Enjoy meeting with colleagues and friends. Make the best out of your presence. And have a pleasant stay in Vienna.

*Thomas Stelzer*

*Permanent Representative of Austria to the United Nations (Vienna)*

Thank you very much for the opportunity to extend the greetings and the welcome of the host country to the participants in this Congress. As a representative of the host country, I am in a unique position here. We are interested, not only in the content of the work of the Vienna-based international organizations, but also in their smooth functioning. Therefore, I was pleased to hear the confirmation by the Under-Secretary-General of the unlimited support for UNCITRAL, which of course is a result of the value that UNCITRAL has been able to add to the international system—that is support born out of merit. We recognize that, and we also thank you for the kind words to the host country which are reassuring for us. Our support for UNCITRAL has to be strong; it will be strong. I remember when UNCITRAL moved to Vienna, more than 28 years ago, there were doubts as to whether Vienna could provide a conducive environment for UNCITRAL to flourish and grow and to do its work well. I do not think any of these doubts persist. Vienna has proved to be a good environment and UNCITRAL has been able to benefit from that in its work and live up to the expectations placed on it.

This is not an ordinary session, but one that is marked as a jubilee, which is a good time to look back and to look forward. In fact, that is the mandate of this Congress: to review the working methods and achievements of UNCITRAL, but at the same time to look forward and evaluate topics for future work programmes. That is a big mandate for this week. I hope that the participants will not be overly tempted by the many attractions

offered by Vienna. You will be taken to the city centre on the occasion of a reception during this week, but of course we are all here to work and to do what we can to further the mandate of UNCITRAL. So I wish you well in your work. I assure you of the continued support of Austria and I am very happy to be with you.

## **II. Process and value of uniform commercial law**

### **A. Process and methods of international rule-making**

*Chair: Dobrosav Mitrović*

*Chairman of the fortieth session of the United Nations Commission on International Trade Law*

The presence of such a large number of participants here today shows that this Congress, held within the framework of UNCITRAL activities, has found resonance among experts. The fortieth annual session of UNCITRAL has facilitated a review of the Commission's work in progress, and now the Congress will take place over the coming four days. During the Congress, as indicated in the programme, we will examine 15 different topics with 60 rapporteurs. This is important work, and we will begin with the topic "Process and methods of international rule-making". First, we have the pleasure of hearing an opening address by Mr. Didier Operti Badán, Secretary-General of the Latin American Integration Association.

#### *1. Keynote address*

*Ambassador Didier Operti Badán*

*Secretary-General, Latin American Integration Association\**

#### *Opening remarks*

In extending my thanks to UNCITRAL and, in particular, to its Secretary, Mr. Jernej Sekolec, for their invitation to participate in this Congress, I welcome you all and duly undertake the task of opening this gathering of such important speakers.

As the purpose of my address is to put forward a number of issues for round-table discussion, one possible approach might be to raise in the form of a questionnaire certain points deemed necessary in identifying the legislative processes and methods of international rule-making in global commerce.

For strict reasons of imposed brevity and in line with the nature and aims of the Congress, I will refrain from presenting a conventional doctrinaire study and will directly expound these points and their rationale through a series of questions extending from the very generic to the specific.

\* The opinions expressed are solely those of the author and do not necessarily reflect the views of the Latin American Integration Association (ALADI) secretariat.

*First question**Has the experience of UNCITRAL been positive?*

1. In General Assembly resolution 2205 (XXI) of 17 December 1966, UNCITRAL was given the mandate to further the progressive harmonization and unification of the law of international trade. That includes rules of private international law, which back in 1947 had been signalled as an area for progressive development of international law which, in line with the position taken in the Sixth Committee of the General Assembly, should not be centred solely on public international law.
2. While the establishment of UNCITRAL is today beyond dispute, an aspect to be explored is whether its programmes of work, agendas, topics, methods, practical experience and approach have been appropriate or could, as a whole, be improved.

This is our standpoint in considering the objectives of this Congress.

*Second question**Does UNCITRAL as a body possess the necessary competences and conditions today to meet the challenge of globalization in the field of international trade law?*

1. The structure of the programme for this Congress clearly shows that UNCITRAL does not see itself as isolated from other agencies engaged in formulating new and urgent international rules for cross-border trade, which have to be geared to the development of the international community.

The presence here of the United Nations Conference on Trade and Development (UNCTAD), the Hague Conference on Private International Law, the International Institute for the Unification of Private Law (Unidroit) and ourselves, ALADI, is evidence of the wish of UNCITRAL to continue the process of coordination and cooperation, which encompasses both States and other organizations, whether international or regional.

2. The effects of globalization on private international law form a specific subject that has been addressed by several authors, of whom I will cite just some who have published recent works: Jürgen Basedow,<sup>1</sup> Spiros V. Bazinas<sup>2</sup> and Eric Loquin.<sup>3</sup> With regard to Unidroit, I cannot omit the article by Herbert Kronke published on the occasion of Unidroit's seventy-fifth anniversary congress and entitled "Worldwide harmonization of private law and regional integration: hypotheses, certainties and open questions",<sup>4</sup> or Camilla Baasch Andersen's most recent paper, "Defining uniformity in law".<sup>5</sup>

<sup>1</sup>Jürgen Basedow, "Worldwide harmonisation of private law and regional economic integration: general report", *Uniform Law Review/Revue de droit uniforme*, vols. 1-2, 2003, p. 32.

<sup>2</sup>Spiros V. Bazinas, "Harmonisation of international and regional trade law: the UNCITRAL experience", *Uniform Law Review/Revue de droit uniforme*, vols. 1-2, 2003, pp. 53-62.

<sup>3</sup>Eric Loquin, "Les règles matérielles du commerce international", *Revue de l'arbitrage*, vol. 2, 2005, pp. 443-464.

<sup>4</sup>Herbert Kronke, "UNIDROIT 75th Anniversary Congress on Worldwide Harmonisation of Private Law and Regional Economic Integration: hypotheses, certainties and open questions", *Uniform Law Review/Revue de droit uniforme*, vols. 1-2, 2003, pp. 11-27.

<sup>5</sup>Camilla Baasch-Andersen, "Defining uniformity in law", *Uniform Law Review/Revue de droit uniforme*, vol. XII, No. 1, 2007, pp. 5-55.

There are many other published works on private international law and its “spirit and methods”, one in particular being *Mélanges en l’honneur de Paul Lagarde*.<sup>6</sup>

May I also cite an article of my own, “*El derecho internacional privado en tiempos de globalización*”,<sup>7</sup> while reiterating that the present paper is intended not as a doctrinaire study but as a contribution to the discussion of ideas.

3. Globalization, universalism and regionalism can, from a general perspective, appear as a conflicting or harmonious world.

That remark leads to the next question.

### *Third question*

*If we assume as an axiom that a globalized society exists, at least in some spheres, such as the economic field, should we accept that this necessitates or determines the production of uniform substantive rules for international trade (Loquin, supra., p. 446)? And within whose purview would that lie?*

1. The absence of an international legislator entrusted with that specific responsibility precludes a radical affirmation as implied in the question.

There are currently no public agencies—international organizations, in particular— which the international community as a whole has so empowered on an exclusive basis.

Global economic operators are nevertheless endeavouring to identify rules and procedures that will provide them with certainty, predictability and clear action lines within a global market, which in the commercial sphere is not subject to philosophical and, less still, ideological trends. There are also institutions, such as UNCITRAL, Unidroit, the Hague Conference etc., which have undertaken such law-making at the universal level within their own limits.

2. The question is thus still valid in that an affirmative answer to it reflects a genuine and readily apparent need.

A methodological question may be posed on the rule-making model that UNCITRAL could use in responding formally to this call from the business world for legal norms.

I will revert to this question but would state here that current private international law is influenced not only by market globalization and the call for substantive rules but also, perhaps partly, by the significant change that has occurred in the concept of the nation-State and by the indisputable advances made in the processes of political and economic integration, either as the effect of or as an alternative to such globalization. At the Common Market of the South (MERCOSUR) level, the article coordinated by Professor Diego Fernández Arroyo and

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<sup>6</sup> Bertrand Ancel and others, *Le droit international privé: esprit et méthodes; mélanges en l’honneur de Paul Lagarde* (Paris, Dalloz, 2005).

<sup>7</sup> *Year VI*, No. 6 (2005), pp. 15-40.

entitled “Derecho internacional privado de los Estados del MERCOSUR”<sup>8</sup> may be consulted. Worthy of specific mention in that legal expert’s work is chapter 1, which deals with basic concepts and issues of private international law, in particular globalization as one of the conditioning phenomena of current private international law.<sup>9</sup>

3. None of those present here, all of whom have a direct responsibility to clearly understand the current situation and respond to it, could fail to realize that, without any specifically legitimizing universal rules, such a titanic task necessarily entails broadening the perspective in the absence of international governance and developing to the extent possible this transnational dimension of commerce to achieve the transition from the traditional State-based source to another (including the *lex mercatoria*) which is in process of reaffirmation and expansion.

Once again, pluralistic solutions help clarify the picture in properly valuing the contribution that we may all make. That observation brings us to the next question.

#### *Fourth question*

Taking up Basedow’s proposition concerning the existence of three phases, which he identifies as (a) regionalism in disguise, (b) the rise of universalism and (c) the dawn of interregionalism, in the development of the relationship between national, regional and international uniform laws (see Bazinas, op. cit., p. 53, note 3), we could ask:

*At which of those phases is the work of UNCITRAL today?*

1. We truly believe that the debate which had been raised, at the time of the establishment of UNCITRAL, on the concentration of functions within the Commission has been resolved from a theoretical standpoint. However, from a practical and operational perspective, there is a need to reaffirm the *dialogue des sources*, or “dialogue” among sources of law, which is only possible with an inclusive and non-exclusive approach to the role to be fulfilled by each of the aforementioned agencies engaged in formulating international trade rules. That concern, which has been overcome at the theoretical level, thus requires us to respond by averting other risks such as duplication or relative isolation in relation to other codifying processes, such as the Inter-American Specialized Conference on Private International Law (CIDIP), which has completed its sixth session and is preparing to hold its seventh. One may note especially the coordination of work carried out in this field by the Hague Conference and Unidroit and in the area of integration by the European Union, MERCOSUR and the recently established (1993) Organization for the Harmonization of Business Law in Africa (OHADA), which covers the south-Saharan region.

2. If we agree with Bazinas (ibid., p. 53) that interregionalism does not, strictly speaking, differ from universalism, this would mean recognizing work at the regional level and identifying the most appropriate ways of making it part of the work of UNCITRAL.

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<sup>8</sup>Diego Fernández Arroyo, *Derecho Internacional Privado de los Estados del MERCOSUR: Argentina, Brasil, Paraguay, Uruguay* (Buenos Aires, Zavallía, 2003).

<sup>9</sup>Ibid., pp. 59-65.

We believe that the debate on the advisability of developing regional and subregional processes of codification and progressive development of private international law—an idea which could also apply in public international law—has been settled, as is best demonstrated by the list of ratifying States, for example within the inter-American system through the CIDIP sessions.

The question is therefore how a contribution can be made to the dawn of which Basedow speaks, assuming that UNCITRAL is at that phase.

Consideration should now be given to what could be the best means of pursuing such coordination from a stance which does not ignore that regularly adopted by UNCITRAL itself, which, like the Hague Conference and Unidroit, is constantly concerned about preventing duplication and consequent unproductiveness and the wastage of ever limited resources available in the legal sphere.

All of this prompts the next question.

#### *Fifth question*

If no one or virtually no one disputes the necessity and desirability of strengthening coordination and preventing possible inter-secretarial and inter-normative conflicts, the following question may be asked: *What other efforts should we—experts and Governments—make to ensure that the regional and international organizations in which we work and of which we form part achieve a higher degree of collaboration than at present?*

1. The first requirement is naturally that we all keep each other duly informed of our respective agendas and programmes of work, which is greatly facilitated by electronic means. Also, having an executive summary or account of the objectives and expected outcomes of the different topics would help give UNCITRAL or others a more focused and defined role.
2. It should then be borne in mind that the various forms of norm creation used by UNCITRAL—conventions, model laws, rules and guides—allow for different degrees of involvement by States in building consensus positions or formulating definitions necessary for putting them into effect.

It is also clear that the role of Governments and economic operators varies according to the forms of norm creation concerned.

For example, in some cases, such as the Unidroit Principles of International Commercial Contracts or the International Commercial Terms (Incoterms), these are based on contract practices and their acceptance by arbitral tribunals in general.

3. A further aspect to be considered is the membership of UNCITRAL, which, notwithstanding its undeniable representativity and legitimacy, calls for extensive globalization in its composition owing to the presence of the major economies with a relative margin of influence for the others.

That observation is not based on any politico-philosophical or ideological tenet but describes realities and opportunities. It is well known that it is materially impossible for a large number of States to have delegates admitted to the many working groups set up by UNCITRAL. A somewhat similar situation occurs with Unidroit.

This is not a criticism but a statement of fact.

What concerns us is how to deal with it and this might be a good time to discuss the issue without prejudices or complexes.

4. While the opening up of UNCITRAL to observer institutions (such as the European Union) is generally viewed very positively, it serves to confirm the greater possibilities of some regions compared to others.

There may be no optimum corrective means to overcome this situation but it is clear that, from 1966 to the present, the most successful work of UNCITRAL has been that which could answer the lucid questions posed by A. Farnsworth in 1972 (during the early years of UNCITRAL): “UNCITRAL—Why? What? How? When?”,<sup>10</sup>

5. The United Nations Convention on Contracts for the International Sale of Goods of 1980 (CISG) and the UNCITRAL Model Law on International Commercial Arbitration of 1985 are excellent examples of how positive results can be achieved and how the agreement and commitment of individuals and States can be secured when issues whose regulation is essential are addressed. Also, the viability of different forms of rule-making is thereby proven.

6. An aspect worthy of deeper examination has to do with the different kinds of regional organizations that participate in UNCITRAL activities under certain conditions. Taking the European Union again as an example, we can observe the following:

(a) It is a supranational organization whose members in many cases have dual status as States members of UNCITRAL and at the same time of the European Union, admitted as an active observer. It is well known that the degree of influence is accordingly increased;

(b) Anyone acting on behalf of the European Union will be able to express a position that is binding on its member States;

(c) In the case of intergovernmental organizations such as MERCOSUR or ALADI, their intergovernmental status would not enable them to put forward or support positions that entail the assumption of definite commitments but only the provisional acceptance of certain conceptual consensus positions;

(d) States belonging to this second kind of organization are entitled, normally by constitutional mandate, to give or withhold their approval on measures taken in UNCITRAL. This is undoubtedly a serious difficulty.

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<sup>10</sup>Regarding the first 25 years of UNCITRAL, the chapter on UNCITRAL, entitled “Balance de 25 años de codificación—derecho del comercio internacional”, may be consulted in *Terceras Jornadas de Derecho Internacional Privado*, (San Lorenzo de El Escorial, Centro de Estudios Superiores Sociales y Jurídicos Ramón Carande, 1991), pp. 73-170, in which there appears the eloquent citation given by Javier Carrascosa González, p. 95, note 1. E. Allan Farnsworth, “UNCITRAL: Why? What? How? When?”, *American Journal of Comparative Law*, vol. 20, 1972, p. 314.

7. Active communication by UNCITRAL with United Nations Members, while not restricted to official missions but extended to include an approved list of experts and academics in the subject areas involved (in particular, private international law, international trade law, arbitration, integration law etc.), can produce an undoubtedly very useful network of information exchange. I am aware of what is being done and even more so of the information available via the Internet, but I am referring to a different form of communication that is personalized and can engender dialogue whose multiplier effect at different levels—official, private, academic, business etc.—is one possible consequence.

### *Sixth question*

As stated at the beginning of this presentation, I am not aiming to make an exhaustive analysis of the work of UNCITRAL or a methodical examination of issues that may arise from the round table now being opened. For example, I do not intend to review every coordination technique or list the texts adopted, which I assume are known to all those present. Nor will there be further theorizing on universalism and regionalism as a pairing for whose coexistence we are all responsible.

Having thus delimited the subject, my next question will deal with the forms of rule-making employed by UNCITRAL.

In this connection, *do model laws, conventions and legislative guides all have the same prospects of acceptance by public and private agents?*

1. Model laws (for example, the Model Law on International Commercial Arbitration of 1985, the Model Law on Electronic Commerce and the Model Law on Cross-Border Insolvency), inasmuch as they are concerned with international trade in very specific areas, attract the attention of the manufacturing and industrial sectors, which, through their incorporation in contract provisions, render them mandatory on the basis of party autonomy or contractual freedom. Being rules extraneous to the parties, they are espoused by them.

An interesting aspect here is that of the revision of the model laws, as illustrated, for example, by the proposal concerning articles relating to international commercial arbitration (see General Assembly resolution 61/33 of 4 December 2006 and revised articles in document A/61/17), which includes the highly debatable topic of interim measures in arbitration and provides for criteria regarding the interpretation of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958).

In addition to the intrinsic merit of the revision, one may observe the open nature of the text through a methodological approach to flexibility in line with present-day realities and from a perspective of modernization as endorsed by the General Assembly in the aforementioned resolution 61/33.

2. Conventions, which are prepared essentially on the basis of substantive rules, are aimed at meeting the needs of international trade, which is not exactly the same as traders, since common objectives or, for others, the general interest and public policy are limits that do not appear when all that counts is the autonomy of the parties. That could, however,

even with a convention such as the United Nations Convention on Contracts for the International Sale of Goods (CISG), mean non-application (art. 9, para. 2) through reference to known and regularly observed practices.

One can thus see flexibility among the international community of traders, which has enabled doctrinal writing to recognize such customs and contract practices as rules that judges and arbitrators will make binding.

Notwithstanding all the foregoing and irrespective of the sources which served as a basis for the preparation of the CISG, it is a fact that the method used, i.e. binding substantive rules, has been wholly successful.

A further observation: the ratifiers belong to different legal families and encompass different economic systems, thus demonstrating the universality of the solutions adopted. The influence of the Convention on States' laws, which is of particular significance in regard to the non-ratifiers, is also evident.

3. Legislative guides are another means used by UNCITRAL which, in the form of recommendations, can have an effect on domestic and also regional law.

4. To sum up very briefly, different prospects are offered depending on the rule-making method chosen by UNCITRAL. This also reflects a high degree of flexibility, whose dominant features, as noted by Loquin, are, with specific reference to the CISG, syncretism of solutions through the use of rules stemming from different legal systems, utilitarianism in that the rules are best suited to contractual practice, and effectiveness, as shown by their acceptance by courts of law and arbitral tribunals (*ibid.*, p. 55), not forgetting the extension of the application of the Convention beyond its original scope by virtue of party autonomy and, where the Convention is not chosen, through arbitrators' awards.<sup>11</sup>

### *Seventh question*

While we have so far posed questions about one dominant means of norm creation, that of uniform substantive rules, which are characteristic of the international commercium spoken of by our unforgettable Professor Quintín Alfonsín back in the 1940s,<sup>12</sup> account has to be taken of the conflict rules or traditional rules to which major operators in cross-border trade and predominant modern laws do not appear attracted.

The following questions then arise:

*What role should UNCITRAL reserve for conflict rules?*

*Will they merely be a crutch as, somewhat pejoratively, they have been called?*

1. When the effectiveness of the substantive law created by UNCITRAL (or other mechanisms for formulating uniform substantive rules) is considered and is viewed from a State's perspective, the need emerges to incorporate that law in the State's legal system if its binding effect is to be achieved.

<sup>11</sup> Eric Loquin, "Les règles matérielles du commerce international", *Revue de l'arbitrage*, vol. 2, 2005, p. 455.

<sup>12</sup> Quintín Alfonsín, *Teoría del Derecho Privado Internacional*, 2nd ed. (Montevideo, Idea, 1982).

By way of example, one may cite the CISG, whose ratification by a State (there are 71 ratifiers to date) obliges that State to apply it with regard not only to cases where both States (affected by the legal relationship in question) are parties to that uniform law but also in cases where the State to whose law the solution of the conflict is referred so requires, even if the other State has not ratified the Convention.

It is thus possible to see how the formal rule serves the substantive rule since, without the former, the latter would not, in the case presented, be applicable.

2. Moreover, the application of the Convention has to be recognized where the parties have chosen the law of a non-contracting State through the legitimate exercise of party autonomy. The Convention will also apply on the basis of the location of the contracting parties even where the conflict rule under private international law states that the law applicable is the law of the place of performance of the contract or the place of its conclusion and either of them is situated in a non-contracting State.

In the last-mentioned case we have a uniform substantive law that would apply regardless of the law governing the contract under the rules of private international law.<sup>13</sup>

3. Methodological pluralism can on the basis of the foregoing be affirmed and this does not detract from the substantialist approach but makes it viable.

### *Eighth question*

An examination of modern uniform law leads us to believe that we can adopt it as a common theory within the framework of globalization or, put differently, in what Ulrich Beck called the cosmopolitan vision,<sup>14</sup> although the author denies that Europe can ever achieve a homogeneous national structure. Camilla Baasch-Andersen<sup>15</sup> prefers, perhaps more modestly, to define uniformity—from an essentially legal and less sociological stance—in a practical way in order thus to encompass the different uniform laws.<sup>16</sup> In line with this framework and bearing in mind the remarks of a former Secretary of UNCITRAL (John Honnold) in this respect when defining the goals of unification as (a) clarity, (b) flexibility, (c) modernization and (d) fairness, we may, in conclusion, affirm that these are the true aims of UNCITRAL.<sup>17</sup>

The following question is framed around this set of ideas:

*Would we today be able to adopt a common theory of uniform modern law with the involvement of UNCITRAL, Unidroit and the Hague Conference and of other institutions engaged in this work?*

<sup>13</sup>These examples, which we provide in our classes, are put forward by Loquin in his study, Eric Loquin, “Les règles matérielles du commerce international”, *Revue de l’arbitrage*, vol. 2, 2005, p. 456.

<sup>14</sup>See, in particular Ulrich Beck, *Cosmopolitan Vision* (Cambridge, Polity Press, 2006), p. 173.

<sup>15</sup>Baasch-Andersen, “Defining uniformity in law” (see footnote 5).

<sup>16</sup>It is thus given in the summary of her paper entitled “The uniformity of the international sales law”, cited in the article appearing in Baasch-Andersen, “Defining uniformity in law” (see footnote 5), p. 54.

<sup>17</sup>*Uniform Commercial Law in the Twenty-first Century: Proceedings of the Congress of the United Nations Commission on International Trade Law, New York, 18-22 May 1992* (United Nations publication, Sales No. E.94.V.14), p. 11.

1. In posing this question we are very much aware that Unidroit, for example, has formulated principles on international commercial contracts and civil procedure as well as texts on other, not strictly trade-related matters, such as cultural objects.

That marks an important difference between UNCITRAL and Unidroit, which has far more to do with their respective agendas than with their procedures for formulating uniform legislation.

2. We also note on conflict-of-laws resolution what Erik Jayme in his Hague lectures of 1995 termed the passing of the golden age of American theory (“*l’âge d’or de la théorie américaine*”), doubtless reformulated by markedly rupturist and judicialist Savignian location criteria with a strong extrajudicial dimension, while recognizing the validity of a number of propositions, such as that of Brainerd Currie with his concept of governmental interest analysis.

3. Added to this situational framework is regional economic integration, which was a topic at the very useful Unidroit seventy-fifth anniversary congress, as reported in volume VIII, 2003-1/2.<sup>18</sup>

The legal construct is thus seen to be enriched but not without complexities.

4. It would be irresponsible of me to pose this question without underscoring the importance of the Principles (with a capital P) in that construct, which would *mutatis mutandis* fulfil a similar role to that played by them in our revised inter-American private international law (work of CIDIP), the Inter-American Convention on General Rules of Private International Law (CIDIP II, Montevideo, 1979), to which Professor Werner Goldschmidt made an indisputable contribution.

5. It would also be irresponsible not to explore that objective together and examine in depth what would be the nature, scope and aim of those Principles.

6. Assuming that we consider the bodies directly responsible for this exploration to be UNCITRAL (as with Unidroit and the Hague Conference at the global level) and, at the regional level, MERCOSUR and the Organization of American States (OAS) in regard to private international law, through CIDIP, we could start from a common supposition, that of viewing the law in the present and working to build, with no strict time limit, the new institutions that globalization calls for, seeking harmony between the state and society, which in international trade law is equivalent to saying between the state and the market or, better still, between public entities and civil society or between official organs and private operators.

Here we may pose the following question: Do we today have an armour of general principles to give this undertaking a set of conceptual categories that can withstand the “investiture conflict” of related theories?

7. It is at least worth attempting this on the basis of the work done and its main structural elements in order to highlight the now indisputable role of international organizations, regardless of their size or scope, when they are capable of developing rational and convincing agreements.

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<sup>18</sup> *Uniform Law Review/Revue de droit uniforme*, vols. 1-2, 2003.

8. The risk of statist or privatist extremism is with us. Manichaeic conceptions are also prone to appear in the field of the law.

For example, the law of the Charter (epiphenomenon or pathology of unlimited party autonomy?), as a product of globalization, deals solely with specific issues having no reasonable or predictable certainty that are in all cases linked to the state sphere as the focus of general interest fuelled by the general will and democratic systems.

That does not mean that globalization—a natural phenomenon in the evolution of modernity—is seen as an enemy that destroys established legal traditions. That would be as naive as disregarding the need to still have global visions that can interpret the public good. This is not ideological in the normal sense of the term but ethical and ultimately a legal principle.

9. The proposed undertaking would not exactly mean a soft landing since in such an exercise as this we are all obliged not to deny ourselves the freedom to propose, provided only that there is an underlying rational basis. We thus concur with Basedow's three-phase proposition and in particular with his observations concerning the problems in adjudication with the different organizations, including regional ones, in identifying the borderline between internal cases and international fact situations to which uniform laws relate.<sup>19</sup> We very much share Basedow's view when he states that the admission of regional organizations to universal organizations will enable a new role to be adopted in global law-making<sup>20</sup> and his idea regarding the setting up of a working group of international organizations dealing with uniform law. This would mean, *inter alia*, greater consistency between international private law and regional integration.

### *Ninth question*

The links between globalization and uniform law are quite clear, although we cannot affirm that the sole purpose of the latter is to serve the former.

Several of the questions raised show that the choice of the method of uniformity addresses the need to develop the concepts of predictability and certainty, as inherent traits of international trade law, going beyond theorizing, albeit valid. There may also be several ways of viewing globalization. Although at this gathering we are, because of its nature, concentrating on legal aspects, it is well known that the spheres in which globalization expresses itself are diverse (financial, economic, scientific, cultural etc.).

In this part of my presentation I should like to review the relationship of UNCITRAL with CIDIP in order to illustrate the influence on the latter from the former.

The question can thus be put as follows:

*How does the work of UNCITRAL influence the work done by CIDIP?*

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<sup>19</sup> See, in particular, on this point, Jürgen Basedow, "Worldwide harmonisation of private law and regional economic integration: general report", *Uniform Law Review/Revue de droit uniforme*, vols. 1-2, 2003, p. 49.

<sup>20</sup> *Ibid.*, p. 44.

The following may be noted by way of information:

1. In 2001, after a long drafting process, UNCITRAL finalized a convention on the assignment of receivables, whose aim is to facilitate the use of credit at the international level as a means of funding. That convention was adopted by the General Assembly (resolution 56/81, annex) and opened for signature by member States.
2. At CIDIP V (Mexico, 1994), it was decided to include on the agenda the problems of private international law regarding private international loan contracts and the uniformity and harmonization of secured transactions law.<sup>21</sup>
3. In 2002, the Model Inter-American Law on Secured Transactions was adopted at CIDIP VI (Washington, D.C.), which I had the honour of chairing.
4. The work of UNCITRAL and that of CIDIP find antecedents in the Convention on International Interests in Mobile Equipment (2001).

One can thus observe a concurrence of law-making activities, some international and some regional. Mention should also be made of mechanisms in the conventions, such as in the United Nations Convention on the Assignment of Receivables in International Trade, whereby States parties are authorized to declare at any time the non-applicability of part of its set of rules. We are, to quote Jayme, in the midst of a *dialogue des sources*.

Also, the regional context can in some cases be very advantageous in promoting the enactment of national laws. This is the case with CIDIP VI and its resolution 6/02, in which it is recommended that OAS member States adopt rules on electronic commerce and electronic signatures that are consistent with the model laws of 1996 and 2001.

#### *Tenth question*

An examination of countries' domestic legislation on private international law clearly shows the influence of UNCITRAL instruments on such legislation.

By way of example, one may cite the UNCITRAL Model Law on International Commercial Arbitration of 1985, which has served as a basis for the promulgation of laws on this subject in over 50 countries and in several states of the United States of America. Four of those countries are States members of ALADI (Chile, Mexico, Paraguay and Peru).

I could add with regard to my own country (Uruguay) that a legislative bill currently under consideration by Parliament transcribes that Model Law almost entirely.

In addition to all the foregoing, one can observe a very strong influence of uniform law and substantive rules on general legislation relating to private international law.

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<sup>21</sup> See details in an article by Diego Fernández Arroyo, "El caso de la reglamentación internacional de las garantías mobiliarias", in *Globalización y Derecho*, Alfonso Luis Calvo Caravaca and Pilar Blanco-Morales Limones, eds. (Madrid, COLEX, 2003), pp. 279-312.

In the case of Uruguay, a general law has been drafted on private international law, incorporating the principle of specificity of international trade law (art. 12) and recognizing as sources, inter alia, custom or practice, general principles applicable to international commercial contracts and decisions of courts or tribunals (art. 12.2).

We may ask the following:

*Does UNCITRAL assess its influence on domestic legislation?*

1. This gathering, which is taking place at the generous invitation of UNCITRAL, can serve as a forum for reviewing the work undertaken, the approaches adopted, prospects, topics covered etc. and, in particular, the procedures for aligning uniform law with States' interests and projects.
2. The formation of an academic group specializing in the subject could be a useful tool for such purposes. The preparation of a questionnaire could assist in achieving that objective.

*Other questions*

1. My efforts to generate dialogue are not of course an affirmation of the relevance of the questions posed. I can, however, reaffirm one certainty: in the processes of international law codification there is a commercialization and privatization phenomenon by which none of the institutions involved, be it UNCITRAL, Unidroit, the Hague Conference or CIDIP, is unaffected.

And all this is within a framework of globalization that has to be accepted as fact, at least in the legal field, where regionalism and in turn arbitration could play a moderating role.

2. Globalization is in the present case ensured through the presence of the World Bank and UNCTAD, institutions for which I have the greatest respect while not endorsing all their assessments.

In the specific case of UNCTAD, I have to state that I myself and ALADI greatly value the ongoing, extensive cooperation projects being pursued in Montevideo and Geneva in areas of international commerce (trade in services, among others). UNCTAD has thus sought, on the prompting of my friend Supachai, to provide technical assistance to ALADI through a process of ever constructive, modernist international dialogue without conceptual prejudices or self-imposed limits.

3. Other observations could be added to these but that is not the aim.

The aim, for us, is to foster this exchange with the necessary willingness of spirit in order to return to Montevideo, the seat of MERCOSUR and ALADI, with more and better information and, most especially, with new ideas that our creativity can engender.

## 2. Round table

*Jernej Sekolec*

*Secretary of the United Nations Commission on International Trade Law*

International law formulating agencies must continually assess and reassess their processes and methods and orientation. For UNCITRAL, this Congress and the discussions that will follow it are a good opportunity to do so. During the formal debates last week in UNCITRAL, we started a discussion about the decision-making process in UNCITRAL—questions like the interrelationship between member States, observer States and non-governmental organizations. This discussion will continue later this year and next year, and I propose not to speak about this today, even though this is a very important discussion.

Instead, I would like to say a few brief words about developments in national trade and contract practices that are affecting the form and orientation of the work of UNCITRAL and also other related rule-formulating agencies.

One such development is a shift from the traditional orientation of UNCITRAL to limit its work to legal relations that are international. In recent years, we have seen States becoming increasingly interested in legislative texts that govern transactions irrespective of whether they are domestic or international. The areas where we observe this trend include, for instance, electronic commerce, public procurement, insolvency, public-private partnerships, privately financed infrastructure projects and various types of contract practices designed to secure the performance of business transactions, but also arbitration, conciliation and mediation.

Related to this development and also as a consequence of it, UNCITRAL is moving away from its initial and traditional focus on the unification of law. In a number of areas, Governments are interested more in the laws being modern than the laws being unified. Governments want laws that are accommodating modern contract practices, that are in line with modern means of communication, that are respectful of different legal traditions and in particular that provide for effective and efficient enforcement of contract obligations.

These developments have led UNCITRAL to opt more frequently for flexible legislative recommendations in the form of model laws, commentaries, legislative guides and so forth. The shifts in emphasis demonstrate that differences among legal systems are not the main problem in international trade. Incidentally, this also has an interesting linguistic aspect. The founding act of UNCITRAL, other similar documents and many legal books frequently used the words “unification of law”. We hardly use the word “unification” anymore, in UNCITRAL and elsewhere.

Let us take the example of England trading with continental Europe, England being the bastion of common law and continental Europe the guardian of the so-called civil law. They boast a vibrant trade. So the differences, and there are many, do not seem to be the obstacle. What these legal systems have in common is that the parties can use modern contract solutions and in particular that in the case of problems they can fall back on effective and efficient methods to enforce contractual commitments.

What is the position of developing countries in this? I am invoking their particular position not because we in UNCITRAL are urged by our founding documents to do so but

because it is in the interest of each and every one of us, no matter where we live, that trade in developing countries, among developing countries and with developed countries should be growing. What changes in the legal regimes of developing countries should have priority in their agendas and therefore also in UNCITRAL? I think the reason that some countries are struggling with slowly developing economies is not that they are lacking some inherent qualities that others have, but rather that developed countries and faster developing economies are more successful in putting in place legal mechanisms that ensure effective and efficient enforceability of contractual obligations and that are accommodating modern contract practices.

No matter what legal system we are talking about, trade will grow and investment will prosper only if businesses—local, national and international businesses—have a reasonable assurance that contractual commitments will be complied with. Contract discipline among businesses is crucial in particular in order to allow the country to break out of the economy based on the so-called “spot trades”, that is, trades where parties are located close to each other and where money is exchanged for goods or services on the spot, within short periods of time.

Developing countries practise too much “spot trade”, too little long-term trade and too few transactions with distant parties. In “spot trades”, one does not need much law since the commercial risks of the parties are minimal. However, “spot trades” do not contribute to the growth of the economy or the creation of wealth for the parties and for the national economy.

In order to facilitate access of parties in developing countries to trade that creates growth, we need to enable them to trade on credit and with geographically distant parties. It is particularly contract discipline—and legal and contractual mechanisms that support contract discipline—that will do that. In my view, UNCITRAL and other rule-formulating agencies need to pay particular attention to helping countries and the private sector develop and use effectively mechanisms to support long-term and long-distance transactions. For that reason, UNCITRAL and other similar agencies continue to be indispensable in removing these less visible obstacles to international trade.

*Hans van Loon*

*Secretary-General, Hague Conference on Private International Law*

All organizations around this table dealing with private and commercial law are currently facing challenges because of both rapid globalization and regional integration.

What makes globalization so relevant to our organizations is that the driving force behind this phenomenon is not governmental policy but private initiative: expanding markets; worldwide competition; growing mobility of individuals and families, companies, goods, services and capital; and instant sharing of information through the mass media and the Internet. The result is a host of new international legal issues, not primarily between States but between private and commercial parties, which often involve the private and commercial law systems of more than one jurisdiction. UNCITRAL, Unidroit and the Hague Conference are called upon to create legal frameworks that provide the necessary coordination among legal systems and cooperation among courts and other authorities of different States. Such frameworks are increasingly needed. On the one hand, there is a

growing need to remove legal obstacles resulting from the current patchwork of State-based private and commercial law systems. On the other hand, they are indispensable to protect values and interests at risk—from cultural property to vulnerable adults and children. There is a normative deficit that in part explains current concerns about globalization. In this sense our organizations are, together, building step by step a global international commercial and private law, thereby creating a global legal fabric that provides commercial and personal security—and both are very much needed.

Regional integration is in part a manifestation of globalization, because the forces of expanding markets and mobility naturally permeate contiguous nations even more than countries at a distance. But as a common policy, a political endeavour, regional integration is also an effort to bring back some measure of governmental steering and control—and indeed a new common regional identity—to emerging societies and markets. Given the nature of the forces at work, this naturally also leads to regional activity in the field of private and commercial law. We have examples of such activity not only in Europe but also in Latin America, Africa and Asia, and as a result we are increasingly faced with the question of the relationship between regional and global rule-making. This is becoming a leading question for all our organizations.

The Hague Conference has, in some respects, been a forerunner with regard to the impact of European integration on its processes and methods of rule-making, and even on its institutional structure. It may, therefore, be useful to briefly mention some of the Conference's recent experiences in this regard and to offer a few thoughts on that basis.

The European integration process started to affect the Conference's working methods when, following the entry into force of the Treaty of Amsterdam (1 May 1999), coordination among States members of the European Community reached a level that influenced, or was perceived by third countries as influencing, the voting patterns in the Conference on sensitive issues during negotiations for a global judgements convention. The appearance of bloc voting led us to abandon the traditional voting system and move to the consensus procedure. Our new statute and new rules of procedure, both of which entered into force on 1 January 2007, confirm the consensus rule. But already the Securities Convention, completed in 2002, and the Choice of Court Convention, concluded in 2005, were adopted without a single vote being taken. The consensus method in general probably prolongs the negotiation process (although the negotiations on the Securities Convention proceeded on a fast-track basis), but has the advantage of engaging the participating parties more. During the current negotiations on a new global convention on child support and other forms of family maintenance, we have seen that the Latin American countries are now intensifying their mutual consultations within the Hague Conference. There are also indications of closer consultations among some Asian countries. This has the great advantage of raising perspectives to the global level. When the member States of the European Community (or the Latin American States) negotiate en bloc with the United States of America and Canada, or China, or India, the challenge is not just to find common positions among the States of the region but also to engage in a give-and-take with these larger politico-legal systems.

In order to consolidate the position of the European Community as a partner in the global negotiating process, it was important that it become a full member of the Hague Conference. That took place on 3 April 2007, when the European Community acceded to

the Conference's new statute which was amended to make this accession possible. The transition was quite smooth, however, because under the flexible practice regarding the role of observers in the Hague Conference negotiations, the Community had already been able, as an observer, to freely exercise its external competence. Also, it should be noted that the question whether the European Community or its member States, or both, can join a Hague convention is determined by each convention individually and not by the statute of the Conference. The true significance of European Community membership of the Hague Conference, therefore, is that it links the Community to a global forum, and invites the Community to negotiate private international law treaties within rather than outside this global forum.

The challenge for all concerned will increasingly be to work towards the right balance between three levels of law-making and law implementation: national, regional and global. Continuing cooperation, in particular between our organizations and regional organizations including the European Union, will be needed in this respect.

The starting point in a globalizing environment ought to be that, where possible, solutions for global problems are negotiated at the global level. Where possible, though, there should also be flexibility to allow for complementary legislative activity at the national and the regional levels. Hague conventions, for example, systematically provide for respect for legal pluralism—whether based on territorial or personal criteria—at the national level. They also provide that regional socio-economic and cultural ties among nations may warrant specific regulation that may depart from the general convention scheme. Our recent experience suggests that a regional focus on implementation issues of global instruments may be a particularly fruitful approach to ensure both the effective operation of that instrument—which is in the global interest—and the meeting of regional concerns.

There is reason both for some optimism and some concern in this respect. Let me give you an example of each. The Hague Child Abduction Convention—not a commercial instrument but vital from a personal security point of view in a globalizing environment—allows its States parties (80 States) to agree among themselves to limit the restrictions to which an order for the return of a wrongfully removed child may be subject. The recent Brussels II bis Regulation on matrimonial matters and matters of parental responsibility does exactly that: it reinforces the six-week term for a decision on the return of a child and to that extent strengthens the integrity of the Convention. It is true that it contains some provisions that present risks for consistent interpretation and application of the Convention among all of its—European Community and non-European Community—States parties. But with wisdom on the part of courts of European Community member States, it will be possible to ensure that the Convention's effective operation will not be undermined.

My second example concerns the international holding and transfer of securities. Cross-border transfers of securities offer an example, *par excellence*, of a global marketplace. Thus when financial authorities worldwide had recognized the need for new and adequate uniform conflict-of-law rules at the global level for the holding and transfer of securities, it was natural that a mandate was given to a global forum—the Hague Conference—to prepare a global instrument on conflict of law rules. The result was the Hague Securities Convention, unanimously adopted in December 2002. The European Communities Financial Collateral Directive, adopted earlier the same year, only partly

addresses the legal issues at stake and was in any case expressly intended as a regional interim solution pending completion of the comprehensive global convention.

The United States of America and Switzerland signed the Securities Convention last year, and the European Commission supports its signing by the European Community member States. Nevertheless, there is still a movement in some financial centres in Europe that has difficulty seeing the global dimensions of the securities market place. As a result, the European Community member States have not yet been able to make the decision—which can no longer be made individually—to move forward and sign the Convention.

These examples show that much work remains to be done in terms of reinforcing the global perspective that is increasingly needed nowadays, characterized by such new phenomena as “micromultinationals”—with manufacturing relationships in Malaysia and China, some design in Italy, some customer support in India and the Philippines, and some engineering in the Russian Federation and the United States of America. If this is the wave of the future, we can expect many legal issues arising from the point of view of commercial, financial and personal security. One of the common challenges for UNCITRAL, Unidroit and the Hague Conference is to reach out and inform the world that an impressive portfolio of more than 70 carefully negotiated multilateral instruments—conventions, principles, model laws and legislative guides in the fields of commercial and finance law, of judicial cooperation, of access to justice and dispute resolution in civil and common matters, and of children, vulnerable adults, family relatives and inheritance—is available to respond to global needs.

Cooperation between our organizations and other multilateral institutions, in particular the World Bank but also regional organizations such as MERCOSUR in Latin America and OHADA in Africa, is highly desirable to this end. It is all the more desirable since providing information on these instruments is not enough: as we all know, there is a huge need for assistance with implementation and application of international instruments. Rule-making without providing monitoring and assistance is, in our experience, incomplete. At the Hague Conference, we were able, earlier this year, to set up a small International Centre for Judicial Studies and Technical Assistance. But this Centre could not possibly operate in isolation: cooperation with other international organizations, including our sister organizations UNCITRAL and Unidroit, will be essential.

I would like to conclude by expressing my great appreciation to my colleagues around the table for their cooperation over the past years. An atmosphere of common understanding and friendship has grown among us and has been highly beneficial to our work, and this should enable us to deepen and strengthen our collaboration even more in the years to come.

*Herbert Kronke*

*Secretary-General, International Institute for the Unification of Private Law*

The overall topic this morning is process and methods. To put it very briefly we are entirely happy and satisfied with our methods, but a lot of improvement is needed as far as the process is concerned.

Since my dear colleagues and friends have outlined the theoretical framework of what we are currently doing and what needs to be done, I would like to add just a few remarks from a very practical point of view and the starting point is a meeting in Valparaíso in Chile two weeks ago. I was called to testify before the foreign relations committee of the Chilean senate, and the questions were: what is Unidroit currently working on; what are you planning to do over the next years; and how does that relate to the work in the other private law formulating agencies, in particular UNCITRAL? And I think the answers I gave to the distinguished senators might also be of some interest here.

As many of you will know, under Unidroit practice we have triennial work programmes—quite different from UNCITRAL—and this is, as we found out also, a certain problem as regards coordination of work. Our current triennial work programme 2006-2008 is about to expire. We will continue to work on two areas where cooperation is very close and very good.

First of all, obviously, the work on the Unidroit Principles of International Commercial Contracts will go on. The 2004 version was endorsed by the Commission last week; for the present and during the next triennial work programme, a working group tasked with the drawing up of five additional chapters will do what they were asked to do. For the next triennial work programme (which begins in 2009) and following our practice, invitations to submit suggestions will go out to Governments, to other international organizations and to trade organizations and professional organizations around the world at the end of this year and at the beginning of 2008. We expect that the response will be: go on with what you are doing and what went well over the last three years, but which is not yet finished—apart from the contract principles, the work in the area of secured transactions, i.e. the outstanding third protocol under the Convention on International Interests in Mobile Equipment (2001) plus a model law on commercial leasing. Secondly, finalize the work in the area of capital market law and that means primarily the adoption of the draft Convention on Intermediated Securities by a diplomatic conference to be held next summer.

As always, in these very small and, as far as resources are concerned, overstretched and underfunded organizations, there are priority items which we could not tackle over the last few years. One of them again is located in the area of capital markets law: a legislative guide on rules capable of enhancing trading in securities in emerging markets.

What were the criteria of the Chilean senators who posed those questions? And that obviously goes to the heart of what the delegates are interested in today. The Unidroit General Assembly and the Governing Council just say “since you have limited resources, you should only do what you can do better than other private law formulating agencies or the development organizations”—an obvious criterion and a clear instruction.

The answer to the question as to which are the areas where work can more effectively be carried out in one rather than in another organization is easy if you have personified expertise on a secretariat of an organization. The Governments would probably not wish Organization B to work on insurance law or securities if in Organization A there are dyed-in-the-wool insurance law experts or securities or company law experts. So that is an obvious criterion.

But it is more difficult to identify which is the organization to tackle any particular subject matter area where other factors have to be taken into consideration, and Ambassador Opertti mentioned the regional and worldwide aspect, the coordination of the modernization of commercial law at the regional level on the one hand and the worldwide level on the other hand. Now, there it is probably easier for an, if you will, old-fashioned organization such as Unidroit, which for historical reasons has almost no, or very few, rules of procedure. Our rules of procedure are based on practice—in 1926 the fathers and mothers of the organization obviously did not think about to what extent industry organizations should be involved, non-governmental organizations should be involved, or indeed whether regional specificities should be taken into consideration. This developed as we went along. Therefore, the members of the Governing Council did not even blink when the Unidroit secretariat suggested that our next project in the area of capital markets law might, quite against our tradition, start at the regional level, with regional study groups whose results would then be pulled together at the worldwide level.

The Chilean senators were very much interested in another criterion as regards the coordination of the work among the private law formulating agencies—the suggestion that there are subject matter areas where an instrument needs worldwide legitimacy even at the price of some technical compromise. Obviously, UNCITRAL would be the organization where Governments would look to develop such an instrument because you cannot have greater worldwide legitimacy than in an organization, such as the United Nations, with 192 Member States. On the other hand, if you have highly technical or highly sophisticated types of transaction and where the instrument is not necessarily targeted at the worldwide community, the 192 Member States of the United Nations, then maybe you go for an organization with a lighter regulatory framework. As far as regional versus global is concerned, I note that substantial progress has been made over the last few years. For the first time in our history, a diplomatic conference held in a European country for the adoption of one of our instruments, in Luxembourg last February, was attended by the Southern African Development Community as an organization, by the African Union as an organization, and even MERCOSUR announced that it was contemplating attending but then apparently had difficulties of a practical nature. But this is very, very encouraging.

Lastly, since Ambassador Opertti, Mr. van Loon and Mr. Sekolec mentioned the type of legislative approach we are taking, I would like to draw the hall's attention to something which is happening not just in putting at the disposal of the international community an increasing number of different types of instrument, but of the changes which we are observing within the traditional instrument of the binding treaty: the convention. Both the Cape Town Convention on International Interests in Mobile Equipment and much more so the currently negotiated draft convention on intermediated securities go for a menu approach: a vast variety of opt-ins/opt-outs within the same instrument, the binding instrument, with a great deal of confidence that what the mothers and fathers of the process originally envisaged, i.e. modernization, not necessarily or only a minimalist degree of harmonization, indeed will still be achieved. Yet since it is a matter of third-party effects and so forth, obviously it is preferred to have the binding instrument as such, which in some areas of the world will provide for harmonization, in others just for modernization, and overall for the possibility to build bridges between various regions of the world.

The coordination and cooperation, which both my colleagues Hans van Loon and Jernej Sekolec mentioned as working well, are in good shape, and I wish to place Unidroit's

gratitude for this on record. But obviously there is room for improvement and I think we all look for opportunities—and we have already identified one—where we can maybe develop one project as a joint venture of the private law formulating agencies. If the bureaucratic instincts in some of the organizations do not become too strong and if the business-friendly scholarly anarchy in other organizations does not become too strong, such joint ventures should materialize and become possible.

*Khalil Hamdani*

*Director, Division on Investment, Technology and Enterprise Development, United Nations Conference on Trade and Development*

I bring to you the greetings of the Secretary-General of UNCTAD and the desire of UNCTAD to participate and cooperate with the other organizations on this podium through the UNCITRAL process in the future. In the four or five minutes that I have, I should like to focus on international rule-making in the area of investment. Foreign direct investment has been the major driving force in the last 20 years, growing much more rapidly than world trade or indeed global output. International rule-making in the area of investment has been as dynamic as the growth of investment itself. The latest UNCTAD survey shows that there are currently more than 5,500 bilateral investment treaties, double taxation treaties and other agreements, such as free trade agreements, dealing with investment. On average more than three treaties were signed per week over the past few years. Agreements of course increasingly overlap, as they are concluded at the bilateral, regional, interregional, sectoral, plurilateral and multilateral levels. And these agreements and their subject matter have become increasingly complex, as they cover not only investment issues per se but also related matters, such as trade, services, intellectual property, industrial policies, labour issues, movement of personnel, environmental concerns and many others. International investment rule-making lacks any system-wide coordination. In the absence of global investment rules, the existing international treaty system is evolving into a highly atomized multilayered and multifaceted network of treaties, which shows a considerable variety of approaches and is not very transparent.

In the absence of a global body administering the process, countries continue to conclude investment treaties on an individual basis, thereby further perpetuating and accentuating the existing international patchwork of treaties. We call it the “spaghetti bowl” of international rule-making.

Looking to the future, we see the process going actually in the wrong direction. International rule-making is advancing towards more and more bilateralism and regionalism, which is just the opposite of a harmonized collective approach, which is needed in order to create parity, stability and transparency in international investment relations.

When talking about international investment rule-making, we also need to mention the interpretation that international tribunals give to individual treaties. Investor-State disputes continue to increase. In 2006, the number of treaty-based investor-State dispute settlement cases that we know of in UNCTAD grew by at least 29 disputes, bringing the total number of disputes to 259 by the end of 2006.

While international arbitration is an important means of strengthening the rule of law and of increasing legal stability, a number of conflicting awards have also led to new

uncertainties concerning the interpretation of some core investment provisions. Likewise, differences in arbitration rules, while offering foreign investors the choice between various options, might also contribute to incoherence in the system.

Trying to keep this highly atomized system of investment agreements as coherent as possible is a difficult task, and it has become a key challenge for policymakers and for negotiators at the country level in the international treaty rule-making process. It is a particularly serious challenge for developing countries that have less expertise in negotiating matters and in the complexities of international investment agreements. I think that international organizations have an important role to play in this context. We in UNCTAD consider the issue of international investment rule-making and its implications in particular for developing countries as one of our core activities. Just 10 days ago we held an expert meeting on this topic in Geneva, where our member States and experts and stakeholders took stock of the evolution of the international investment agreement universe. One main outcome of this meeting was that our member States see a need for a more coherent and coordinated approach in these matters. We expect that UNCTAD, at its next global conference in April 2008, will establish a standing committee on international investment rule-making within the framework of the UNCTAD machinery.

In the absence of concerted action, we feel that there is a risk that the international investment agreement universe will degenerate into an increasingly non-transparent hodgepodge of diverging rules that countries, in particular developing countries, will find more and more difficult to cope with.

Current UNCTAD activities in this area of international investment agreements relate to policy research and analysis, to the maintenance of databases on investment agreements and on dispute settlement and to technical assistance. Technical assistance is very important, as emphasized by other speakers, and we in fact provide advisory services and in particular technical assistance to developing countries and economies in transition. These various activities can make, we believe, a valuable contribution to working towards a more transparent, consistent and development-friendly international investment agreement system, and I am glad that we have established fruitful and mutually beneficial cooperation with UNCITRAL, the International Centre for Settlement of Investment Disputes (ICSID) and other international organizations in this context.

I will conclude with just a very brief reference to examples of cooperation that we have engaged in over the past couple of years. For example, in December 2005, UNCTAD, the Organisation for Economic Co-operation and Development (OECD) and ICSID organized a symposium on making the most of international investment agreements. The symposium was held in Paris, and UNCITRAL, the Energy Charter Secretariat and the World Trade Organization (WTO) were represented there and participated. The emphasis was on possible ways of improving the system and capacity-building in developing countries in the area of international investment dispute settlement. UNCTAD has also co-organized a number of national and regional seminars on investor-State dispute settlement, particularly focused on identifying technical assistance needs and capacity-building requirements in developing countries. We have done this in cooperation with UNCITRAL and ICSID, and participant speakers at these seminars have included colleagues currently on the podium right now. We organized, for example, an advanced seminar on managing investment disputes, in Washington, D.C., in November 2005, and we also co-organized a similar

seminar in Peru, in May 2007. I am happy to say that we are also organizing an advanced training course for Latin American countries, which is scheduled to take place in Montevideo, Uruguay, in close cooperation with Ambassador Operti Badán of ALADI, in the second half of November this year. This will be the first time that we cooperate with ALADI in this field and UNCTAD looks forward to more joint activities in the future. As far as research is concerned, UNCTAD has been monitoring the surge in investor-State disputes and has conducted studies that consider the effect of arbitration tribunal decisions on the evolution of substantive treaty provisions and dispute settlement procedures under the international investment agreements. We had a very useful exchange of views with ICSID in this regard and we hope to be issuing shortly a forthcoming study on alternative methods for treaty-based investor-State dispute resolution.

In addition, UNCTAD has developed a comprehensive database of treaty-based investor-State dispute settlement cases searchable by name, country and year and also by substantive and procedural issues. This database is available to you on the UNCTAD website and we count on cooperation with ICSID and UNCITRAL to ensure that the database remains complete and up to date, since according to our estimate more than 80 per cent of all known investor-State disputes are settled under the ICSID or UNCITRAL rules.

To conclude, we hope our good collaboration will continue and intensify in the future. I see potential for this and not least because international investment rule-making increasingly covers both investment and trade aspects. At the end of 2006, there already existed 241 such multifaceted investment trade treaties and their number continues to grow rapidly. One consequence of this development is that we need to bring trade and investment expertise together in analysing these agreements and in assessing their implications. We are also ready to explore possible ways of collaborating with other institutions such as Unidroit and the 26, in this area of investment.

*Vijay S. Tata*

*Chief Counsel, Finance, Private Sector and Infrastructure, Legal Vice Presidency, World Bank*

It is an honour for me to represent the Legal Vice Presidency of the World Bank at this Congress, particularly as we celebrate the fortieth anniversary of UNCITRAL—a highly effective international body with which the World Bank has long had an important working relationship. We acknowledge the importance of the Commission as a deliberative body of representatives and designated experts from a broad array of countries focusing on the development of legal norms in areas fundamental to international commerce and trade. The Commission's work on laws relating to privately financed infrastructure projects, arbitration, procurement, electronic commerce, insolvency law and security interests have all made a direct contribution to the development of legal norms for commerce in a globalizing world. The contribution of UNCITRAL has been of benefit to the World Bank and other development institutions in their work on the modernization of legal systems.

The revolution in information technology and electronic commerce and the mobility of capital, goods and services have led to the development of new and complex commercial and financial relationships, transactions and instruments. Because of the transnational

character of these relationships, it is sometimes beyond the jurisdictional limits of individual nation States to define and enforce all of the rights and obligations connected with such novel transactions or instruments.

Consistent with these developments, the international flow of funds has increased, and the flow of private capital into developing countries has significantly surpassed the flows of official funds. A recent World Bank study reported that “cross-border net flows of private capital to developing countries have experienced a tenfold increase since the early 1990s. This in part reflects a process of liberalization and international opening of financial markets in developing countries (particularly middle-income countries), where the degree of financial market liberalization now approaches that in the developed countries.” These developments, taken together, highlight the importance of the work of UNCITRAL in harmonizing private law and, equally important, in modernizing commercial law. UNCITRAL provides a forum in which to address the needs of the globalizing economy for workable legal frameworks that can facilitate the flow of capital and commerce. Indeed in light of these achievements over the last 40 years, one could say that the work of the Commission is a signal contribution to the process of sustained globalization.

The World Bank is not of course, like the other bodies represented at this panel, an international “law-formulating body”. But your work is essential to the Bank’s work with our client countries and supporting the modernization of legal and institutional infrastructure for finance and commerce. Your work serves as a point of reference in the policy dialogue in relevant areas. At the Bank, we see our role as supporting policymakers in our client countries in their efforts at modernization and reform by making relevant expertise and resources available to them.

In our 60 years of development experience in the field, we are uniquely positioned to harness global knowledge (including that represented by UNCITRAL and the other law-formulating organizations) to the service of local needs. Through identification and dissemination of international best practices, diagnostics, research and capacity-building, the Bank can, together with entities like UNCITRAL, seek to empower the domestic modernization and reform processes in our client countries.

I would also like to acknowledge the welcome that the secretariat has always extended to the World Bank as an observer to participate in and contribute to the work programme of the Commission in areas relevant to the work of the Bank. We value these invitations as an opportunity to represent the perspective and to articulate some of the concerns of developing countries. At the same time, we urge the active participation of the developing countries and their appointed representatives in the various working groups. Given the importance of the Commission’s work, we believe that the developing countries who are current members of the Commission can contribute to and benefit from the active participation in the working groups and the vigorous and informative debates that sometimes characterize these sessions.

In conclusion, I would just like to note that in the Bank’s diagnostic and operational work in the important areas that UNCITRAL has addressed, we look to your legislative guides, model laws and conventions as an indispensable resource. We take this opportunity to congratulate the Commission on its outstanding contributions to the international community.

### 3. *Allocation of work among formulating agencies*

*Chair: Jeffrey Chan Wah-Teck*

*Principal Senior State Counsel, Head, Civil Division, Attorney-General's Chambers, Singapore*

#### *Introduction*

In any discussion pertaining to the harmonization or unification of trade law, it would be useful to begin by revisiting the reasons for these efforts. Human society in this world of ours is organized around States, each with its own unique legal system whose rules apply within its own territory but not outside. The world is a Babel of legal regimes, each applicable only within the confines of a small portion of the Earth's surface. Thus when a person, or a transaction involving persons, whether natural or legal, crosses national boundaries, he or it is subjected to different rules in the different geographical areas where that same transaction occurs. Often it is not even possible to determine with certainty which legal regime, and thus which rules, would apply to that single transaction.

The application of different legal regimes or rules to the same transaction and, worse, the inability to determine which legal regime, if any, is applicable leads to uncertainty of outcomes for all those involved in that transaction. This is whether that transaction is in respect of a personal relationship, such as marriage, divorce or adoption, or a commercial transaction such as the supply and purchase of goods and services. Whatever the transaction may be that takes place across national boundaries, the application of different legal rules raises the cost of that transaction. This may be in the form of an actual cost, such as the cost of obtaining legal advice from lawyers in different jurisdictions. Or it may be the cost of the uncertainty of outcomes, which is the result of not knowing which legal rule applies. All these are costs which are factored into the price, actual or notional, of the transaction.

The uncertainties that arise from the application of different legal rules to an international trading transaction constitute obstacles to that transaction, retarding its further expansion. Harmonizing or unifying the legal rules that apply to the same trade transaction as it crosses national borders makes for certainty of outcomes, reduces cost and removes obstacles to the further development of trade in that area.

The main objective of the United Nations is the preservation of world peace. It is strongly believed that increased international trade, which carries with it the increasing interdependency of nations as well as greater and better interactions between the peoples of the world, is a strong contributing factor to world peace. Thus the strong support by the United Nations to all initiatives that would remove obstacles to world trade, such as initiatives to harmonize or unify the rules of international trade law.

#### *"Harmonization/unification"*

The terms "harmonization" and "unification" have been ascribed different meanings by different authors. A useful and comprehensive definition of "unification" is that described by Kamba (as cited by Osborne, 2006), viz. "the process whereby two or more different legal provisions or systems are supplanted by a single provision or system".

“Unification” is thus a very intrusive process. “Harmonization”, on the other hand, is “a process whereby the effects of a type of transaction in one legal system are brought as close as possible to the effects of similar transactions under the laws of other countries” (Goldring, as cited by Osborne, 2006). Given that the multilateral environment requires the consent of States to any initiative to define the applicable laws to a trade transaction that crosses national boundaries, and that States are often very jealous in safeguarding their own legal regimes, harmonization is the more practicable modality to achieve commonality of legal rules in different jurisdictions on the same subject matter.

#### *International agencies for harmonization of trade law*

The numerous bodies currently involved in attempting to formulate harmonized or unified legal regimes for trade law can broadly be grouped into either public, or governmental, bodies and private, or non-governmental, bodies. Public bodies can be international bodies, such as agencies of the United Nations, Unidroit and the Hague Conference on Private International Law. Or they can be regional bodies such as the European Union, the Association of Southeast Asian Nations (ASEAN) and the Commonwealth of Independent States. Private bodies include business groupings such as the International Chamber of Commerce, trade associations such as Comité maritime international, and the like. Private bodies may also include learned institutions with an interest in contributing to the harmonization and unification of international trade law, although it appears clear that scholars who work in this area have found that they can make much more substantial contributions through their involvement in public bodies.

#### *United Nations Commission on International Trade Law*

The United Nations Commission on International Trade Law (UNCITRAL) occupies a special position among the many public agencies devoted to the harmonization and unification of international trade law. This body was established by the General Assembly in 1966 with a mandate to further the progressive harmonization and unification of international trade law. What is often not recalled is that UNCITRAL was established specifically to enable developing countries to participate in the process of harmonizing and unifying international trade law. There was at that time concern that most international bodies involved in such activities, whether public or private, were dominated by the representatives of developed countries and that the interests of developing countries were not factored into their deliberations and the outcomes of their work. Thus the need arose for an international agency that would be very much more inclusive.

UNCITRAL was established with a wide and ambitious mandate. But it did not have an exclusive mandate. When it was established, it was another institution in a field where several other well-established institutions, including public institutions such as Unidroit and the Hague Conference on Private International Law, were already operating, albeit with different modalities. At the time of inception of UNCITRAL, there appeared to have been no effort made to delineate in its mandate the areas of harmonization/unification on which UNCITRAL should focus, and which the other agencies involved in similar activities should leave to UNCITRAL.

Since its inception, the achievements and outcomes of UNCITRAL have been extremely impressive. Foremost among these are the UNCITRAL Arbitration Rules (1976), the Model Law on International Commercial Arbitration (1985), the United Nations Convention on Contracts for the International Sale of Goods (1980) and the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (1995). In the area of shipping law, UNCITRAL produced the now widely used Hamburg Rules (1978). UNCITRAL was very much the leader in the area of electronic commerce, with its major achievements being the Model Law on Electronic Commerce (1996), the Model Law on Electronic Signatures (2001) and the United Nations Convention on the Use of Electronic Communications in International Contracts (2005). In the high-value area of government procurement, it produced the Model Law on Procurement of Goods, Construction and Services (1994). All these were in addition to numerous other treaties, model laws, legislative guides and other recommendations that addressed the whole range of international trade issues.

#### *Work of other agencies*

During this same period, Unidroit worked on and formulated the 1984 Uniform Law on Formation of Contract and Uniform Law of International Sale of Goods, the Convention on International Financial Leasing (1988), the Convention on International Factoring (1988) and the Convention on International Interests in Mobile Equipment (2001) (popularly referred to as the “Cape Town Convention”). Parts of the Cape Town Convention duplicated in a different way the legislative regime offered by the United Nations Convention on the Assignment of Receivables in International Trade. Unidroit is now working on the Convention on Substantive Rules regarding Intermediated Securities, which moves forward the work undertaken and completed by the Hague Conference’s PRIMA (“Place of Relevant Intermediary”, or “Securities Held with Intermediaries”) Convention (2006).

During this same period, the Hague Conference, which has its origin in the imperatives in Europe at the end of the nineteenth century to unify legal rules pertaining to personal status, has also been active in various initiatives to harmonize trade laws. Its achievements in this area during this time include the Law Applicable to International Sales (1986) and the recently concluded Choice of Court Convention (2005). Determining the proper forum for the resolution of disputes between parties in different States is one of the most crucial issues in international trading transactions which require a common set of rules.

While UNCITRAL, Unidroit and the Hague Conference are public trade law harmonization/unification agencies which espouse membership of the entire international community, other public agencies with far more limited membership are also active in similar activities. An example would be ASEAN, which is now actively engaging in a number of projects, some at the behest of international consultancy firms, to formulate harmonized legal regimes for its member countries in areas such as e-commerce, arbitration and legalization of documents. Other regional groupings engaged in similar activities include, obviously, the European Union, the Organization of American States and the Commonwealth of Independent States. Even within the United Nations system, notwithstanding the ambitious mandate conferred on UNCITRAL, regional United Nations groupings, such as the Economic Commission for Europe, have engaged in

programmes akin to formulating a common legal regime for aspects of international trade. While the declared focus of public regional groups is always to provide for the specific needs and requirements of their own regions, as these tend to be common internationally, the same solutions developed for the region can be offered internationally. So in effect, the efforts of regional groupings in this area are also efforts at formulating internationally applicable legal regimes to overcome the differences in national laws on various subject areas of trade law.

Apart from public agencies, private agencies were also very active in formulating common rules for international trading transactions. Some of these rules are widely accepted and used. Foremost among these would be the Incoterms developed by the International Chamber of Commerce. Other examples include the harmonized construction contracts developed by the International Federation of Consulting Engineers (FIDIC). The achievements of private agencies, especially trade associations and business interest groups, in formulating harmonized legal regimes for international trading transactions cannot be understated. However, as they are private rather than public initiatives, they are established to further the interests of their membership rather than the wider public. Their outcomes would, not unnaturally, reflect their objectives. This sets them apart from what is expected from Governments and the public agencies that Governments populate.

#### *Harmonization/unification worldwide*

A quick appreciation of the work and outcomes of the many public and private agencies currently involved in the harmonization/unification of international trade law reveals a rather confusing picture. There is no lead agency, although UNCITRAL, being an agency of the United Nations, enjoys greater recognition in many countries of the world. While each agency has its own working modalities and approach issues from its own perspective, which often are not the same as that of other agencies, in many areas agencies are seeking solutions for the same issues and difficulties which are common to all international traders. While some attempt is made at coordination at the informal level, this appears to be dependent on personal relationships. There have been instances where agencies have interpreted coordination as meaning persuading another agency not to work in an area or on an issue where they are interested in working. Because there is no single body having oversight of the numerous initiatives being undertaken by the different agencies, there is no compulsion to avoid duplication of work.

The fact that many different agencies, all fully staffed and with highly qualified experts as regular participants, are seeking solutions to the same issues at the same time means an inevitable wastage of resources. What is potentially more serious is that each agency may formulate different solutions to the same common problem, and then promote its solution as the preferred solution to that problem. As each agency promotes its outcomes to the same international community, the fact that some States may be persuaded by some solutions, while other States may be persuaded by other solutions, means that different legal regimes may be enacted domestically in order to bring about a common legal regime for that same transaction. The result is “dis-harmonization” rather than harmonization or unification of trade laws. This leads to exactly the same results that the proposed solutions are to mitigate: confusion over applicable legal rules, increased cost and more obstacles to the expansion of world trade.

*Contributing factors*

The reasons for the present situation among agencies involved in the formulation of harmonized/unified legal regimes for international trade are not difficult to discern. Foremost would be the numerous historical factors. Different agencies were established at different points in time in order to address perceived needs at that time. Over time, these agencies evolved a life of their own and identified their own objectives, which they then pursued. This is buttressed by the fact that all agencies tend to develop into institutions, each with its own fairly defined community of stakeholders. Among the most important stakeholders are their members. Equally important and influential stakeholders are the numerous experts who find that in the agencies they are engaged in an appreciative forum for the application of their intellect. Once established as institutions, agencies operating in any arena find it difficult to reduce the space they currently occupy. If anything, their natural imperative is to expand that space.

Other major, and unsaid, factors in the present situation include a certain level of scholarly competition to come up with solutions to the same issues, national pride whereby States having a strong influence over a formulating agency would not like to see the influence of that agency diminished, and commercial imperatives whereby interested commercial groups seek the most sympathetic forum in order to formulate preferred commercial outcomes. Also, the personalities involved in different formulating agencies have a great influence on the work of these agencies. So it is not difficult to see why there are overlaps and duplications with regard to many issues among agencies involved in the harmonization or unification of international trade law.

The present international scene in the field of harmonization/unification of international trade law means that many of the hopes underlying the establishment of UNCITRAL have not been fully realized. UNCITRAL is a body of States established to give developing countries a voice in this area of work. The fact that there are numerous other agencies working in the same area, many of which are composed of States, can only mean that the voice and influence of UNCITRAL in the harmonization of trade law is less than what was intended by its promoters. This may be because of insufficient appreciation among the members of the United Nations of the reasons underlying the establishment of UNCITRAL. It may also be because of a code of commitment to these objectives. If so, then this would be sad.

*Looking forward*

To fully optimize efforts in the harmonization or unification of international trade law, there is a need for a new paradigm in the work of the numerous formulating agencies, whether public or private, regional or international. There should be clearer delineations of work between different agencies, which would result in optimum utilization of resources, especially the intellect of experts. As all countries are engaged in international trade, there is an overarching need to ensure that all countries of the world, not just well-endowed States or States with articulate representatives, have a voice in the process of harmonization or unification of international trade laws. This is especially important for developing countries which do not have the resources to actively participate in a large number of law-formulating forums.

Any step to move forward to achieve this goal must be mindful of the will of States as expressed through the United Nations. Foremost in this regard is the basic principle that all States should have a role in formulating the legal regimes and rules that their people will be subjected to when trading with each other. Also, it is important to recall that public and private formulating agencies serve different interests and that the primary responsibility for the introduction of mandatory legal regimes rests with Governments, and not with groupings of private commercial interests.

### *The ideal world*

In an ideal world, the process of harmonization or unification of laws, whether trade laws or laws pertaining to personal status, should be undertaken by a single agency and not a myriad of uncoordinated or even competing agencies. This may be an unrealistic expectation given that commercial interests will naturally press for legal rules and regimes favourable to them through their respective trade groupings. But this is conceptually achievable among States, especially when those States are members of the same universal organization, namely the United Nations. For example, while UNCITRAL and Unidroit adopt different working modalities in formulating their respective outcomes and work with different interest groups, they address the same issues in broadly the same area: international trade law. Many States are members of both. It does appear somewhat lavish and rather unfair to States with limited resources for both agencies to be operating separately. This is an issue for States who are members of both to address.

If indeed it is possible to establish a single public body internationally for the harmonization or unification of trade laws, then this body can be mandated to coordinate the work of other regional and multilateral bodies in the same area. The success or otherwise of such efforts would again depend on the commitment of the States involved to the need for a coordinated effort in this area of work. Any body established to this end must be one that is both consultative and inclusive. It must take into account the views of all the stakeholders on an issue it is deliberating on, and where possible include them in its deliberations. Its work and processes must also give effect to the intent of the nations of the world expressed through the United Nations that any harmonized or unified legal regime or rules formulated by public formulating agencies must provide for the interests of not just the developed world but developing countries as well.

### *Conclusion*

The present international scene in respect of the formulation of a harmonized or unified legal regime and rules for international trade is very dynamic with numerous initiatives being undertaken by various formulating agencies. Many notable and successful outcomes have been produced, especially in recent years. There have however been overlaps and duplication of work in a number of areas and on particular issues. This means a wastage of resources and intellectual effort. The presence of numerous public formulating agencies working in the same areas means that less-resourced States, in particular developing nations, are not able to participate effectively in the formulation of rules that affect them. This is contrary to the intent of the nations of the world as expressed in the establishment of UNCITRAL in 1966.

It is important that the work of formulating agencies in this area be optimized. The ideal solution would be if there is a single formulating agency with a mandate to coordinate the work of other public agencies in this area. This is probably not a realistic expectation given the history and the long institutionalization of the major formulating agencies. The alternative is to establish regular forums whereby the work of the present agencies can be coordinated. Whether this can be achieved would depend on a host of factors, both institutional as well as personal. The determining factor in achieving this objective is the will of States, especially States who are members of the different formulating agencies and who participate actively in their work.

A forum to coordinate the work of the present formulating agencies would in effect be a vehicle for harmonizing or unifying the work of these agencies. It appears somewhat ironical that in order to effectively harmonize or unify the trade laws of the world, the agencies charged with this task must themselves first be harmonized or unified. Failure to achieve this would mean that the world must contend with the fact that the initiatives to put in place more harmonized and certain rules for the flow of international trade in order to remove obstacles to world trade would instead produce greater disharmony and thus additional obstacles to the continued expansion of trade among nations. The effect of these new obstacles in the area of international trade on the maintenance of world peace is a major factor that must be considered.

#### 4. *Coordination of domestic positions in international forums*

*Kathryn Sabo*  
*General Counsel, Department of Justice, Canada*

##### *Introduction*

The importance of coordinating domestic positions in international forums cannot be stressed enough if States are to maximize the potential of these forums (and the resources they devote to them). There are multiple challenges inherent to coordinating domestic positions in international forums, but steps can be taken to ensure that effective coordination does take place or at least occurs more regularly.

This text simply aims to set out different aspects of the problem and put forward some ideas as to how the problem might be remedied, in hopes of stimulating discussion and, ideally, action in States.

##### *The problem*

The problem manifests itself in several situations. For example, States may approve work programmes that duplicate work done elsewhere, leading to an inefficient use of resources. States may take a different position on the same or similar issue across various instruments and across international forums, which can result in delay in the process of development of an instrument or even in conflicting instruments. The seriousness of the latter case is that the acceptability and therefore the effectiveness of the instruments which conflict are directly reduced. Moreover, the credibility of the organizations under whose auspices the instruments were prepared might also be negatively affected.

The presumption here is that the apparent lack of coordination arises from inadequate information-sharing and not from any intention on the part of a State to seek duplication of efforts or conflicting results. While it is perhaps stating the obvious, Governments are organized in different ways in different States. The allocation of responsibility for any given organization varies from one State to another. When this is combined with overlapping, but not identical, mandates in the various international organizations, and in many cases a perennial lack of resources, one can understand how inadequate information-sharing can result.

The simplest case where the need for coordination can arise would be within one State regarding different projects ongoing within one organization. Examples at UNCITRAL could include the work on the *Legislative Guide on Insolvency Law* and the *Legislative Guide on Secured Transactions*, or the draft Convention on the Carriage of Goods and the UNCITRAL Arbitration Rules. In such cases, even though only one organization is involved, its projects may fall under the responsibility of different government ministries or different units of the same ministry because of the subject matter. For some States, including Canada, even this simplest illustration of the need for coordination is rendered more complex because of an allocation of responsibility over the different subjects among different levels of government.

Coordinating the position within one State with respect to the work of different organizations requires a broader perspective. In many countries, UNCITRAL, Unidroit and the Hague Conference on Private International Law all fall under the responsibility of the Ministry or Department of Foreign Affairs or its equivalent, making it fairly easy to coordinate. In other countries, some or all of the responsibility may lie with the Ministry or Department of Justice or Industry. On the other hand, the World Bank, for example, may be the responsibility of another department altogether. Moreover, the position of a State on a given issue usually needs to involve the part of the Government that is responsible for that issue in domestic law, not just the ministry or department responsible for the organizations in question. To add to the complexity, there are many organizations whose interest in matters of commercial law is more or less direct depending on the subject matter of a given project and so the range of coordination necessary will vary.

### *Solutions*

States need to understand and agree that a coordinated approach brings greater benefits. The solution will undoubtedly vary from one State to another and will be determined in part by the availability of resources, but will need to be based on the timely sharing of information about initiatives through a network of officials.

Member States, both new and old, should be invited to consider whether they have such a network or to review their existing information-sharing structures to determine whether they are adequate. Within a State, officials might ask whether centralization of responsibility might improve coordination. To the extent that information is shared regularly, centralization is not essential, but the centres of responsibility for the various organizations and for the specific subject matter need to be identified. Coordination should be viewed from a general perspective as well as with respect to particular projects. Can a permanent inter-ministerial body be created?

The limits of effective and efficient coordination need to be considered as well. A State's interest in coordinating its position in global and regional forums should be evaluated. The range of interests involved will vary depending on the subject matter: some initiatives go beyond private law to touch on areas of public law; some commercial law projects go into areas of more strictly private law.

The extent to which the secretariats of the various organizations concerned can assist member States in their internal coordination should also be taken into account. Certainly when there are horizontal links to be made between or among projects of one organization, the secretariat can assist by convening, for example, joint sessions of the respective groups involved. Coordination when more than one organization is involved is likely much more limited.

### *Further perspectives*

Internal coordination might be viewed as only one building block among several that could be put in place to construct a more efficient and effective framework for the development of harmonized or unified commercial law. Consistently coordinated positions on behalf of one State from one project to another and from one organization to the next, at least at the level of global multilateral organizations, would be a step forward.

A well-established information-sharing network could also go beyond the preparation of new instruments and be helpful in the promotion and adoption of existing ones.

In seeking a more efficient and effective framework for the development of harmonized or unified commercial law, States might go even further. Where membership in global organizations overlaps, those States should seek to coordinate their respective positions. Because membership does not overlap in all cases, coordination of the work among organizations requires additional mechanisms. While some coordination can be done directly among secretariats of the various organizations, member States need to consider how they might establish effective inter-organizational coordination mechanisms.

The various organizations concerned could be more proactive to move their member States to take steps to coordinate, both internally and across organizations.

### *Conclusions*

The suggestions for coordinating domestic positions may not completely resolve the problem, but would go some way toward improving the situation. States need to make the appropriate links and consider creating permanent structures to ensure timely information-sharing.

It should be recognized that coordination of domestic positions is only one aspect of the broader problem of coordination of harmonization and unification globally. The various organizations concerned and their member States would benefit from further discussion of the coordination of domestic positions in the context of a discussion of the process and methods of international rule-making.

## 5. Comments, evaluation and discussion

*Majeed H. al-Anbaki*

*Permanent Mission of Iraq to the United Nations (Geneva)*

My name is Dr. al-Anbaki. I am a professor of private law at Iraqi universities and now Minister Plenipotentiary at the Iraqi Mission to the United Nations in Geneva. First of all, I would like to congratulate you, Mr. Chairman, and other distinguished members on the occasion of the fortieth anniversary of UNCITRAL.

The points I would like to raise are the difficulties I face when I go back home and try to convince my colleagues in the Government of the importance of the instruments issued by UNCITRAL, as they are based on legal concepts which are different from those that prevail in my country, particularly when the matter falls in the field of contracts and tort liability. As you well know, Iraq has a very rich legal tradition, starting with the Code of Hammurabi more than 4,000 years ago and continuing with Islamic jurisprudence up to modern legislation influenced by the civil law system. I think that the promotion of the work of UNCITRAL in my country would be facilitated if UNCITRAL were to avoid dealing in detail with matters, such as formation of contracts and law of torts. Therefore, if we want to develop a model law on investment, for instance, we should state the rights and the duties of the contracting parties rather than enter into the formation of contracts because this depends on internal law. In the future, I would like to see the instruments developed by UNCITRAL state that contract formation and torts should be subject to internal law. This would allow us to follow our civil system or our principles of contract for purposes of contract formation, while applying the rules developed by UNCITRAL to the rights and obligations of the contracting parties.

### **B. Harmonization of commercial law: practical importance and economic value**

*Chair: Kazuaki Sono*

*Hokkaido University, Japan; and Secretary of the United Nations Commission on International Trade Law, 1980-1985*

I am pleased to be here on the occasion of the fortieth anniversary of UNCITRAL and to meet many former colleagues. It is also my honour to be invited to chair this panel. This conference room is filled with pleasant memories, starting with my younger days when the International Trade Law Branch, not yet a division in those days, was transferred to Vienna from New York in 1979. Since then, UNCITRAL has continued to grow steadily and its work has expanded in scope in response to the globalization of economic activities.

Now the panel is invited to discuss the so-called law and economics approach, which might be used in assessing unification efforts of commercial law. As we all know, the unification and harmonization of the law of international trade has been the very core mandate of the Commission since its establishment in 1966. Therefore, most of those who participate in the work of the Commission take a position favourable to legal unification. Thus, probably, this is the first time for UNCITRAL to focus officially on the costs and benefits analysis in the context of the unification process. Meanwhile, cost and benefit

analysis is now in fact in full swing in Europe, in particular in relation to the question of whether the European Union needs a single unified contract law, and all of our panellists here this afternoon are presently actively involved in that issue within the domain of the European Union. It must also be noted as a matter of fact that the international community has already had experiences in empirical analysis of costs and benefits for international legislation, namely the Convention on International Interests in Mobile Equipment (2001). This work was undertaken in view of the significant financing requirements of the aviation industry over the coming years. And before agreeing on the Convention, the working group undertook empirical research to examine how much benefit could be expected from introducing the framework and how the benefits would be distributed among the borrower, the financier and society in general.

It can also be predicted that in the areas of highly advanced global business activities, where traditional legal concepts or theories can no longer provide adequate solutions, assessment on the basis of costs and benefits may become more popular and it will provide a basis for finding a shared preference among States for a uniform law.

The first speaker is Professor Gerhard Wagner of the University of Bonn. He is a professor of private law, civil procedure, private international law and also comparative law. He holds a Master of Law degree from the University of Chicago Law School and has published many articles, both in English and in German.

### *1. Transaction costs, choice of law and uniform contract law*

*Gerhard Wagner*  
*University of Bonn, Germany*

#### *(a) The benefit of harmonization: reduction of transaction costs*

Harmonization of commercial law would replace the many legal systems of the different nations with a single legal instrument. Obviously, such a sweeping measure would simplify a lot of things. Courts sitting within one of the signatory States would have to apply the same provisions, commentators would have to refer to the same language, theorists would have to theorize on one and the same set of rules, and parties would have to accept or contract around the same balance of costs and benefits that is enshrined in a particular legal rule.

It cannot be disputed that full harmonization of commercial law would yield considerable benefits in the form of transaction costs saved. The proliferation of legal rules under the current system of legal diversity imposes serious costs on enterprises doing business in more than one jurisdiction because they have to comply with the differing standards of a whole array of legal systems. Although the many different legal systems of the world may be lumped together into a rather small set of “families”, each of which contains similar provisions, the variance in detail remains vast, even within one and the same family. Each legal system supplies rules on, e.g. form requirements, duress and unconscionability, on prescription periods and the like which may rest on common principles in the abstract but are nonetheless different in detail and thus yield divergent outcomes when applied to a case at hand.

The resulting legal diversity forces an international enterprise to change its way of doing business upon crossing the border from one jurisdiction to another. The enterprise has to develop and draft specific contracts for each and every jurisdiction in order to obtain a perfect fit with the respective legal environment and institutional framework. Company law is a good example. The usual strategy for a multinational enterprise to deal with the fact that each jurisdiction has its own set of corporate entities, runs its own register and has its own minimum standards and requirements for incorporation is to form a different legal vehicle for each jurisdiction which is in charge of the business done in the particular market. Of course, the need to establish a separate corporate vehicle in each jurisdiction comes at a cost which increases the price of the goods in the market. With respect to the European internal market, judges and lawmakers have taken measures aimed at economizing on these costs, e.g. the institution of the European company/*société européenne* and the *Centros* jurisprudence of the Court of Justice of the European Communities, which allows companies incorporated in one member State to move to another member State without changing their legal status.

Also in the area of contractual dealings, the financial burden associated with the need to make special provision for each and every jurisdiction in which the enterprise does business is likely to be considerable. It looms particularly large in the service industry, which oftentimes “sells” products that are created with the means of the law, in the sense that the core of the obligation of the supplier cannot be identified and described without reference to the applicable legal regime. Insurance contracts are a pertinent example. The current fragmentation of insurance law places considerable costs on multinational insurance firms, raises barriers to entry into foreign markets and thus supports the current fragmentation of insurance markets.

However, the mere existence of transaction costs does not automatically entail that they must be saved. The crucial question is not whether transaction costs exist but whether they outweigh the benefits associated with legal diversity, which is the current state of affairs in international law. What would be lost in the course of harmonization is the treasure of different solutions to a given legal problem which is preserved within the many legal systems still existing on this planet. In this respect, law behaves like any other feature of life. Just as the extinction of species reduces the variance within the biological system, so the annihilation of the municipal systems of commercial law would reduce the variance within the legal system. The experience to draw on would be diminished and the potential for fatal errors increased.

But still, there clearly are examples in legal history where a single nation or a commonwealth of nations came to the conclusion that the benefits of harmonization are greater than the benefits of diversity. In Germany, argument over this question went on throughout the nineteenth century until a uniform German civil code—the *Bürgerliches Gesetzbuch*—came into force on 1 January 1900. In our days, the European Union is faced with the same choice of whether to replace the contract laws of the member States with a single European civil code. On the international level, UNCITRAL works for the harmonization of divergent laws by promulgating model laws like the Model Law on International Commercial Arbitration and conventions that supply a uniform set of rules for cross-border transactions. The most prominent example here is of course the United Nations Sales Convention (CISG). The success of both the CISG and the Model Law on International Commercial Arbitration is evidence of the fact that both lawmakers and the business community think that there are gains from adopting the Model Law and signing

the CISG. These gains are in the form of transaction costs saved. In both cases, adoption of the UNCITRAL texts makes it easier for foreign practitioners to find their way into a foreign legal system that otherwise would be very difficult to access. The example of international arbitration is particularly striking: in this area it is thought that adoption of the Model Law makes a given country much more attractive as a place of arbitration than it would otherwise be. In a similar vein, it is thought that adhering to the CISG as the international standard in the area of sales law makes enterprises residing in a given country more attractive as a trading partner.

What is interesting about these examples is the fact that the Model Law and the CISG gain their followers not so much or not only for the sake of their inherent virtues. Of course both instruments aim at representing the best legal practice in their respective fields but—as always—there is no consensus as to whether this aim has been reached. States which adopt the Model Law or which accede to the CISG are not motivated by the intrinsic virtues of these instruments but by the simple fact that they want to run with the crowd. Whether the CISG really is superior to any other given law of sales will always be a matter of dispute; the decisive point is that many lawyers around the world feel comfortable with the CISG—for better or worse. The reason they feel so comfortable is that they know something about the CISG and are thus better able to predict outcomes and to anticipate outcomes when drafting the terms of their contracts and making choices about the way they do business.

It needs no further explanation that a quantitative analysis of the relative costs and benefits of legal diversity and legal unity does not exist and is impossible to come by. There is simply no way of measuring with any exactness the benefits and costs both of legal harmonization and of legal diversity in order to compare the two. However, the mere fact that it is impossible to come up with numbers must not close the door to a more thorough analysis of the crucial issues. In particular, it should not preclude the task of investigating the costs and benefits to the fullest possible extent and of engaging in some sort of weighing up of the advantages and disadvantages and the costs and benefits of diversity, on the one side, and of unity, on the other.

*(b) Choice of law as a substitute?*

Businesses do not need harmonization in order to be able to operate on the basis of a single set of legal rules. The same result may be obtained by using the mechanism of choice of law. By exercising this choice in favour of a single legal system, uniformity may be achieved across all transactions in which a particular business engages.

It is easy to see that the argument just made is highly stylized. What is true in theory may be dead wrong in practice. To be sure, there is no doubt that choice of law is a question which is ordinarily discussed and resolved in the course of contract negotiations. There are not many cross-border transactions where there is no choice-of-law clause included in the agreement. In doing so, the parties are able to reap considerable benefits. In particular, the parties are being transposed into a position where it is possible to write a contract with confidence that it will not be annulled by a court should a dispute arise. To put the matter straight, it is only possible to contract around default rules and to avoid mandatory rules with the potential to nullify the entire contract or significant parts thereof if the parties know what those rules are. Unless the

prerequisites for a finding of unconscionability are known, the parties are unable to avoid the consequences of this doctrine. A contract will be written differently if the parties anticipate that the judge or arbitrator interpreting the contract down the road will follow a passive approach and honour the principle of party autonomy to the greatest possible extent, or if they imagine an active judge or arbitrator who is under a duty to question the fairness of a contract and to set aside specific provisions which he or she deems unfair. This list of examples could be expanded considerably. The power of the parties to designate the law applicable to their contract enables them to anticipate the rules which will be applied in case a dispute should arise in the future and to draft their agreement accordingly.

What choice of law still cannot do is provide a uniform legal framework for all the business activities an international enterprise engages in. Even for powerful international firms that have enough bargaining power to impose their terms on their contract partners, the idea of putting each and every business relationship on the same legal footing remains an illusion. In some markets and with some clients, the firm will be able to have its way, but no firm will be powerful enough to always have its way and to include the same choice-of-law provision in every single contract it concludes.

The upshot of the preceding analysis is that choice of law is a valuable instrument for parties in the process of negotiating a contract “in the shadow of the law”. What it does not do, however, is provide the enterprise with a single legal environment. Powerful firms will be able to fix the law of their home State as the applicable law in many instances but they will not be able to push this position through each and every time. Apart from this, it must not be forgotten that there is always another party to the transaction. If the other contracting partner has imposed terms by insisting on the legal system it always chooses because it knows that system best, this means for the other party that it has to live with the choice of a foreign law which it might not be able and willing to understand, let alone to anticipate the outcomes of legal disputes arising in the future.

Therefore, at least one party to the transaction will be burdened with the high information costs which ensue if a dispute arises. At that point, the party or parties not familiar with the chosen law will have to search for an attorney in another jurisdiction in addition to the one regularly employed, will have to explain its business practices to a foreign court and mingle them into the law that was chosen, hoping that the latter will accept the gift, and so on. For the rank-and-file contracting party, the costs associated with such investigations may be prohibitive.

The upshot of the preceding analysis is that choice of law is an indispensable tool to provide legal certainty and the protection of legitimate expectations. What it does not do, however, is fully cure the transaction cost problem. Rather than decreasing the costs of contracting, choice of law may rather add a considerable sum to the bill. Therefore, the transaction costs rationale for harmonization remains intact.

*(c) Uniform contract law in action: procedural prerequisites*

The final question to be asked in this short presentation comes back to the cost reduction argument developed above. Now is the time to examine more carefully the underpinnings and prerequisites for harmonization to bear the fruit that it is expected to

yield. The objective of harmonization is to economize on transaction costs by allowing a multinational business to operate within a uniform legal framework and to use a single set of contracts and other legal products. How realistic is it to assume that matters will ever be as simple as that? This leads to the question whether harmonization “on paper” is enough to generate the benefits of a uniform legal framework.

As lawyers know only too well, different courts might understand identical texts in utterly different ways. What some regard as a major principle, others regard as a rare exception. What some regard as so obvious as to merit no further discussion, others take to be extremely controversial. And, most often, where some lawyers are convinced that A is the proper solution to a given problem, others think that non-A is preferable or they prefer an intermediate or an utterly different solution. As a consequence, a uniform legal framework presupposes not only that statutory sources are identical but also that there is a single decision maker charged with the authority to decide controversies of opinion one way or another.

Current experience with one of the most prominent achievements of UNCITRAL, the CISG, may illustrate this point. International conventions necessarily represent a compromise between the conflicting views of the States involved and their respective legal systems. One strategy for reaching a compromise in the face of strong differences in substance is to resort to vague terms. If States cannot agree whether a time limit for a particular remedy should be two weeks or two months, one solution could be to agree on one month; but another one might be to stipulate that notice shall be given or a statement of claim served within a “reasonable” time or without “unreasonable” delay. The strategy of overcoming differences in substance by resorting to vague standards instead of hard and fast rules works fine for negotiators and lawmakers but it is anathema to courts and practitioners. Legal certainty and the foreseeability of outcomes are sacrificed in order to achieve the harmonization goal.

Whenever a bad compromise in the sense just described is reached, the responsibility to fashion a legal rule is shifted to the courts. Within the context of the national legal systems it is then for the supreme court of the particular jurisdiction to decide what the lawmakers were unable to settle. The same consequences ensue within the European Union where the Court of Justice of the European Communities is charged with the authority to resolve disputes involving the interpretation and application of European law. There is no doubt, for example, that the Brussels I instrument—now a regulation, formerly a convention—has made such a stunning career for the simple reason that the Court was accorded the competence to authoritatively interpret the legal text on which the member States had agreed. Without the jurisprudence of the Court, there would be as many versions of Brussels I as there are member States.

On the international level, however, an institution charged with the authority to finally settle disputes turning on a question of international law is missing. There is no court competent to interpret the CISG with a binding effect for all the States parties. Quite the contrary, it is for the judicial systems of the several States parties to resolve disputes around the CISG. Not surprisingly, they have come up with different interpretations and solutions. A pertinent example is article 39, paragraph 1, of the CISG which requires the buyer to give notice to the seller of any defect of the goods delivered, and to do so “within a reasonable time” after it has discovered the defect or “ought to have discovered it”. Courts in different

countries have differed widely about how long a “reasonable” time might be. For parties writing a contract and thinking about choice of law, such ambiguities are much worse than clear-cut rules, although the risk with the latter is that they get it wrong, e.g. provide a time limit which is too strict or too lenient. Clear-cut rules have the important advantage of being foreseeable in their application. Thus, it is easy to contract around them if need be.

For this reason, it was perhaps no accident of history but a well-made choice, either deliberate or intuitive, that procedural law goes first when the hour of harmonization strikes. At the end of the nineteenth century, when Germany finally became a nation State, one of the first areas harmonized was the code of civil procedure. The substantive law followed almost a quarter century later. The same development evolved at the European level during the last 40 years. The former European Community of six nations enacted the Brussels I Convention on the harmonization of the rules on jurisdiction and recognition and enforcement of judgements in civil and commercial matters already in 1968, long before the legislation of the Community reached the substantive law.

Without a judicial system authorized to interpret and apply the products of harmonization, the whole enterprise is questionable. Harmonization “on paper” remains worthless unless it is transformed into or supplemented by “law in action”. While it is certainly true that the mere fact that there is a common legal text that is binding for everybody leads to convergence, this is a far cry from the legal certainty and predictability of outcomes that a business enterprise needs in order to write its contracts accordingly.

In other words, a uniform law of contract is in urgent need of a unified system of judicial administration in civil matters that is capable of resolving the many issues of doubt with which any civil code will invariably be afflicted. Harmonization of civil law makes full sense only in conjunction with a thorough and ground-breaking reform of the international system of civil justice.

To be sure, issues of procedural reform have recently been discussed at the European level but the scope of the analysis was narrow, i.e. focused on reforms within the current system of one or rather two central European courts. The superior court of the two, the Court of Justice of the European Communities, serves at once the function of a constitutional court, of a forum for disputes involving a vast range of issues of administrative law, and of the highest European court in civil matters as far as the application of Community law is concerned. To everybody who takes harmonization seriously it should be obvious that such a system of judicial administration simply does not live up to the objective of administering a European contract law that is relevant to the thousands of disputes that are heard in the many European courts every day.

The procedural cornerstone of harmonization is still missing, even in the area where European Community law governs, but even more so on the international level. For this reason, international harmonization of commercial law necessarily remains incomplete. It is of course true that man-made solutions are rarely “complete” or perfect. Every human institution necessarily is defective if judged against a model of pristine perfection. To say that something is incomplete does not mean that it is to be discarded.

However, the problem with harmonization goes deeper than the acknowledgement of the unavoidable deficiencies of human institutions. It is no secret that many parties and

their advisers prefer national legal systems of good reputation like the English or the Swiss one to instruments of international law like the CISG. The main reason for said preference is certainly not that parties or counsel think that the national system in question is superior to the CISG. Such a conclusion would presuppose comprehensive analysis comparing the two systems which is costly and time-consuming and whose results will always remain controversial. The forces behind the drive towards national systems rather is the high degree of certainty and predictability of outcome these systems have to offer in conjunction with the good reputation of the respective judicial system charged with applying and developing the national law in question. These interests must not be sacrificed for the sake of harmonization. Rather, the parties must retain the power to come back to local law, i.e. by exercising their choice in favour of a well-renowned system of national law.

*(d) Conclusion*

This presentation dealt only with a few aspects of harmonization. The common thread linking the topics raised is the question of what the costs and benefits of harmonization might be. The approach is deliberately down to earth and party-centred. Harmonization is thought to be an object of choice rather than an end in itself. If decision makers ask whether they should harmonize commercial law or continue to live with diversity—or rather, a mix of harmonized and national law—the answer must be that this depends on whether the balance of costs and benefits is positive. Although it is impossible to arrive at a definitive answer, even a sketchy analysis raises serious doubts whether the benefits will really outweigh the costs. Therefore, it is crucial to leave the parties the choice of opting out of instruments of international law to come back to the national system they prefer. As long as this is possible, the downside of harmonization may easily be avoided and the costs of harmonization shrink to the point where they are equal to the costs of drafting and negotiating the international instrument in question. These costs will always be worthwhile.

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*Kazuaki Sono, Chair*

This is a good start for the afternoon: a very provocative way of presentation and very exciting and extremely interesting. Probably we can discuss later some of the important points that you have raised. But may I just mention that when you mentioned article 39, the importance of article 7, paragraph 1 might have been very much underestimated. In that case, parties can always agree on the length of the period, but we will come back to that later. Also, with regard to the intersystem competition which you appreciate, certainly uniformity may eliminate that kind of intersystem competition, because we lose diversity. But you might also consider that in the case of UNCITRAL or international unification of law, no domestic law is disturbed for the moment. These days, things are changing, but I hope the distinguished participants will keep those points in mind in making comments to us.

The next speaker is Professor Jan Smits. He is a professor at the University of Maastricht, Netherlands, and holds the Chair of European Private Law. He holds a Master's degree and a PhD degree from the University of Leiden. He has held many visiting positions at many academic institutions, such as Tulane Law School; Catholic University, Leuven; and Louisiana State University. He is widely published in the field of private law,

comparative law and legal theory. Professor Smits has also been an honorary judge in the Amsterdam Court of Appeal since 2004. Professor Smits is the editor of the well-known book *The Need for a European Contract Law: Empirical and Legal Perspectives*, and in fact all the speakers today are contributors to this important book. So, you will see how fortunate we are to have those three speakers, who are experts in this field. Professor Smits, you have the floor.

2. *Economic arguments in the harmonization debate: the practical importance of harmonization of commercial contract law*

Jan Smits

University of Maastricht, Netherlands

(a) *Introduction*

This contribution discusses the practical importance of harmonization of commercial contract law.<sup>22</sup> Do we need such harmonization and, if so, how should we achieve it? All three of today's speakers were asked to address this question. My job is to discuss the various economic arguments in the debate. Gerhard Wagner has already discussed the most important economic argument of the reduction of transaction costs through harmonization of law. I will therefore build on his talk by discussing some of the other arguments in the debate. It will be seen that I am quite sceptical about the need for harmonization of commercial law and that if one wants to harmonize this area, one should do so from the bottom up.

The question I will discuss is to what extent diversity of contract law forms a barrier for international trade. Put otherwise: would a unified contract law promote international transactions? Lawyers and legal scholars tend to answer these questions in the affirmative. I think that the following statement by Ole Lando is representative of the lawyer's view:<sup>23</sup>

“It should ... be made easier to conclude and perform contracts and to calculate contract risks. ... Foreign laws are often difficult for the businessmen and their local lawyers to understand. They may keep him away from foreign markets in Europe. ... The existing variety of contract laws in Europe may be regarded as a non-tariff barrier to trade.”

This argument can be summarized by saying that disparate national laws may lead to higher transaction costs, in particular for small and medium enterprises.<sup>24</sup> But the thing is that the two questions just formulated are not really legal questions: they ask about the effect

<sup>22</sup>This paper is based on previous papers by the same author about the need for the harmonization of contract law. See, in particular, Jan Smits, “Diversity of contract law and the European internal market”, in *The Need for a European Contract Law: Empirical and Legal Perspectives*, Jan Smits, ed. (Groningen, Europa Law Publishing, 2005), pp. 153 ff., on which a large part of the present paper is based.

<sup>23</sup>Ole Lando, “Optional or mandatory europeanization of contract law”, *European Review of Private Law*, vol. 8, No. 1 (2000), p. 61.

<sup>24</sup>Commission of the European Communities, “Communication from the Commission to the Council and the European Parliament on European contract law”, COM (2001) 398, No. 30-32; cf. Commission of the European Communities, “Communication from the Commission to the European Parliament and the Council: a more coherent European contract law—an action plan”, COM (2003) 68, No. 34. Also see D. Staudenmayer, “The Commission communication on European contract law: what future for European contract law?”, *European Review of Private Law*, vol. 10, No. 2 (2002), p. 254.

of law on the conduct of businesses and therefore these are questions that can only be answered by (behavioural) economists or even psychologists. These are the disciplines that deal with human behaviour and therefore also with the behaviour of commercial parties.<sup>25</sup>

In the remainder of this paper, three types of arguments about the need for a uniform contract law are looked at: empirical, economic and psychological arguments.

(b) *Empirical arguments on the importance of (uniform) contract law*

There are two types of empirical evidence on contracting that may be useful to answer the question about the need for a uniform contract law. The first is concerned with the importance of contract law as such for business relationships, the second with the importance of a uniform contract law for international contracting.

Stewart Macaulay's survey of contracting in the State of Wisconsin<sup>26</sup> is still the most important evidence of the importance of contract law for commercial parties. Macaulay discovered that in most cases businesspeople are not interested in the meticulous drafting of contracts at all; in case of a dispute about the performance of the contract, the majority of businesspeople are not prepared to undertake legal action but instead try to informally settle the dispute and take their losses if they do not succeed in doing so. Beale and Dugdale confirmed Macaulay's findings for England.<sup>27</sup> One of the reasons for this reluctance to rely on contract law is that, according to these surveys, most of the time parties deal with counterparts they regularly do business with. Too much contract enforcement would put these relationships under pressure. Another reason is that elaborate planning of the contract is expensive and is not justified by the few cases in which a conflict arises. These findings show that contract law as such is not as important for the enhancement of trade as governments or academics sometimes think. This also puts the need for a uniform law into perspective. The effect that unification of contract law will have is probably not as important as the effect of Europeanization (or globalization) on the market as such.

A good starting point for the second point (the influence of uniform contract law on international contracting) is the European Commission's communication of 2001.<sup>28</sup> In that consultation paper, the European Commission asked businesses to indicate whether they experienced problems through diversity of (contract) law. Most reactions of business organizations and practitioners showed this was not the case.<sup>29</sup> In most reactions, it was remarked that the internal market may not function perfectly, but that this was caused primarily not by differences in private law but much more by language barriers, cultural

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<sup>25</sup>The important theoretical arguments that diversity of law enhances competition and experiment, thus leading to a more efficient and a better law, are not discussed here. A passionate plea in favour of these arguments can be found in Jan M. Smits, "European private law: a plea for a spontaneous legal order", in *European Integration and Law: Four Contributions on the Interplay between European Integration and European and National Law to Celebrate the 25th Anniversary of Maastricht University's Faculty of Law*, Deirdre M. Curtin and others, eds. (Antwerp, Intersentia, 2006), pp. 55 ff.

<sup>26</sup>Stewart Macaulay, "Non-contractual relations in business: a preliminary study", *American Sociological Review*, vol. 28, No. 1 (1963), pp. 55 ff.

<sup>27</sup>Hugh Beale and Tony Dugdale, "Contracts between businessmen: planning and the use of contractual remedies", *British Journal of Law and Society*, vol. 2, No. 1 (1975), pp. 45-60.

<sup>28</sup>Commission of the European Communities, "Communication from the Commission to the Council and the European Parliament on European contract law", COM (2001) 398.

<sup>29</sup>See European Commission, "Reactions to the Communication on European contract law" (2003), pp. 30 ff.

differences, distance, habits and divergence in other areas of the law, such as tax law and procedural law.<sup>30</sup> Orgalime, representing the interests of 130,000 companies in the European mechanical, electrical and metalworking industries, remarked:<sup>31</sup>

“It will of course always to some extent be easier to trade with companies and persons from your own country. This has, however, more to do with ease of communication, traditions and other factors, which are not dependent on contract law.”

It is also worthwhile to make mention of the recent Clifford Chance survey,<sup>32</sup> in which 175 businesses across Europe were asked whether differences in national contract laws presented obstacles to cross-border trade. Two thirds experience “some” (51 per cent) or “large” (14 per cent) obstacles to cross-border trade between member States.<sup>33</sup> But these were due not only to legal issues but also to “natural” barriers (like language). And among the legal issues, it was not contract law only, but also tax law, procedural law etc. In addition, the ability to make a choice of law from different contract law systems was seen as an advantage by two thirds of the businesses. Two thirds preferred to choose their home law (but only 43 per cent in the Netherlands against 97 per cent in the United Kingdom). In line with what one could expect, English law was regarded as the most popular.

This leads me to conclude that the anecdotal and empirical evidence about the effect of uniform law does not clearly point in one direction or another. What is clear, however, is that commercial parties usually deal with the problem of legal diversity by setting their own contract terms and by choosing an applicable law. But there are several reasons why this does not deal sufficiently with the problem.<sup>34</sup> First, it does not prevent the national mandatory law—applicable in accordance with the conflict-of-law rules—from applying. A party still needs to take advice on the unknown applicable law, which will be costly and will also present a commercial risk to that party. Second, it may be that a party with insufficient bargaining power is overruled by the other, economically stronger party. It is likely that this party is then still deterred from contracting, because of the fact that it is obliged to accept the other party’s choice of law.

(c) *Economic arguments on the need for a uniform contract law*

Gerhard Wagner already discussed the transaction costs argument in detail. It is clear that diversity of law does have its costs.<sup>35</sup> Three points should be stressed.

The first is that not all types of parties experience transaction costs to the same extent. Often it is asserted that in particular small and medium enterprises suffer from problems

<sup>30</sup> See e.g. “The reaction of the United Kingdom Government”, available from <http://europa.eu.int/comm/consumers>.

<sup>31</sup> This is confirmed by other reactions of business organizations. See “Communication from the European Commission on European contract law, COM (2001) 398 final of 11 July 2001: Orgalime position paper”, 30 October 2001.

<sup>32</sup> S. Vogenauer and S. Weatherill, “The European Community’s competence to pursue the harmonisation of contract law—an empirical contribution to the debate”, in *The Harmonisation of European Contract Law: Implications for European Private Laws, Business and Legal Practice*, S. Vogenauer and S. Weatherill, eds. (Oxford, Hart Publishing, 2006), pp. 105 ff.

<sup>33</sup> *Ibid.*, p. 125.

<sup>34</sup> See European Commission (2003), No. 28 ff.

<sup>35</sup> For different types of transaction costs, see L. E. Ribstein and B. H. Kobayashi, “An economic analysis of uniform State laws”, *Journal of Legal Studies*, vol. 25, No. 1 (1996), pp. 137 ff.

because of legal diversity.<sup>36</sup> Large companies are usually more experienced in international trade and can benefit from their strong bargaining position. In addition, large companies that deal abroad typically engage in big transactions. Such transactions justify transaction costs. But as large companies usually make their own contract terms, regardless of whether their business partners are located in another country or not, these transaction costs do not fundamentally differ between purely national and international contracts.<sup>37</sup> This is different for small and medium enterprises, as they usually do not set contract terms themselves and therefore have to rely on default law. If the applicable default law is foreign law, uncertainty about its contents could deter this party from contracting. Also the content of the other country's mandatory law could be uncertain.<sup>38</sup> Put differently: for small and medium enterprises, it is often disproportionate to pay for legal advice compared to the value of the transaction.<sup>39</sup>

Second, in an economic analysis the transaction costs argument that legal diversity is costly should always be balanced against the costs of creating a uniform law. Seen from a purely financial perspective,<sup>40</sup> it could well be that the costs of diversity are larger than the costs of unification. Uniform law should therefore only be adopted if the benefits outweigh the costs.<sup>41</sup> This is not easy to calculate. A type of cost that is not mentioned by Ribstein and Kobayashi concerns the costs of transition of one legal system to another or, put differently, the transaction costs of eliminating national legal systems. Such costs are considerable. They include costs of political decision-making and the costs of effective realization of the reform as well as the costs of adaptation to the new regime (such as the cost of amending contracts and of educating lawyers and judges). When a new civil code was introduced in the Netherlands in 1992, it was estimated—albeit disputed—that the costs of this recodification amounted to almost 7 billion euros over a period of 20 years.<sup>42</sup>

Third, we should realize that the effect of the so-called “natural” barriers, like language or distance, on cross-border contracting is difficult to assess separately from “policy-induced” barriers, like regulation and taxation.<sup>43</sup> Following the new institutional economics, a distinction can be made between formal and informal incentives (or constraints) for transacting. Formal incentives for rational behaviour are organized by the Government, such as law and regulations; informal incentives are habits, traditions, “networks” and other informal norms. It seems hard to identify the exact influence of the formal incentives. For example, with the strengthening of the European internal

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<sup>36</sup> See European Commission (2003), No. 30.

<sup>37</sup> See Claus Ott and Hans-Bernd Schäfer, “Die Vereinheitlichung des europäischen Vertragsrechts: Ökonomische Notwendigkeit oder akademisches Interesse?”, in *Vereinheitlichung und Diversität des Europäischen Zivilrechts in Transnationalen Wirtschaftsräumen*, C. Ott and H.-B. Schäfer, eds. (Tübingen, Mohr Siebeck, 2002), p. 209.

<sup>38</sup> *Ibid.*, p. 213.

<sup>39</sup> See also Staudenmayer, “The Commission communication” (see footnote 24 above), p. 255 and, generally, the contributions of Gerhard Wagner and Helmut Wagner to Smits, *The Need for a European Contract Law* (see footnote 22 above).

<sup>40</sup> Leaving out the benefits that competition of jurisdictions brings with it. See the “virtues of competition”, for example, Gerhard Wagner, in Smits, *The Need for a European Contract Law* (see footnote 22 above).

<sup>41</sup> Ribstein and Kobayashi, “An economic analysis ...” (see footnote 35 above), pp. 137 ff.

<sup>42</sup> See J. M. van Dunné, E. A. Luijten and P. A. Stein, *Kosten en Tekortkomingen van het Nieuw Burgerlijk Wetboek (boeken 3, 5 en 6): rapport uitgebracht aan de Vaste Commissie voor Justitie van de Tweede Kamer* (Arnhem, Gouda Quint, 1990).

<sup>43</sup> See for this distinction Commission of the European Communities, “Proposal for a directive of the European Parliament and of the Council concerning unfair business-to-consumer commercial practices in the internal market and amending directives 84/450/EEC, 97/7/EC and 98/27/EC (the Unfair Commercial Practices Directive)”, COM (2003) 356, p. 6.

market the amount of cross-border transactions undoubtedly increased. Between approximately 1985 and 1995, the volume of commerce within the European Union doubled as compared with export to third States, but apparently this was not caused by unification of commercial law.<sup>44</sup>

(d) *Behavioural analysis of uniform contract law*

Finally, it is useful to look at behavioural analysis. Behavioural economic analysis takes as a starting point that the rationality assumption of economic models (“rational choice theory”<sup>45</sup>) is wrong: in real life, people do not always behave rationally. The unrealistic assumptions of economic analysis are thus replaced by the more empirical evidence provided by cognitive psychology.<sup>46</sup>

Can behavioural analysis inform us about how contracting parties make their decisions? On the basis of Sunstein’s book,<sup>47</sup> one can distinguish several psychological phenomena that can help to explain the behaviour of contracting parties. One of these is the “status quo bias”: people tend to like the status quo and are often not willing to depart from it. If a certain situation is to be evaluated, this is usually done by referring to a reference point that is known to them and gains and losses will be evaluated from this point. This implies that contracting parties are more likely to opt for a legal system they know than for a new (uniform) system. This is confirmed by the experience with the United Nations Sales Convention (CISG), that is in practice often excluded.

Another insight from psychology is that it is often difficult to calculate the expected costs and benefits of alternatives and that therefore people simplify their decision-making by reasoning from past cases, taking only small steps ahead.<sup>48</sup> This “case-based decision-making” is important in the courts that decide most cases by analogy, but it may also explain why, again, contracting parties are often not prepared to choose a system they do not know.

A third rule of thumb is that people are loss-averse and therefore twice as displeased with losses than they are pleased with gains.<sup>49</sup> This may imply that parties would be less willing to take legal advice on how to draft their contract or to inform themselves about the applicable legal system and instead just wait until a conflict arises. This is confirmed by Macaulay’s survey. It is also consistent with the ideas of Gerhard Wagner<sup>50</sup> that, if it is uncertain whether uniformity is desired or not, it is best to take only small steps ahead, for example by way of an optional code.

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<sup>44</sup> See Stefan Grundmann, “The structure of European contract law”, *European Review of Private Law*, vol. 9, No. 4 (2001), pp. 509 ff.

<sup>45</sup> See R. Korobkin, “A multi-disciplinary approach to legal scholarship: economics, behavioural economics, and evolutionary psychology”, research paper 01-5, University of California, Los Angeles, School of Law, 2001, p. 4.

<sup>46</sup> See the pioneering work by R. B. Korobkin and T. S. Ulen, “Law and behavioural science: removing the rationality assumption from law and economics”, *California Law Review*, vol. 88, No. 4 (2000), pp. 1051 ff., and C. Sunstein, ed., *Behavioural Law and Economics* (Cambridge, Cambridge University Press, 2000).

<sup>47</sup> See the overview in Sunstein, *Behavioural Law and Economics*, pp. 3 ff.

<sup>48</sup> *Ibid.*, p. 5.

<sup>49</sup> *Ibid.*

<sup>50</sup> Wagner, in Smits, “Diversity of contract law” (see footnote 22).

There is still another interesting insight that needs further attention here. Korobkin applies the status quo bias to default contract terms.<sup>51</sup> This means that the preference of the parties for certain contract terms is dependent on the status quo. Unlike the assertions in an economic analysis of contract law, parties often do not choose for wealth-maximizing contract terms but for the status quo (consisting of default rules). In other words, parties often prefer inaction to action and sacrifice wealth in order to be inert.<sup>52</sup> This is not optimal from the efficiency viewpoint. Korobkin argues that it would therefore be more efficient for lawmakers to have initially created an alternative status quo. Next to term A, a term B could be created as the default rule, thus allowing the parties to have both the wealth-maximizing term and the status quo term.<sup>53</sup> Put otherwise, if the legislator chooses a different default rule (and status quo), this influences the parties to choose the more efficient rule. If parties simply will not contract around inefficient default terms because of the status quo bias, the legislator should make default rules that the fewest number of parties have to contract around to achieve efficient agreements.<sup>54</sup> These are certainly not “untailored” default rules that apply to all parties regardless of their status or their circumstances.<sup>55</sup> Korobkin claims:<sup>56</sup>

“The lawmaker charged with determining a tailored default term must ask not what term most contracting parties would have agreed to had they made provisions for a contingency—a question that does not require an inquiry into the specifics of any one transaction—but what term two particular parties would have agreed to had they provided for the contingency.”

This is an important argument in favour of an optional default contract regime for transfrontier contracts. In its communication of 2004,<sup>57</sup> the European Commission indicates it wants to pursue a discussion on an optional contract code that could contain provisions for commercial parties that engage in international transactions. Parties opting in to such a code could thus indeed profit from both the status quo and an efficient international contract regime.

(e) *Conclusions: an optional code*

The above analysis shows that there is no conclusive evidence that unification of law enhances international trade. Empirical, economic and behavioural analysis confirm that it is difficult to establish the exact relationship between legal diversity and the enhancement of the economy through transfrontier contracting. Three conclusions can be drawn.

First, it seems impossible to calculate either the cost of legal diversity or the cost of uniform law: a quantitative analysis cannot provide the answer to the question raised. This does not mean that the economic arguments set out above cannot play a role, but they

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<sup>51</sup> R. Korobkin, “Behavioural economics, contract formation, and contract law”, in *Behavioural Law and Economics*, C. Sunstein, ed. (Cambridge, Cambridge University Press, 2000), pp. 137 ff.

<sup>52</sup> *Ibid.*, p. 138.

<sup>53</sup> *Ibid.*

<sup>54</sup> *Ibid.*, p. 139.

<sup>55</sup> *Ibid.*, p. 140.

<sup>56</sup> *Ibid.*

<sup>57</sup> Communication from the Commission to the European Parliament and the Council, “European contract law and the revision of the *acquis*: the way forward, COM (2004) 651, 11 October 2004.

should be put into perspective. The best way to address the question is probably to put it in terms of a comparison: would the savings in transaction costs through the removal of legal diversity be greater than the losses caused by the termination of competition of legal systems? This question cannot be provided with a definitive answer either, but phrasing it like this does permit making an analysis on the basis of the quality of the arguments. How these are appreciated depends on one's own preferences.

The second outcome is that it seems wrong to link an increase in international contracting to uniform law. One of the most important arguments of proponents of unification is that legal diversity refrains businesses and consumers from contracting because of the legal uncertainty diversity brings with it. It is indeed likely that legal uncertainty is a barrier to trade, but there is no evidence that uniform law would create more legal certainty than diverse contract law regimes. Provided that enough information is available about the various regimes, the demands of legal certainty can also be satisfied.

The third conclusion that can be drawn from the above concerns the way to proceed with the development of uniform contract law. If one is uncertain about the effects of uniformity on international contracting, it is best to adopt a step-by-step approach. It means the time is not ripe for grand projects. Instead, one should adopt a model that allows corrections at an early stage and allows business and consumers to get acquainted with a new contract law regime. This points in the direction of drafting an optional contract code that parties can choose if they find this code suits their interests best.<sup>58</sup> Such an optional code would allow harmonization to take place from the bottom-up. Unlike the CISG, it could contain rules about different types of commercial contracts and even allow a choice between different sets of rules for these contracts.

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*Kazuaki Sono, Chair*

A step-by-step approach to legal unification without doing too many logical things at one time to make sure that it works: that is your view. The concluding part I am sure would have given some comfort to the audience, because previous to it, as you can imagine, your version was very challenging, I think. On your optional contract code, which seemed to be the keyword in your presentation, we will have a discussion later, but may I just mention my feeling that an optional contract code can and does coexist in the world already with uniform contract law. The inter-Europe principles or the International Chamber of Commerce's various contract grounds are also optional courses. That is for later discussion.

The third speaker is Professor Helmut Wagner. He is a Professor of Economics at the University of Hagen and is currently a visiting professor at Princeton University. Before that, he held many visiting appointments at the University of California, Massachusetts Institute of Technology and Princeton University, and he was a consultant to the International Monetary Fund. It is rather unique to have speakers who specialize in economics, not in law, but at the same time it will be very important, even for us, to listen to various views from different disciplines. And you have a deep interest in this unification process. Professor Wagner, you have the floor.

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<sup>58</sup>For an elaboration of this idea, see Smits, "European private law" (see footnote 25 above).

### 3. *Costs of legal uncertainty: is harmonization of law a good solution?\**

*Helmut Wagner*

*University of Hagen, Germany; and Visiting Professor, Princeton University, United States of America*

Demands for a more comprehensive harmonization of law between legal areas are based on the assumption that legal diversity causes transaction costs and lowers economic trade and welfare, in particular by creating legal uncertainty. It is argued that legal diversity increases the transaction costs of cross-border contracting and discourages consumers and small entrepreneurs from engaging in such transactions. Consumers as well as producers tend to refrain from contracts in foreign legal systems if the costs of information (about the law, about administrative procedures, about competent legal advice) and/or the costs of enforcement (by way of litigation or alternative forms of dispute resolution) seem too high or unpredictable. This unpredictability or uncertainty about the costs of cross-border transactions may stem from the diversity in the formal legal system or diversity in judicial administration across the individual member countries.

The purpose of this contribution is to make some basic observations on the macroeconomic costs of legal uncertainty, particularly on the effects of cross-border legal uncertainty<sup>59</sup> on economic performance, and to ask whether legal harmonization could be an appropriate solution to this problem, or why not. As will be argued, full harmonization may (at first sight) seem to be an adequate instrument for reducing the costs of cross-border legal uncertainty; however, full harmonization itself tends to imply high economic costs, so that it is not generally recommendable. Nevertheless, a gradual (partial) harmonization process could, in some circumstances, be beneficial.

#### *(a) The role of the legal system*

The legal system is one of the most important institutions of a society. Following North,<sup>60</sup> “institutions” are understood here as formal and informal mechanisms, which control social interaction in some form or other and in this way shape restrictions for individual behaviour so that negotiation and coordination costs are reduced.

Not only is the actual existence of institutions regarded here as being important, but also, and above all, their stability. The dominating argument here is that legal uncertainty represents an investment risk for both domestic and foreign investors. Legal uncertainty can be caused not only by imperfect national legal systems, but also by the different natures of legal systems in the international spectrum.

Law is a fundamental instrument of all transnational economic integration. Different legal systems within a global or a regional area increase transaction costs in cross-border business, because, on the one hand, costs occur through the provision of information

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\*This paper draws heavily on H. Wagner, “Economic analysis of cross-border legal uncertainty: the example of the European Union”, in *The Need for a European Contract Law: Empirical and Legal Perspectives*, Jan Smits, ed. (Groningen, Europa Law Publishing, 2005), pp. 25-51.

<sup>59</sup>By “cross-border legal uncertainty”, I mean uncertainty concerning cross-border transactions.

<sup>60</sup>D. C. North, “Economic performance through time”, *American Economic Review*, vol. 84, No. 3 (1994), pp. 359-368.

about, and adapting to, the respective national regulations and, on the other hand, the great number of legal provisions and processes increases the uncertainty which adheres to individual cross-border transactions.

(b) *Costs of legal uncertainty\**

(i) *On the term “legal uncertainty”*

Legal uncertainty always occurs when individual actors are uncertain of the effects of the provisions of the dominant legal system on the results of their actions. In the wider sense, the term covers both “subjective” and “objective” legal uncertainty.

a. *Subjective legal uncertainty*

The term “subjective legal uncertainty” refers here to the subjective assessment of marginal costs and marginal utility, which differs from individual to individual. Subjective legal uncertainty can also be referred to as “uncertainty as to what the law is”. Because an improvement in individual knowledge of the law is bound up with, in part, considerable information and transaction costs, it is irrational to want to do away with complete legal uncertainty. With increasing marginal costs of acquiring information and the sinking marginal utility of additional legal knowledge, individual economic subjects will only spend so much on information and transactions until marginal costs and marginal utility are equal. Ignorance beyond this will remain in existence so that decisions will continue to be taken in uncertainty.

b. *Objective legal uncertainty*

“Objective legal uncertainty” describes an objective reality that has to be accepted to an equal extent by all involved. It is found where statutory regulations for certain sets of facts are either non-existent or do not form a reliable basis for decisions. Examples are:

(a) “Absence of law”: this term applies to areas for which there are (as yet) no statutory rules and regulations;

(b) “Legal instability”: this type of legal uncertainty occurs where regulations are unstable over and beyond consumption or investment periods, because amendments to statutes are frequent and unforeseeable, so that even experts are not clear about the current legal position and the continuance of subjective claims;

(c) “Denial of justice”: this is understood to be the obstruction or prevention of the enforcement of legal rights by State authorities or employees.

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\*Sections 2 and 3 draw closely on H. Wagner, “Rechtsunsicherheit und Wirtschaftswachstum”, in *Ordnungskonforme Wirtschaftspolitik in der Marktwirtschaft: Festschrift für Prof. Dr. Hans-Rudolf Peters zum 65. Geburtstag*, S. Behrends, ed. (Berlin, Duncker and Humblot, 1997), pp. 227-253; H. Wagner, “Macro-economic analysis of the cost of judicial barriers in the single market”, in *Cost of Judicial Barriers for Consumers in the Single Market*, H. von Freyhold and others, eds., report for the European Commission (Bremen, Zentrum für Europäische Rechtspolitik, 1995) pp. 237 ff.

(ii) *Theoretical derivation of the costs of legal uncertainty*

a. *Types of costs*

Legal uncertainty generates the following transaction costs: (a) costs of collecting information; (b) costs of legal disputes; (c) costs of setting incentives for pushing through legal claims; and (d) other transaction costs.

Concerning (a), lack of knowledge of foreign statutes prevents international purchases or leads to the necessity of more or less expensive information collection.

Concerning (b), in the event of international legal disputes, the costs are much greater than in the case of a domestic legal dispute.<sup>61</sup>

Concerning (c), this includes private attempts to speed up approval procedures, and legal procedures in the broadest meaning of the term. As is known, “beneficial charges”, which include bribes or pay-offs, represent an important cost factor for multinational corporations. (This applies in particular in developing countries.) No small part of this is probably the result of having to deal with legal uncertainty or legal instability.

Concerning (d), the difficulties involved in complaining about goods, in making warranty claims and in exchanging goods should probably prove to be much greater in the case of international purchases in comparison with domestic purchases. The associated costs, including travel expenses, time spent (opportunity costs) and annoyance (negative utility), are then correspondingly higher, in particular if law suits are the consequence.

b. *Static versus dynamic costs of legal uncertainty*

Static or level costs of legal uncertainty occur above all in the form of trade and income effects. The derivation of trade and income effects is based on the following presumed causal chain: legal uncertainty implies higher transaction costs. These are reflected in higher prices or in reduced revenues or benefits for the entrepreneur or consumer. Both lead to lower investment, lower consumption and lower national income.<sup>62</sup>

More important, however also more difficult to prove, are dynamic or growth effects of legal uncertainty. In the theory of growth, “technical progress” is regarded as the central engine for economic growth. Several effective channels can be derived through which legal uncertainty can have a negative impact on economic growth.<sup>63</sup> Firstly, efficient use of existing capital is impeded because of reduced marginal yields, so that there is less knowledge-creating investment, innovative research is inhibited and State infrastructure is only insufficiently available. And secondly, international trade exchanges are obstructed,

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<sup>61</sup>H. von Freyhold and others, eds., *Cost of Judicial Barriers for Consumers in the Single Market*, report for the European Commission (Bremen, Zentrum für Europäische Rechtspolitik, 1995) chap. II.

<sup>62</sup>See, in more detail, Wagner, “Macro-economic analysis of the cost”.

<sup>63</sup>Beyond that, we can try to introduce legal uncertainty endogenously. On the theoretical derivation of the costs of legal uncertainty see, in more detail, Wagner, “Economic analysis of cross-border legal uncertainty”; Wagner, “Rechtsunsicherheit und Wirtschaftswachstum”; and H. Wagner, ed., *Bericht zur ökonomischen Analyse der Kosten rechtlicher Hemmnisse für die Verbraucher des Binnenmarkts: Globalanalyse (makroökonomischer Ansatz)*, supplement volume (Hamburg, 1995).

so that the knowledge incorporated in traded goods does not spread as rapidly and the deficient use of comparative advantages leads to the waste of innovative potential. This results in reduced growth dynamics not only for an economic area such as the European Union but also for individual States.

(iii) *Empirical analyses*

Empirical research on the effect of legal uncertainty on economic trade and growth suffers from the difficulty of measuring the degree of legal uncertainty. Most studies derive legal uncertainty from factors such as political instability, juridical incredibility or a lack of civil liberty (see below). They concentrate on explaining cross-country variations in growth due to differences in legal uncertainty within a country in worldwide samples or for developing economies.<sup>64</sup>

A first approach of measuring the quality of (legal) institutions uses easily observable characteristics of formal institutions, such as written law. For example, La Porta and others<sup>65</sup> discovered that formal legal protections for investors correlate with the size and depth of capital markets and hence with investment levels.

However, this approach has its limitations because it cannot capture the role of informal institutions nor can it take possible interdependencies with formal institutions into account. This may distort the findings.

Therefore, another approach uses proxy variables that measure the quality of institutions indirectly.<sup>66</sup> The quality of this approach clearly depends on the quality of the proxy chosen. It has to be guaranteed that the proxy variable does not influence the dependent variable through another channel it stands for. This sensitivity analysis is mostly missing in each of these studies.

A third approach in the empirical literature on the impact of legal uncertainty or institutions on economic growth is based on surveys of country risk experts or foreign and domestic investors. These surveys cover a series of questions about the business environment.

An early attempt stems from Knack and Keefer.<sup>67</sup> This third approach is not undisputed either. Rodrik,<sup>68</sup> for example, notes that the survey data used in this approach raise two difficulties. First, the survey data are highly subjective and may depend upon other aspects than the actual institutional environment (e.g. investors may value the institutional quality highly when there is an economic upswing in the relevant country). The second difficulty

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<sup>64</sup> Studies of these kinds mainly applied the method of ordinary least squares regressions and hence suffer the problems of mutual dependency and reverse causality due to the endogeneity of the institutional variable independently of how it is measured.

<sup>65</sup> R. La Porta and others, "Legal determinants of external finance", *Journal of Finance*, vol. 52, No. 3 (1997), pp. 1131-1150.

<sup>66</sup> R. Barro, "Economic growth in a cross section of countries", *Quarterly Journal of Economics*, vol. 106, No. 2 (1991), pp. 407-443.

<sup>67</sup> S. Knack and P. Keefer, "Institutions and economic performance: cross-country tests using alternative institutional measures", *Economic Policy*, vol. 7, No. 3 (1995), pp. 207-227.

<sup>68</sup> D. Rodrik, "Getting institutions right", *CESifo DICE Report*, No. 2, 2004.

is that this kind of data gives no policy guidelines because the results say nothing about which institutional design is superior, but just that it is important to make investors feel safe.<sup>69</sup>

Apart from these studies, there are also studies that explicitly analyse the effects of cross-border legal uncertainty. In a recent study, Turrini and van Ypersele<sup>70</sup> consider two variables to measure the effect of cross-border legal uncertainty. The first variable is an index of legal similarity; the other is a dummy variable amounting to 1 if a pair of countries shares the same origin of their legal system and 0 otherwise. The estimation of a standard gravity equation augmented by one of these two variables show that trade flows are higher by about 65 per cent if a pair of countries has identical legal procedures or, respectively, by 47 per cent if a pair of countries shares common origins for their legal systems. These results are in line with the results of den Butter and Mosch,<sup>71</sup> who find for a sample of 25 OECD countries that a pair of countries with a similar legal system trades some 46 to 84 per cent more with each other than countries with a different legal system. Den Butter and Mosch<sup>72</sup> re-estimate their gravity function using instrument variables in order to control for problems with omitted variables and confirm the results of the ordinary least squares estimation. Hence, on average a country pair with similar legal systems trades almost 50 per cent more with each other. Using firm-level data of 11 European countries, del Gatto and others<sup>73</sup> simulate that a 5 per cent reduction in international trade barriers—which could, for example, be induced by legal harmonization—results in a 2.13 per cent increase in productivity due to a more competitive environment.

(c) *On desirability and feasibility of full harmonization of law*

The question arises whether there is any possibility of removing/reducing legal uncertainty without leading to new losses of growth or efficiency on the other side. One answer to the problems of legal uncertainty and lack of legal knowledge discussed might be to demand complete harmonization of national legal systems. The question then arises whether this is really (a) desirable and (b) practicable.

(i) *Desirability*

When economic policy conclusions are drawn, attention should be paid to more than just the costs of legal uncertainty. The (transaction) costs of eliminating legal uncertainty (i.e. pushing through a common alternative institutional regulatory framework) also have to

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<sup>69</sup>These difficulties should also be a warning that a “panacea” for the “right” institutional design of an economy does not exist. For this reason, “transferring the formal political and economic rules of successful Western economies to third-world and Eastern European economies is not a sufficient condition for good economic performance” (D. C. North, “Economic performance through time: the limits to knowledge”, paper, 1996, available at <http://129.3.20.41/econ-wp/eh/papers/9612/9612004.pdf>).

<sup>70</sup>A. Turrini and T. van Ypersele, “Legal costs as barriers to trade”, CEPR discussion paper No. 5751 (London, Centre for Economic Policy Research, 2006).

<sup>71</sup>F.A.G. den Butter and R.H.J. Mosch, “Trade, trust and transaction costs”, Tinbergen Institute, discussion paper No. 2003-082/3, 2003.

<sup>72</sup>Ibid.

<sup>73</sup>M. del Gatto, G. Mion and G.I.P. Ottaviano, “Trade integration, firm selection and the costs of non-Europe”, CEPR discussion paper No. 5730 (London, Centre for Economic Policy Research, 2006).

be taken into account, if a balanced cost-benefit analysis is to be carried out. Scientific cost analyses can easily be ideologically misused without this type of consideration of both sides.

There is a good deal of evidence that complete harmonization would lead to substantial costs. These include not only direct costs for developing new bureaucracies or demolishing old structures, but also costs arising from the renouncement of the advantages of system competition, which appear in (a) an adaptation to the variety of preferences; (b) efficiency advantages of regulative competition; and (c) the minimization of “rent-seeking” costs caused by bureaucrats/politicians.

With regard to (a), economic structures in different countries are not identical. However, legal systems must in a sense “harmonize” with the respective economic and social conditions in a country. This means that not every legal system “fits” into a country; put another way, because of its structural peculiarities, each country needs a special legal system as well. For this reason alone, harmonization of the legal system in an integration area with heterogeneous countries would not be appropriate. The central argument as far as economic systems are concerned is therefore: variety of regulations or laws reflects variety of preferences.

In other words, if States compete with their legal systems, more preferences may be satisfied. Furthermore, with such competition between legislators, individuals could choose the legal rules that most efficiently regulate their problems by moving to the jurisdiction that offers laws best suited to their preferences.<sup>74</sup>

With regard to (b), variety of regulations also means competition among rules and therefore represents a process for discovering the regulations that fulfil the desired purpose with the lowest costs.<sup>75</sup> Diversity in laws enables States to experiment in their search for efficient and workable rules of law.<sup>76</sup> Competition between legislators may generate a learning process. Exaggerated harmonization would prevent such experiments and learning processes from arising and transaction costs from being lowered. Market integration would be inhibited. Moreover, dynamic competitive processes between legislators may produce voluntary harmonization.

With regard to (c), not only market failures but also regulatory failures are possible. Bureaucrats/politicians serve their self-interest, too, by maximizing their budget or increasing their status and improving their working conditions. Competition is the most efficient mechanism to control politicians and to restrain their rent-seeking activities. In contrast, harmonization in a union can be considered as a restriction of competition analogous to a cartel, where non-member countries are outsiders.

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<sup>74</sup>National Governments exposed to system competition are subject to constant control by the owners of mobile factors in that the latter are able to evade the sphere of influence of a Government by moving to that of another government. This is also linked to the hope that system or regulation competition can reduce the influence of lobbies to eliminate welfare state incrustations or “institutional sclerosis” (M. Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge, Harvard University Press, 1965)). However, it must be taken into account that international legal uncertainty limits system competition (Wagner, 1997, “Rechtsunsicherheit und Wirtschaftswachstum”).

<sup>75</sup>F. A. von Hayek, “Der Wettbewerb als Entdeckungsverfahren”, *Kieler Vorträge*, No. 56, 1968.

<sup>76</sup>If the possibility of a faulty or unsuitable statutory provision is considered, competition between systems of rules permits a relatively low-risk and low-conflict method of correcting errors, compared with harmonized policies. The controlling effect of competition arises from private agents being able to compare different institutional attempts at solving problems and to sort out inferior ones. There does not necessarily have to be an exchange of the legal system itself, but there may also be, corresponding to the cultural peculiarities, efficient institutional innovations within the prevailing legal system.

*(ii) Feasibility*

With regard to the chances of success of a strategy for full harmonization, attempts at broad harmonization of law are still under way (for example, within the European Union). However, harmonization of behavioural structures, and therefore of the forms of realization of formal law, cannot be ordered from above simply through a formal decree. In other words, uniformity of law cannot be created by just imposing rules through public policy. Compliance with the law requires more than just rules; it must match the (legal) culture of a country. Imperfect matching hampers international trade, too. Formal harmonization decrees can only reduce this to a certain extent. A further reduction can only be achieved through “experienced integration” (by gradually overcoming ignorance and prejudice). This also includes a thorough reform of civil justice and of judicial administration in civil matters. Den Butter and Mosch<sup>77</sup> tried to capture this effect by estimating an augmented gravity equation adding a variable of “informal trust” which they build from the Eurobarometer 1996. Their estimation results indicate that a change of one standard deviation of this variable leads to a change of 24 to 34 per cent in trade volume.

*(d) A case for partial harmonization of law*

In contrast to small companies and to consumers, large companies have the advantage of lower information and coordination costs per unit of output due to economies of scale when doing transborder business. In particular, they can more easily organize or coordinate their common interests. In that regard, it is easier (and/or less costly) for them to reduce legal uncertainty by privately organizing common rules or standards. Therefore it is sometimes argued that harmonization “will occur ‘from the bottom’, through the coordinated actions of private firms operating across borders, more quickly than through international treaties and bureaucrats’ interventions”.<sup>78</sup> Hence, it may be concluded that, contrary to the common view, the “problem is not how to orchestrate harmonization through Government treaties; it is how to create the appropriate regulatory structure to prevent and if necessary discipline antitrust violations in international markets”.<sup>79</sup>

The above finding is typical for large companies. However, this finding cannot be simply applied to consumers, or even to small companies. Higher information costs and higher coordination costs of organizing their common interests may prevent consumers (and even small companies) from organizing efficiency-increasing standards or rules themselves.<sup>80, 81</sup> Thus, while large companies may largely be able to help themselves in reducing legal uncertainty by creating desired harmonization on their own, consumers

<sup>77</sup> Den Butter and Mosch, “Trade, trust and transaction costs”.

<sup>78</sup> A. Casella, “Product standards and international trade: harmonization through private coalitions?”, *Kyklos*, vol. 54, Nos. 2-3 (2001), p. 244.

<sup>79</sup> *Ibid.*, p. 262.

<sup>80</sup> Olson, *The Logic of Collective Action*.

<sup>81</sup> Similarly, it can be argued that “[t]he single market is indeed an opportunity for larger enterprises which are able to reduce legal transaction costs by establishing stable relationships across European borders. The risks of breaking contracts are small in this kind of repeated exchange. The situation is different in anonymous markets with small enterprises and consumers. They need institutions to defend and protect their property rights. The European Single Market has been conquered by these actors only to a limited degree due to a deficient institutional infrastructure of law enforcement” (Von Freyhold and others, *Cost of Judicial Barriers for Consumers* (see footnote 61), p. 5).

and small companies cannot do this to the same extent.<sup>82</sup> Therefore, it is the task of governments to help consumers and small entrepreneurs particularly to reduce legal uncertainty in transborder exchanges through searching for and implementing/harmonizing the right standards or rules. However, because of the costs of full harmonization described above, the level of harmonization should be limited.

(e) *Conclusion*

Legal diversity usually goes along with legal uncertainty and, hence, with a rise in costs. The reason is that legal diversity may imply:

- (a) Additional costs for acquiring the information needed to write a particular contract in other legal areas;
- (b) Higher costs for litigating issues under various contracts governed by different legal regimes;
- (c) Costs of instability due to the fact that several contracts are subject to subsequent changes in the law;
- (d) Diversity in judicial administration across the different countries.<sup>83</sup>

Legal uncertainty can be regarded as a non-tariff trade barrier. But from this it does not follow that full harmonization is necessary, because harmonization itself generates substantial costs. These include not only direct costs for developing new bureaucracies or demolishing old structures, but also costs arising from a loss of the advantages of system competition, the advantages being an adaptation to the variety of preferences, efficiency advantages of regulative competition and the minimization of “rent-seeking” costs caused by bureaucrats/politicians. Nevertheless, from the point of view of the economy as a whole, welfare gains could possibly be realized through more harmonization.

Correspondingly, it might be better to adopt a step-by-step approach. One could start with harmonization of contract law for international (transborder) transactions. This would give individuals time to get acquainted with the new regime and to evaluate it. A step-by-step approach would also allow the correction of errors at an early stage. Against the background of the experience gathered, one could then turn to a more comprehensive harmonization at a later stage if this then is assessed as being desirable. However, legal harmonization only makes sense if it is accompanied by a thorough reform of the system of civil justice and a harmonization of procedural law.

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<sup>82</sup> Nevertheless, during the consultation process on the Commission Communication on European Contract Law, business associations representing small and medium-sized enterprises spoke against full harmonization being necessary to foster competition within the common market. However, as is known, the fact that particular interest groups reject reforms does not mean that reforms cannot be welfare-enhancing on an overall (macro)economic level.

<sup>83</sup> See G. Wagner, “The economics of harmonization: the case of contract law”, *Common Market Law Review*, vol. 39, No. 5 (2002), p. 1014, as well. For a detailed analysis concerning the nature of such costs, see, for example, L. E. Ribstein and B. H. Kobayashi, “An economic analysis of uniform State laws”, *Journal of Legal Studies*, vol. 25, No. 1 (1996), pp. 131-199.

#### 4. *Comments, evaluation and discussion*

*Seward M. Cooper*

*Chief Counsel, Good Governance, Office of the General Counsel, African Development Bank*

I think the presentations have been brilliant. I think, however, that it is important for us to have some definitional framework within which we are operating. It seems to me we are using interchangeably the words “harmonization” and “unification”, but in my mind there is a distinction between the two. Unification, for example, from our perspective would be something like what the Organization for the Harmonization of Business Law in Africa (OHADA) has, where the laws are such that once approved by the ministers of finance and the ministers of justice, they become incorporated directly into the national laws of each country, identically and uniformly. So there is no distinction between those laws. This is different from harmonization of the laws, where there could be major similarities between the laws but they are not identical. So I think it is important to have some definitional framework within which we are operating as we proceed. It would help to facilitate our comprehension of the conclusions that are being reached.

*Paul Marca Paco*

*Permanent Mission of Bolivia to the United Nations (Vienna)*

We know that the European Union has community law. This is directly applied law which is binding on member States. Although all speakers this afternoon are from the European Union, they made no specific references to efforts being made to harmonize law within the European Union. My question is to what extent and how is community law applied and to what extent is it law that still needs further harmonization? Also, is there a distinction between the various kinds of law which are in force within this very diverse area?

*Gerhard Wagner*

*University of Bonn, Germany*

I will try to answer briefly the questions as to how much harmonization there is in Europe and what remains within the realm of national law. This is a complex matter but, in short, harmonization in Europe so far has focused mainly on administrative law, i.e. tariffs and other barriers to trade. It is a recent development that the European Union has devoted some attention to private law, albeit foremost under a consumer law perspective. The main policy objective was the protection of consumers, for instance by granting them rights of revocation. However, the bulk of the private and commercial law is still of a municipal nature. The various legal systems of the member States remain in force side by side. This situation is about to change. There is a current debate, to which Jan Smits referred, on the perspective of harmonizing the core of private law—contract, tort and property. The communication from the European Commission issued in 2001 raised the question whether it is preferable to merge the national systems into a European civil code, and this is the issue we were talking about: whether a European civil code would be a good idea or whether we should instead stick to the traditional system of several national legal systems. To be sure, the second option prevails within the United States where up to this day the core matters of private law are governed by state law, not by federal law.

*Michael Joachim Bonell*  
*University of Rome I “La Sapienza”, Italy*

This Congress is intended to focus on global unification versus global diversification of law. While I certainly have appreciated the presentations of the distinguished panellists this afternoon, in fact they all come from Europe and inevitably have reflected a European perspective, thus neglecting the different yet equally important experiences of other parts of the world. Another reservation I would like to make is that all the speakers referred generically to “parties” without explaining whether they actually meant the businesspersons or their lawyers. I think if you try to find out what the preferences as to the law governing international commercial contracts are, it makes a huge difference whether you put this question to the owner of a business (or to the people of the commercial section of the business) or to the lawyer assisting them. It is well known that the former often do not care at all about the legal aspects of the commercial transactions they enter into and only later, if problems arise, bitterly complain to their lawyers for not having taken adequate precautions.

*Kazuaki Sono, Chair*

May I just read one paragraph from the United Nations Sales Convention? In the preamble, the text reads:

“The States Parties to this Convention,

“Being of the opinion that the adoption of uniform rules which take into account the different social, economic and legal systems would contribute to the removal of legal barriers in international trade and promote the development of international trade.”

At the same time, I just want to recall what Jernej Sekolec said this morning: that we may be moving towards a world where modernization may become more important than unification. All those may have some relationship.

*Jorge Sánchez Cordero*  
*Director, Mexican Center of Uniform Law, Mexico*

I would like to address the economic costs of international transactions. As many people may know, Mexico is a party to the North American Free Trade Agreement, together with the United States and Canada; Mexico also has close free trade agreement ties with other nation States.

In Mexico, there has been a focus on identifying the costs involved in international trade and international transactions, with particular emphasis on the situation throughout the North American free trade area. This is a major concern within our country. I will explain just how commercial imbalance can be reached.

When, for instance, Mexican products exit the country towards North America, they are subject to a specific civil liability regime (punitive damages, strict liability, among others). However, North American products which journey south are subject to a completely

different and more lax regime (*culpa aquilea regime*). The Mexican liability regime, which stems from a very old law, does not have the same economic impact as the one enforced in the legal systems of our commercial partners. The result of these two different liability regimes is a commercial imbalance between the United States, Canada and Mexico. The liability regime to which Mexican products are subject when they travel to the north has hidden costs (insurance costs, for instance). These hidden costs must then be added to the cost price of the product, thus making Mexican products and prices very uncompetitive in contrast with the North American products travelling south that are subject to a dysfunctional liability regime.

*Herbert Kronke*

*Secretary-General, International Institute for the Unification of Private Law*

Mr. Chairman, you mentioned the fact that in the run-up to the negotiations of the Cape Town Convention of 2001, we started not with the comparative law study, but with an economic impact assessment study. And that economic impact assessment study defined the legal tools which needed to be put in place by the Cape Town Convention. Now the Convention is in force, the first protocol is in force, and indeed we did deliver. Debtors in countries which are contracting States are benefiting from a 33-per-cent exposure reduction and that is quite significant.

Secondly, we had an Asia-Pacific Cape Town summit a few months ago and the second largest airline in China made up the following bill.

Just by changing from one insolvency option under the Cape Town Convention to another one, that particular airline—one of the 30 big airlines in China—would save US\$ 30 million over five years, and in an industry with small profit margins, obviously that is very significant. Now the irony is that in economically much more significant subsequent projects such as our current draft on intermediated securities, US\$ 20 trillion trading volume every 20 trading days, there were neither the negotiating governments nor industry willing to put up the money which would have been needed for an economic impact assessment study as they did in the run-up to the Cape Town conference.

*Eric Loquin*

*Director, Centre for Research on Procurement Law and International Investments (CREDIMI), University of Bourgogne, France*

Two comments: we are looking into the respective merits of uniformity or non-uniformity of laws. I think that one has to take a look at whether we are talking about special laws or about general contract law. We consider things like insurance law, for example. There is the contention that each major national law is defending the interests of consumers and when a lawyer is asked, for example, she or he says “well, sell with the CISG and buy with French law”. So when you analyse the respective merits of diversity or uniformity, you also have to factor in that debate, which is a fundamental one. When you look at the law of general obligations, that is a different situation. The Unidroit Principles are certainly very neutral. Whereas special laws are very difficult to render uniform, even if we have the CISG. It is much more difficult to achieve unification because the interests at hand are necessarily contradictory and various approaches need to be reconciled. I

believe that the main legal obstacle to international trade is posed by procurement law and the operation of national judiciaries, rather than contract law per se. Of course, arbitration allows for a globalized procedure to a certain extent, but you know that arbitration is too expensive for many—especially small companies. So, I wonder whether we should not especially focus on problems having to do with the varying speed and modes of operation of national justice systems, which are the real obstacles to international trade.

*Beate Czerwenka*

*Federal Ministry of Justice, Germany*

I have mainly two questions. The first one is for Professor Wagner. In his presentation, he pleaded for the creation of a single judicial system in order to achieve uniformity. Like Professor Bonell, I believe this proposal is based on a perspective which is very European-focused. I wonder whether on a global level the creation of a single judicial system is really in the interests of trade. A single judicial system on a global level might force the parties involved to appear before a court sitting at the other side of the globe. I doubt that this would be a desirable result for those parties. The second question goes to Mr. Smits. He suggested a step-by-step approach when unifying the law. However, uniform commercial law consists not only of non-mandatory law, but also of mandatory law. The latter can be found in the draft UNCITRAL convention on transport law. I wonder how the step-by-step approach could be implemented in this context.

*Jan Smits*

*University of Maastricht, Netherlands*

My answer is very brief. I agree with you. If we would say we need to have mandatory rules in some area of the law, we then cannot have a step-by-step approach. This is, for example, also true in the field of consumer protection: if a weaker party needs to be protected, harmonization from the bottom up will most of the time not work.

*Gerhard Wagner*

*University of Bonn, Germany*

I just want to clarify that I am not in favour of creating a single judicial system, either in Europe or even for the whole world. I just wanted to emphasize that, given that our aim is security of transactions and reduction of transaction costs, we have to make sure that the law in action is unified, not only the law on paper. Unifying the law in action, however, requires much more than the creation of a common code. As you said a minute ago, the differences between the judicial systems are much more important as barriers to trade than the differences between the codes. My intention was to make this clear, not to advise that everything should be unified in this area.

*Arie Reich*

*Vice Dean, Bar Ilan University, Israel*

I think what was missing in your normative framework is the fact that there is a process of learning, of sharing experience in harmonization. The process of harmonization allows

States with longer experience, for instance larger or older jurisdictions, to share their experience with countries that have less experience. Consider, for instance, the countries that joined the CISG. It is not that they took their own national or international sales law and switched to the international one—they did not have one. This is the first international sales law they had. The same thing happened with arbitration, the same thing with procurement—many countries did not have any law. And by the way, it is not only for developing countries; it could also be a developed country that needs to develop its law. British law and American law, for instance, still apply some highly idiosyncratic doctrines which are outdated and do not work well; through the process of harmonization, they, too, can learn from experience and adopt better legal solutions that work well in other countries.

*Gerhard Wagner*  
*University of Bonn, Germany*

I perfectly agree with you. This is what is hidden behind the term of legal diversity, i.e. the fact that jurisdictions have the opportunity to learn from each other. If all laws were uniform, this process of learning and adapting would come to an end. Harmonization does bring everybody up to the same level, which is a good thing, but it keeps everyone on this same level moving forward. With respect to the future, the potential for experimenting and learning from each other is foreclosed, simply because everything is the same.

*Didier Operti Badán*  
*Secretary-General, Latin American Integration Association*

I would like to add a couple of additional thoughts.

First of all, I think that we ought to agree whether we are talking about reality or utopia. If we are talking about reality, the reality is that the world is made up of States, and each State responds to traditions among other things.

Second point: What is the most important objective that we can get in relations among States? Harmony and peace, which are the great values of international civilization.

Third point: What can we get in private international law? What can we achieve? This is an area of the law that is intimately related to rules arising out of custom with custom regulations which have developed over, sometimes, thousands of years. An approximation in a more or less common language, a lingua franca, in legal terms, that is what we are now talking about. Unification would be the highest level perhaps of a scale of approximations.

Fourth point: Harmonization proceeds either by osmosis or by activity. Osmosis occurs when several regions exchange views or identify common ideas; and when harmonization by activity occurs, an institution is established. The progressive development of the law provides to the economy an element which favours the circulation of goods and services. There are no instantaneous solutions. We are looking for progressive solutions, because otherwise we will not get anywhere. Disillusion brings about suspicion and lack of confidence. It is an enemy of law.

### C. Commercial law development and technical legal assistance: goals and stakeholders

*Chair: William T. Loris*

*Director General, International Development Law Organization*

The International Development Law Organization (IDLO) looks at legal harmonization and unification from a different perspective and that is: how do we provide training, technical assistance and other kinds of help to those who have to make the laws and then those who have to implement them, that is, the lawyers, the judges, the notaries, the businesspeople, the citizens. That is not an easy process. IDLO started its work many years ago—25 years ago. At that time, IDLO was rather alone in the field in providing legal technical assistance and training. There were American initiatives and Professor Wallace, who is here, was one of the originators of the whole idea. He is very well known at UNCITRAL. Nowadays this is a crowded field. Just to give you an idea of how crowded the field is, IDLO just put together a directory of this kind of work—legal technical assistance and training—that is available on the IDLO website. Searches can be done in various ways: by country etc. We found that there are at least 3,500 projects going on right now; and 500 actors, that is, those implementing projects both in developing countries and in Europe and North America. All of the donors in the development assistance business are involved in this kind of work. So, it is now a huge activity; there has been a lot learned here, and that is what we are going to hear today from our speakers. We are going to start with Gerard Sanders, who is the Deputy General Counsel at the European Bank for Reconstruction and Development (EBRD). He comes from New Zealand; he has worked both in the private sector and in the public sector, and he has been the leading light, as it were, at EBRD for a number of years in the legal technical assistance work and rule-of-law work related to the countries in which EBRD operates. He is a joy to work with and a person who has spent some time, as you will see today, trying to draw some lessons from that. And he has some lessons—five, actually—and I would like to hear those.

#### *1. Multilateral organizations and legal technical assistance: learning from experience*

*Gerard Sanders*

*Deputy General Counsel, European Bank for Reconstruction and Development\**

Assisting countries in improving their laws is today a mainstream activity of many multilateral organizations. For the international financial institutions, this work goes to the heart of their efforts to foster progress, particularly by seeking to improve the climate for both domestic and cross-border trade and investment. This objective is shared by other bodies too, including the United Nations Commission on International Trade Law whose important work we are marking at this Congress. This shared purpose is accompanied by a growing convergence of the ways in which assistance is delivered.

But this state of affairs was not always so. The early work of the international financial institutions focused heavily on financing infrastructure development with technical assistance playing a modest and subsidiary role. Legal assistance was rare and was limited to introducing technical rules rather than strengthening the system that created and implemented them. This reflected a view of development that confined the role of the law to articulating economic prescriptions.

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\*The views expressed in this paper are those of the author alone and do not necessarily reflect those of the European Bank for Reconstruction and Development.

But by the eve of the establishment of UNCITRAL some 40 years ago, the United Nations, in a report based on the seminal study of Professor Clive Schmitthoff, was confident enough to proclaim that “there is an increasing awareness that a modern legislative framework is the necessary foundation for sound economic and social progress”. Interestingly, a footnote to the report reveals what was apparently a representative view at the time that “the law should not [be allowed to] lag behind technical progress and material achievements”. It was as though, at best, law could avoid imperilling such accomplishments. However, in the subsequent two decades the idea that law could actually help drive and shape progress did slowly take hold among multilaterals. But when set against the immense needs of client States, the volume of technical legal assistance provided by multilaterals was tiny.

Certainly at the time when UNCITRAL was established, it could not have been expected that the organization would provide very much by way of technical assistance. The report of the Secretary-General of the United Nations that recommended the creation of UNCITRAL proposed that its “primary function” be as a coordinating body of the agencies already working on international trade law. Formulating new laws was also envisaged. However, “services in connection with technical assistance activities” in the field of international trade law was the last of the various functions enumerated, provided they were “within the limits of available resources”. Given the sheer breadth of the initial remit of UNCITRAL, there must have been very obvious limits to what could be expected of a secretariat comprised of only as many lawyers as could be recruited within a budget—even in 1967 terms—of US\$ 31,600!

For their part, the international financial institutions tended to finance legal assistance not from their ordinary capital resources, but through donor funds provided by their shareholders. However, funding legal technical assistance was often uninteresting for donors. This was because, while providing support was usually conditional on advisory services being delivered by a national of the donor, the demands of the reform project often called for the funding of locally based expertise, particularly for analysing and drafting laws and supporting them through the approval and implementation phases. Donor funding was also more available for technical assistance projects that offered measurable results within the time horizons of the donors’ budgetary rounds. Yet legal reform processes and outcomes, whether evolutionary or more radical, are rarely tidy or predictable. This recalls the sentiment attributed to Zhou Enlai, who, when asked about the impact of the French Revolution, thought it was too early to say.

But while the tied nature of much donor funding may have made legal reform projects more challenging, the constraints imposed by the conditional nature of the support should not be exaggerated. Where legal technical assistance has produced disappointing results, the source of funding is usually irrelevant (although there is evidence that tied funding makes the cost of delivery higher) and the reasons often varied and complex. In this respect, legal technical assistance is a field that has yielded many lessons. Many of these are acknowledged by multilateral organizations and have been internalized by them in the design of their legal reform programmes.

Five lessons stand out.

First, law is relevant to the development process.

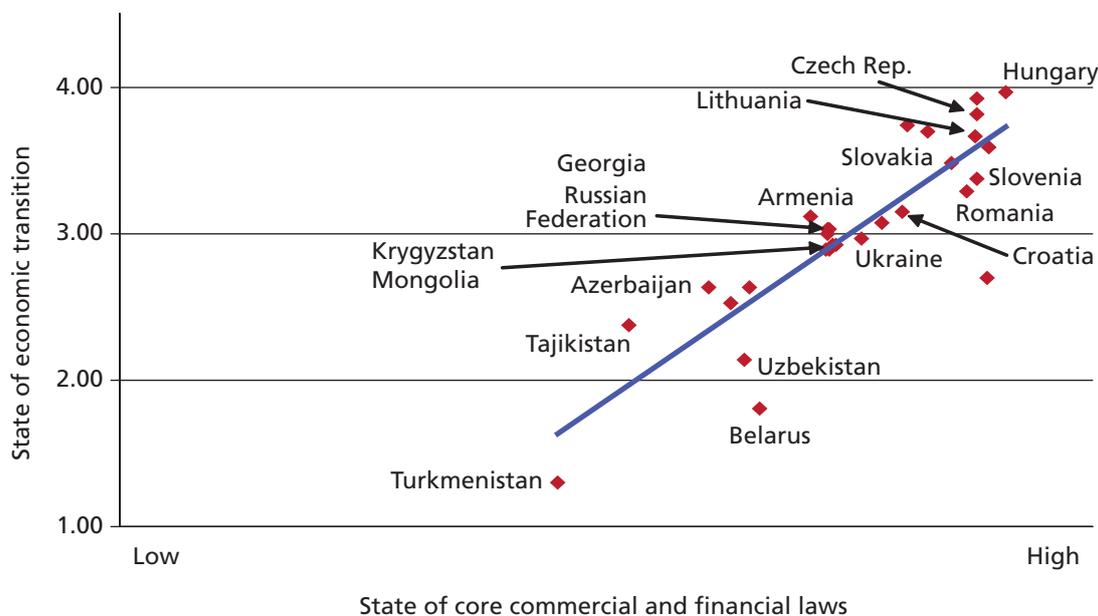
The Asian Development Bank was among the first international financial institutions to conclude emphatically that law played a role in the growth of what were then called the Asian tiger economies. It did so after a multi-year study of the economies of Asia, the conclusions of which were published on the eve of the crisis in the Asian financial markets in the 1990s. That event, like the subsequent turmoil in the Russian markets that followed, gave resonance to the earlier finding and spurred the multilateral development banks to make strengthening the investment climate a more direct subject of their work.

Prior to this, the dominant view in policy circles was that the laws and institutions that support the market would develop naturally in response to the needs of the projects and the entities which the development banks financed. In the past decade, all of the major international financial institutions have called for legal systems to be responsive to the needs of the market and all provide legal technical assistance for this purpose.

Secondly, sound economic laws go hand in hand with other dimensions of reform.

Studies of several international organizations, including the World Bank in its *Doing Business* reports, explore the linkages between legal and economic reform. Since 1995, EBRD has measured annually both dimensions of reform across the region where it invests, namely Central and Eastern Europe and the Commonwealth of Independent States. EBRD studies suggest that, at least in the region where it operates, there is a strong positive correlation between the quality of core commercial and financial laws and the state of economic advancement (see figure I).

**Figure I. Relationship between commercial and economic advancement in transition countries**

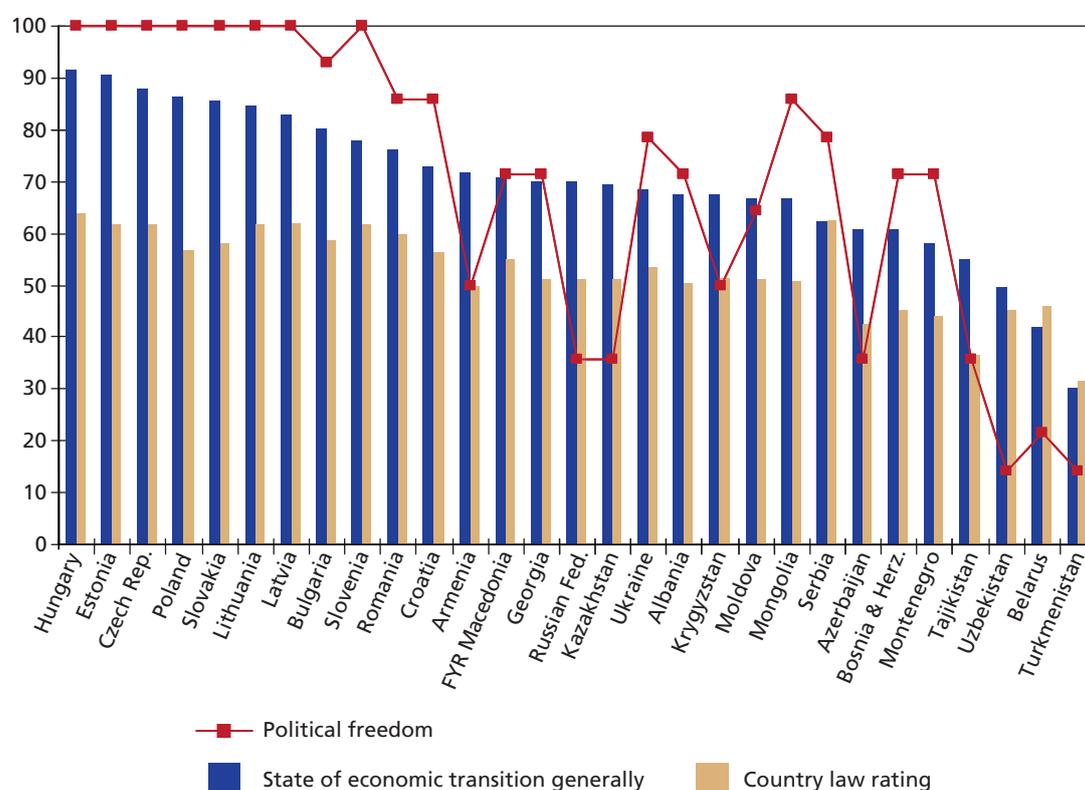


Source: European Bank for Reconstruction and Development, *Transition Report 2006: Finance in Transition* (London, 2006), table 1.1; European Bank for Reconstruction and Development, Composite country law index, September 2006.

Note: Economic transition ratings range from 1 to 4.5, with a perfect score indicating that economic transition has been achieved across all key economic dimensions. A perfect score for core commercial and financial laws indicates that such laws fully conform with international standards and are fully implemented.

The issue of causality is more complex of course. And the question of whether progress is linked to political freedoms can be a difficult and sensitive one for multilateral organizations given that their charters frequently prohibit them from taking political considerations into account in their decision-making. But it is an easier subject institutionally for EBRD to grapple with given that, unique among international financial institutions, its support is confined to those geographically qualifying countries that embrace democratic principles and market-oriented economies. The Bank's own studies, as well as the research of others, show that in the countries where EBRD operates the levels of economic advancement, legal progress and political freedom are positively correlated and that progress and failures along these dimensions tend to reinforce one another (see figure II).

**Figure II. Relationship among law, economic transition and political freedom in transition countries**



Source: European Bank for Reconstruction and Development, Composite country law index, September 2006; European Bank for Reconstruction and Development, *Transition Report 2006: Finance in Transition* (London, 2006), table 1.1; Freedom House, *Freedom in the World 2007* (Washington D.C., 2007). Available from [www.freedomhouse.org](http://www.freedomhouse.org).

Note: The higher the score, the higher the state of economic transition, commercial laws or political openness.

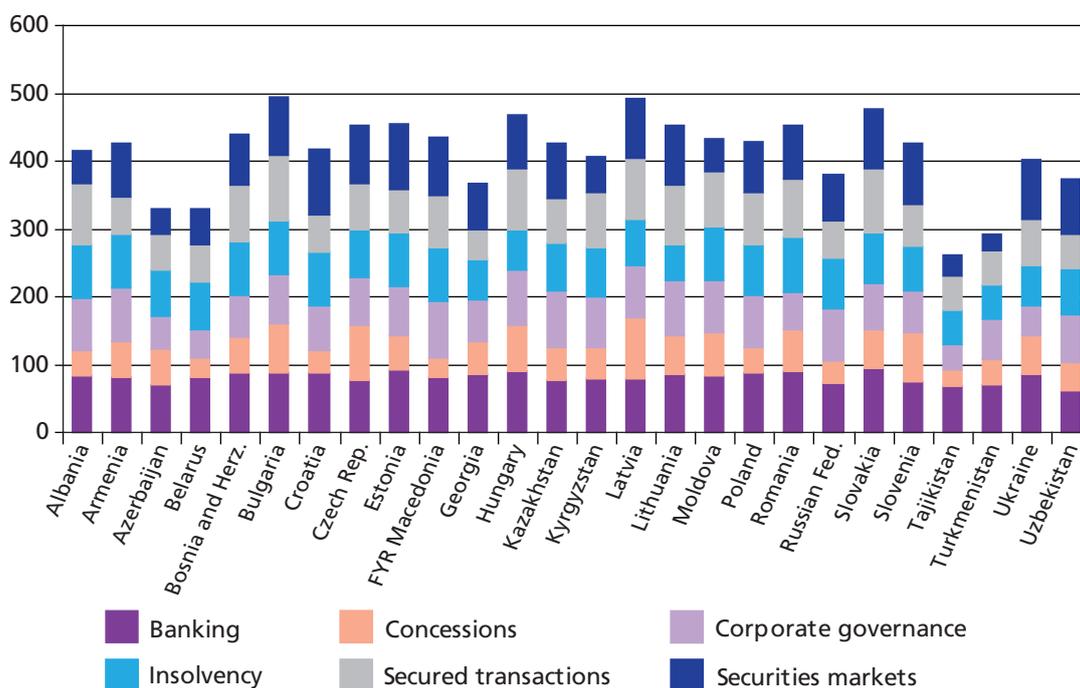
Thirdly, economic laws should be benchmarked against international standards.

Following the Asian and Russian financial crises, the World Bank and the International Monetary Fund took the lead in working with the multilateral development organizations

and others to forge international standards in key areas of economic activity. Subsequently, in 2002, the Monterrey Declaration<sup>84</sup> called for economic laws to be evaluated relative to international standards or uniform principles, thereby fostering greater transparency and comparability of laws across different countries. These efforts built on existing initiatives and helped spur the development of emerging ones. For example, in the early 1990s, EBRD developed a model law based on core principles for the legal creation of non-possessory pledges of moveable assets. The Organisation for Economic Co-operation and Development (OECD) developed principles on corporate governance and the World Bank developed guidelines for insolvency laws. UNCITRAL has developed many texts which embody or establish international standards, including, for example, its *Legislative Guide on Privately Financed Infrastructure Projects*.

For its part, EBRD has assessed the state of many core economic laws in the transition countries, including the laws on concessions and public-private partnerships using the work of UNCITRAL in this field as the preferred standard (see figure III). Later this year, the Bank will publish an assessment of the state of international arbitration laws in the countries of the Commonwealth of Independent States measured against the UNCITRAL model law on this subject (see figure IV).

**Figure III. Conformity of commercial laws in transition countries with international standards**

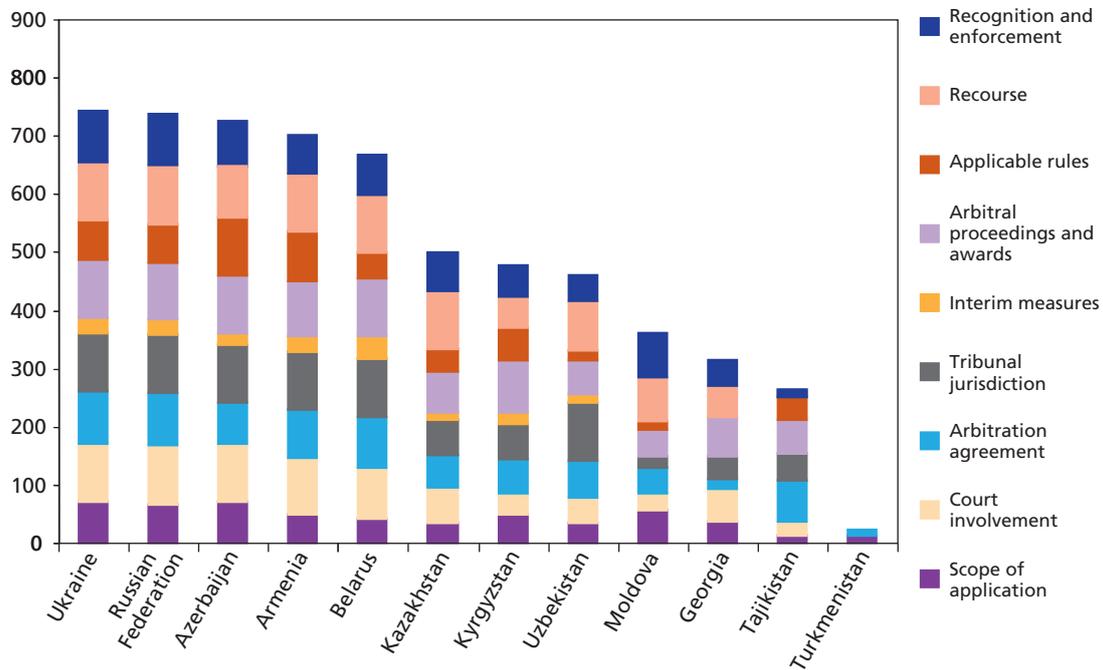


Source: EBRD Legal Surveys 2000-2007.

Notes: The laws of each sector are scored using an index of 100. Sectoral scores are then tallied, with 600 representing full approximation with international standards. The higher the score, the greater the degree of conformity with international standards.

<sup>84</sup> Monterrey Consensus of the International Conference on Financing for Development (*Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (United Nations publication, Sales No. E.02.II.A.7), chap. I, resolution 1, annex).

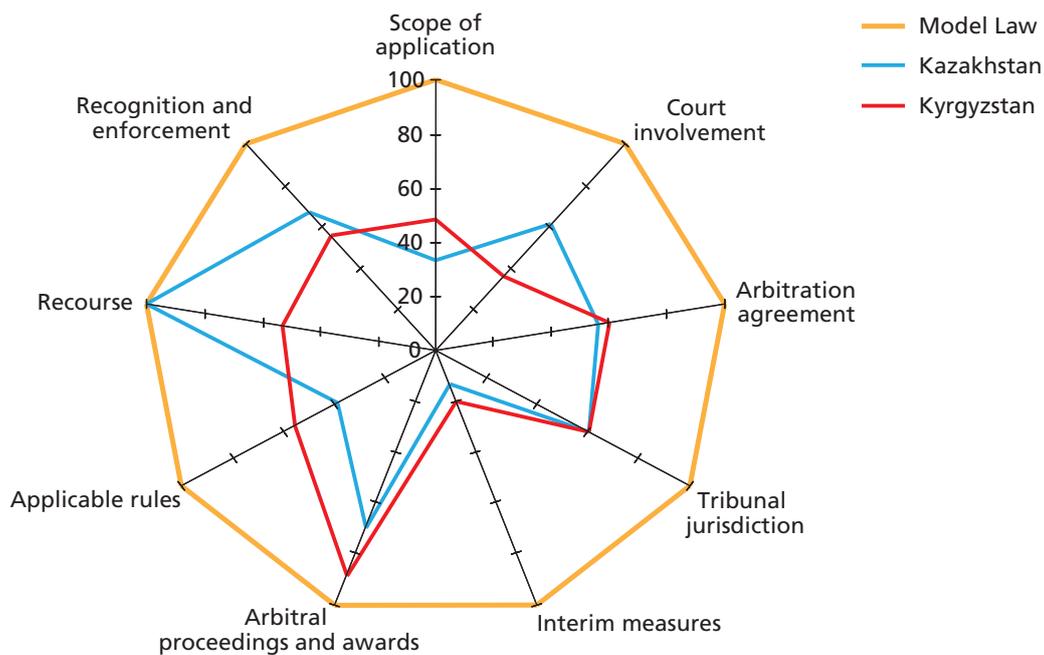
**Figure IV. Conformity of commercial laws of Commonwealth of Independent States countries with the UNCITRAL Model Law on International Commercial Arbitration**



Source: EBRD arbitration law assessment, 2007 (to be published).

Note: The laws of each sector are scored using an index of 100. Sectoral scores are then tallied, with 900 representing full approximation with the principles of the UNCITRAL Model Law on International Commercial Arbitration.

**Figure V. Conformity of commercial laws of Kazakhstan and Kyrgyzstan with the UNCITRAL Model Law on International Commercial Arbitration**



Source: EBRD Arbitration Law Assessment, 2007 (to be published).

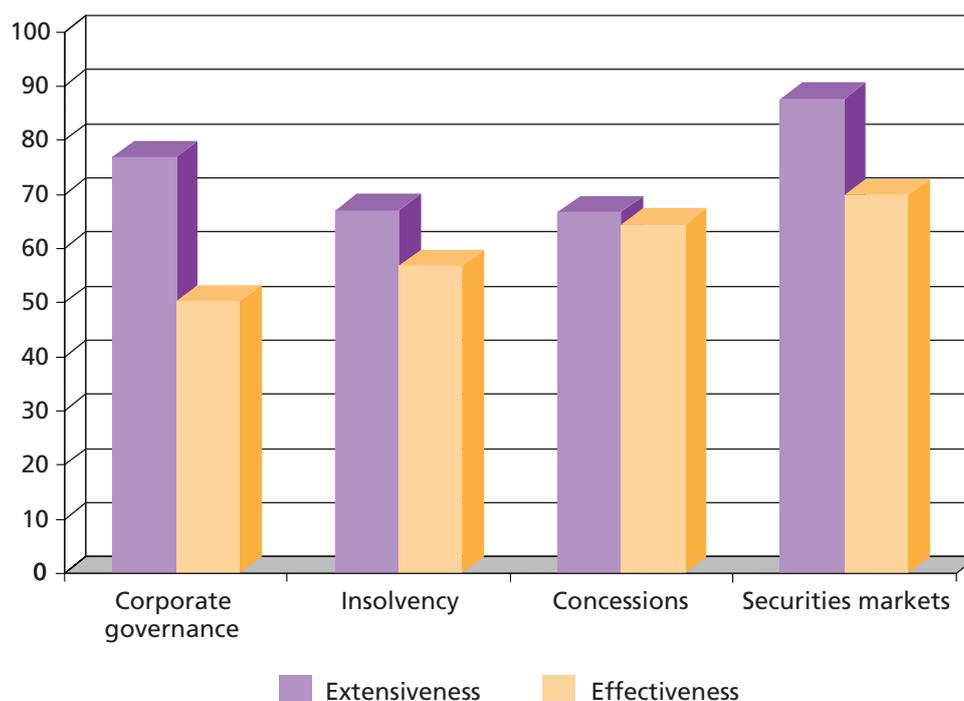
Note: The fuller the web, the more compliant the law with the UNCITRAL Model Law on International Commercial Arbitration.

International standards also provide a reference point for the design of legal technical assistance projects. Detailed assessments also help identify precisely where assistance is required (see figure V). Rarely is there a need for the introduction of wholly new laws, particularly in core areas of economic activity, and it is better to retain what is good and discard only what needs discarding. Designing legal technical assistance projects that use international standards as a benchmark also helps guard against the danger, sometimes seen in the past, of crudely transposing foreign laws which may be unsuitable for countries seeking to enter, or entrench their positions in, the international economic order.

Fourthly, technical assistance should extend to ensuring good laws are actually implemented.

Historically, legal technical assistance tended to confine itself to the drafting of new laws or the revision of existing ones. Insufficient attention was given to how these laws would be implemented. However, a dominant feature of the commercial and financial laws in the region where EBRD operates is that there is a consistent and stubborn “implementation gap” (see figure VI). This is troubling because good laws that are not effective are deprived of the economic benefits they should bring. For example, EBRD research suggests that in attracting foreign investment and improving access to domestic credit, the existence of a bankruptcy regime that actually works is more important than whether a specific insolvency law is more creditor- or debtor-friendly. But even more worrying, where laws are routinely not implemented—to the point where there is a chasm between what the law requires and what it actually means—confidence among citizens in the rule of law is eroded.

**Figure VI. Comparison of quality of legal rules and their degree of implementation: the case of the Baltic States**

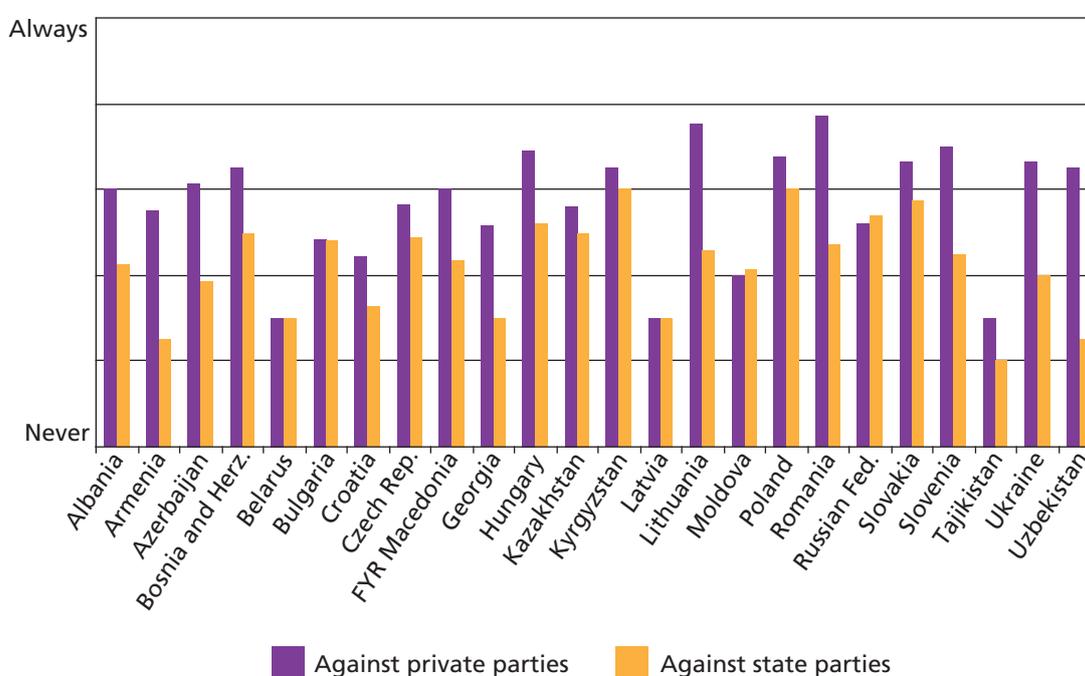


Source: EBRD Legal Assessments, 2004-2007.

Note: Scoring is based on an index of 100, with a perfect score indicating that the relevant law fully conforms with international standards (extensiveness) and/or is fully effective (effectiveness).

Accordingly, technical assistance projects should be designed in a manner sensitive to how the new laws will be supported judicially and administratively, including whether the institutions required to implement the law are equipped for the job. Where required, advisory services should extend to building the legal institutions themselves, including strengthening the independence and competence of the legal profession, the law universities and the courts. Here, the International Development Law Institution has done valuable work in strengthening the judiciary and EBRD is pleased to be working with IDLO to train judges in Kyrgyzstan. There is an urgent need in many countries for this kind of “institution-building”, especially if the confidence of those subject to the law is to be earned and enhanced (see figure VII).

**Figure VII. Perception among local lawyers of how often courts in transition countries uphold legal rights in commercial disputes**



Source: EBRD Legal Indicator Survey 2002.

Note: Law firms were asked: “Do private parties generally believe that courts would recognize and enforce their legal rights against (a) another private party and (b) States parties?”

Fifthly, the legal reform process itself should be a focus of technical assistance.

Legal technical assistance has sometimes foundered because efforts to craft good laws, even those well calibrated to the enforcement capacity of the recipient country, have not been matched by the attention paid to ensuring that the economic purposes of the laws are well understood by those who prepare, legislate, execute, advise and adjudicate on those laws. While the idea of law is highly ambulatory, reform proposals that are sponsored from abroad must be embraced locally and adapted to local conditions if they are to become embedded in the legal system of the home State and are to have the best prospects of achieving their goals.

To be sustainable, reform should also address or have a positive influence on the processes by which the law is improved. This way countries can build on the experience that aid provides. The legal and institutional reform process should be inclusive and open. This will help ensure that those who must enforce the law or are affected by it understand its core objectives, thereby facilitating future changes to the law when needed and reducing the chances of the law being subverted through improper influences. Focusing on improving the processes by which countries improve their law may also stimulate demand for better economic laws, thereby encouraging a virtuous cycle of reform.

### *Conclusion*

Provision by multilateral organizations of legal technical assistance has yielded many lessons for each of those bodies. But there is likely too an acknowledgement among most international organizations that the five lessons listed above are lessons they all recognize to some extent. A shared view of what experience has taught multilateral organizations whose specific mandates differ, sometimes markedly, should not be surprising. Underlying values, such as the need to support development and the belief, held by UNCITRAL and others, in the promise and potential of international trade law to help achieve prosperity, are values that can be embraced by many. And the belief that law can be harnessed to secure not only the material progress of nations but—as Cicero believed its purpose to be—the well-being of the people is a conviction that can have universal appeal.

\* \* \*

*William T. Loris, Chair*

That was extremely interesting and thought-provoking. Charles Schwartz, who is sitting on my left, is the next speaker. Charles has wide experience in a range of commercial, legal and institutional reform projects and activities, both outside and within the agency where he now serves, which is the United States Agency for International Development, where he is the senior commercial law reform adviser. He has also had a very innovative experience and input into a project on commercial dispute resolution, which he will talk about. He is going to talk about his experience in this area of commercial law and innovation and reform, particularly focused on dispute resolution. He is also going to unveil a very unique assessment tool which he uses and I think that will help us in the future in thinking.

## *2. Commercial law harmonization and bilateral assistance*

*Charles A. Schwartz*

*Senior Commercial Law Reform Adviser, United States Agency for International Development*

Technical assistance to developing countries can take many forms, harmonization of commercial laws with international best practices being one of them. Many international organizations are active in developing model laws and practices for a plethora of legal subject-matter areas, such as contracts, company law, and insolvency and reorganization.

A discussion of technical assistance practices in every area would fill a legal treatise. This paper will examine commercial legal harmonization in a crucial central area, something that we at the United States Agency for International Development (USAID) refer to as commercial dispute resolution. Commercial dispute resolution is a term of art that attempts to provide a comprehensive categorization of all formal methods of resolving disputes in a given country. Thus, it would include the formal court system, alternate dispute resolution techniques and international arbitration.

Commercial dispute resolution is essential to a thriving and vibrant business environment. With rapid globalization, differences in interpretation of contracts and other legal agreements are bound to multiply. Even assuming that all parties to all international agreements are acting in good faith, disputes will inevitably arise owing to misunderstandings based on differences in culture, language and local norms.

USAID has funded a great deal of technical assistance in commercial dispute resolution in developing countries. Typically, the need for commercial dispute resolution technical assistance activities is identified through a baseline diagnostic called a commercial legal and institutional reform (CLIR) assessment.

What are the CLIR assessments?

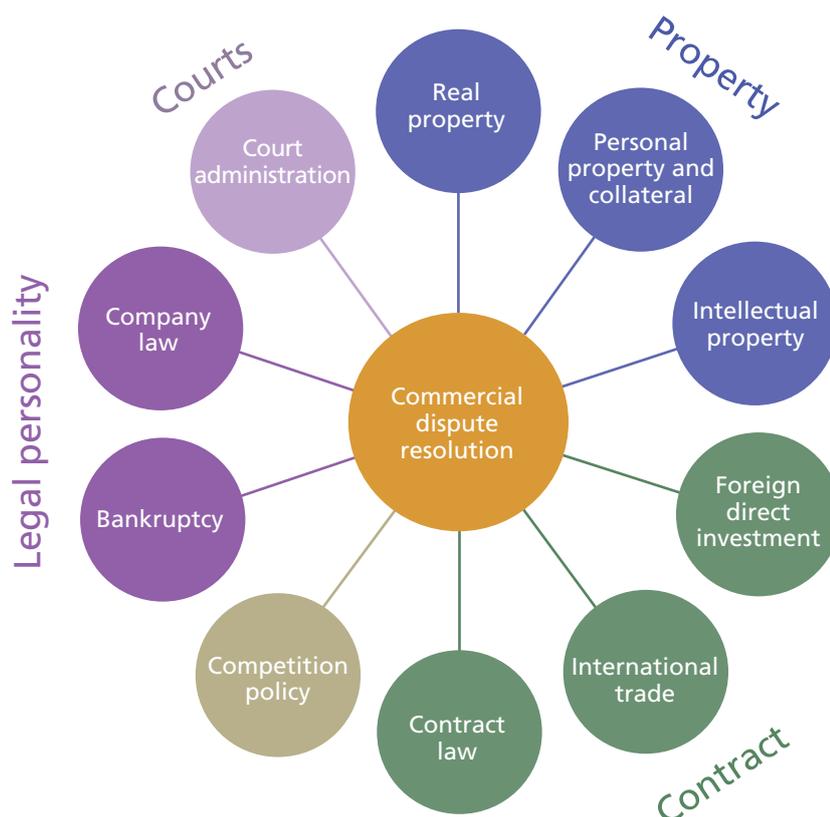
Stemming in large part from the United States Congress's mandate to assist countries in Eastern Europe and the former Soviet Union in becoming market economies, USAID designed a CLIR assessment tool in 1997. The Support for Eastern European Democracy (SEED) Act of 1989 (22 U.S.C. 5401) had a number of objectives, one of which was "to promote the development in Eastern European countries of a free market economic system". Under the FREEDOM Support Act (or the Freedom for Russia and Emerging Eurasian Democracies and Open Market Support Act of 1992) (22 U.S.C. 5801), programmes for developing market economies, similar to those conducted under the SEED Act, were extended to the former Soviet Union. The earliest CLIR assessments were conducted, beginning in 1998 in Poland, Ukraine, Kazakhstan and Romania, and were found to be quite useful in pinpointing bottlenecks and chokepoints in the commercial legal systems. These and other assessments led to commercial dispute resolution projects, such as those in Croatia and Serbia. The Croatia project, for example, dealt with extensive court administration and case management improvements.

As the importance of improving the business enabling environment was better understood by the world community, demand for CLIR assessments from USAID local offices in other regions of the world increased. As a result, we conducted a regional set of country assessments for the Central American Free Trade Agreement (CAFTA) region. Conducting CLIR assessments for a grouping of countries pointed out even more clearly for us the need for effective commercial dispute resolution mechanisms, such as the need for an effective arbitration institution for countries in the CAFTA region, which will be dealt with later in this paper.

Recently, the commercial law systems of several South-East Asian countries have been the subject of commercial law assessments, specifically in Viet Nam, Laos, Cambodia, the Philippines and Indonesia. Also, recent assessments have been performed in Ethiopia, Afghanistan and Pakistan. Future assessments are planned for Africa. All the assessments that have been published to date can be found at the following website: [www.bizlawreform.com](http://www.bizlawreform.com).

The existing CLIR diagnostic methodology covers 15 subject matter areas (11 legal areas and four trade areas); additional areas are being developed. These subject matter areas are thematically linked and grouped, as visibly demonstrated in the following diagram.

### USAID commercial law paradigm



As you can see, commercial dispute resolution occupies the centre of the chart, further underscoring its centrality to a sound business enabling environment. The diagram further groups the various CLIR subject matter areas into four legal groupings: contract, legal personality, property and commercial dispute resolution.

A key feature that distinguishes the CLIR diagnostic methodology from other tools developed so far is that it takes a four-dimensional approach to assessing legal systems. This allows for a holistic understanding of specific CLIR and trade-related challenges and also allows the assessors to identify cross-cutting problems that may pervade the entire commercial law system. The analysis consists of the following:

(a) *Legal framework.* Basic legal documents that define and regulate substantive rights, duties and obligations;

(b) *Implementing institutions.* Governmental, quasi-governmental or private institutions in which the primary legal mandate to implement, administer, interpret or enforce framework law(s) is vested;

(c) *Supporting institutions.* Governmental, quasi-governmental or private institutions that either support or facilitate the implementation, administration, interpretation or enforcement of framework law(s);

(d) *Social dynamics.* The interplay of stakeholder interests within a given society, jurisdiction or group that, in aggregate, exert an influence over the substance, pace or direction of commercial law reform.

#### *What has the United States Agency for International Development learned?*

In trying to improve the dispute resolution environment, regional as well as national approaches should be considered. Regional approaches can range, depending on the region and the countries in it and the conditions which prevail, from a modest approach, such as exchanges of information, to a more ambitious approach, such as the creation of a regional arbitration centre.

The CAFTA region is one for which a regional arbitration centre has been proposed. A recent law journal article by Omar Garcia-Bolivar<sup>85</sup> draws heavily on the results of the USAID assessments in the CAFTA region and contains a number of recommendations regarding the demand for arbitration and for enhanced quality of arbitration. It views the passage of the CAFTA legislation as presenting special opportunities:

“As a result of the Agreement, Central America is bound to integration. As a single market, Central America will have a greater appeal to local and foreign investors. Thus the demands of globalization call for world-class arbitration centres where sophisticated international disputes can be solved quickly and transparently ... One option would be for Central American countries to coordinate the use of arbitration in the region and create a regional arbitration centre ... For this to occur, countries need to harmonize their legal frameworks regarding arbitration. While ambitious, given the nascence of alternative dispute resolution as a concept throughout the region, it would likely be easier to pursue such reforms and harmonization in the near future before each country becomes entrenched in disparate practices.”<sup>86</sup>

Note that Mr. Garcia-Bolivar sees economic integration leading to:

- (a) Greater local and foreign investment;
- (b) Demands of globalization calling for more sophisticated, speedy and transparent international dispute resolution;
- (c) The establishment of a regional arbitration centre as one way to coordinate the use of arbitration;
- (d) The need to harmonize legal frameworks regarding arbitration in order to achieve these results.

#### *Other regional approaches and harmonization*

A regional approach can also be helpful when one country can serve as mentor to other countries in the region. One example of a regional project with a mentoring approach

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<sup>85</sup> Omar Garcia-Bolivar, “Dispute resolution process and enforcing the rule of law”, *Southwestern Journal of Law and Trade in the Americas*, vol. 12, 2006, p. 381.

<sup>86</sup> *Ibid.*, pp. 403-404.

is a project which I developed and supervised. The design of the project was influenced by the belief that finding a “champion” in the region is the best way to attract interest among countries in the same region.

The goal of the project was to find an institution in one country which was relatively well advanced and had the capacity to mentor sister institutions in neighbouring countries which were relatively less advanced. Two parallel programmes were run—one in Eastern Europe and the second in the former Soviet Union. This was done for a number of reasons, one of which was that the social, political and legal institutions in Eastern Europe (especially those of the republics of the former Yugoslavia) were similar to each other, but different from those of the republics of the former Soviet Union, and vice versa.

The project was remarkably successful in leveraging resources, in incorporating the pro bono assistance of organizations and individuals and in mentoring and knowledge-sharing. For example, the project held symposiums in which United States federal judges and court personnel, and officials and representatives of UNCITRAL and the International Chamber of Commerce, all gave their time to help new and developing alternative dispute resolution institutions in the two separate geographic regions covered by the project. These efforts were joined in by the two mentoring institutions—for Eastern Europe the mentoring institution was the District Court in Ljubljana, Slovenia, which has a court-annexed mediation programme, and the mentoring institution in the region covering the former Soviet Union was the Russian Chamber of Commerce and Industry.

Unfortunately, not all countries are in a position to learn from each other or to harmonize their laws. Indeed, many newly independent countries wish to assert their new-found “separateness” and consciously try to differentiate their laws (and other institutions) when formerly they had had very similar or even identical laws and institutions.

#### *Harmonizing through use of model laws*

If countries are willing to harmonize their laws, one very effective way to do so is to encourage the adoption of model laws. I have personally seen, as a member of the United States delegation to the UNCITRAL working group that drafted a model law on international commercial arbitration, that developing countries see the benefit of using a well-thought-out model law as the basis of their own legislation.

What is the attraction of a model law? One is that it is a form of best practices and the result of deliberations by experts in the field. Moreover, since a developing country can itself participate in the proceedings and influence the drafting of the model law, it will be familiar with the model and will understand the reasoning behind the provisions. And UNCITRAL is making efforts to assist countries which have adopted the UNCITRAL Model Law on International Commercial Arbitration with substantial deviations which jeopardize the application of these national laws. UNCITRAL is also looking to promote the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) among sub-Saharan African countries. This is vital to promoting investment in the region, since the granting of an award is meaningless without the ability to enforce.

The influence of UNCITRAL in developing model laws can be seen from the great number of countries which have adopted the various models. For example, the Model Law on International Commercial Arbitration has been adopted by approximately 50 countries, plus six states within the United States. Other model laws have also received similar widespread acceptance.

### *Conclusions*

With the world becoming “smaller” through globalization and with economic growth depending so heavily on international trade, technical assistance programmes are increasingly looking at regional solutions. Often, this will entail harmonization. While it is important to respect local cultural and social practices, it is also important to understand that having an efficient commercial dispute resolution system is crucial for investment and economic growth. National governments will not be able to achieve economic growth without making their commercial dispute resolution systems more efficient, user-friendly, understandable and effective.

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### *William T. Loris, Chair*

I think there are many interesting aspects of that presentation, but one notable one is to see a major bilateral donor country making use of all these international arrangements in which the country participates and, working for a multilateral organization myself, I am always happy to see that; and these are very interesting tools. Can I just ask you one question: are the results of all of these assessments available to the public?

### *Charles A. Schwartz*

*Senior Commercial Law Reform Adviser, United States Agency for International Development*

Yes. Thanks for mentioning this. About 25 of the assessments are on the website already. The link is [www.bizlawreform.com](http://www.bizlawreform.com). Several more are being reviewed, edited and revised, and they will be posted on the site shortly so that the site has all the assessment reports that we have done. The site has other materials of interest in connection with commercial legal and institutional reform.

### *William T. Loris, Chair*

Jean-François Bourque is our next speaker. He is the senior legal adviser at the International Trade Centre UNCTAD/WTO, which is a joint technical cooperation activity of UNCTAD and WTO. He has been in charge of a number of activities at UNCTAD and WTO, including the creation and implementation of various legal support activities. He has an interesting background. He will talk about LegaCarta, which is a searchable, computer-based database that offers a wealth of information on what is happening around the world on legal technical assistance. He also, I think, is going to startle us in a way with some of the statistics on how complicated the forest is behind the WTO tree, and has some suggestions for how we deal with that. I also find it as a thing of personal interest that he did his university studies in Chad and Cameroon, which qualifies him to take a slightly different point of view on what he is going to be talking about.

3. *Managing complexity: experience of the International Trade Centre  
UNCTAD/WTO in trade law technical assistance*

*Jean-François Bourque*

*Senior Legal Adviser, International Trade Centre UNCTAD/WTO*

*Multilateral trade rules and the World Trade Organization*

The establishment of WTO in 1995 has had a pervasive influence on our economies and lives. Not surprisingly, its bearing on how trade law is perceived by decision makers in the ministries of trade and commerce of several developing countries has also been very significant.

According to WTO official terminology, the multilateral trading system is “the system operated by WTO”. For most people involved in WTO negotiations, therefore, “multilateral trade law” is, simply put, the WTO rules. It takes a lot of persuasion to direct the sight of policymakers towards the forest of multilateral trade law rules emerging behind the WTO tree.

Still, in this light, there is a positive outcome from the advent of WTO: an implicit recognition of the impact of non-tariff trade rules on trade. For nearly 50 years, from 1947 to 1994, trade negotiations focused primarily on reducing tariffs on trade in goods. From 1948 onward, most of the subsequent rounds resulted in bigger packages of tariff concessions, while adding on the way a few new items, such as anti-dumping regulations. For that reason, the basic legal principles of the General Agreement on Tariffs and Trade remained much as they were in 1948, during almost half a century. When countries embarked on the Uruguay Round in the 1980s, the average tariff on industrial products in developed economies had lowered to 6.3 per cent.

As the industrial tariff barriers progressively fell to their current low level (they are presently at 3.8 per cent for developed economies), other barriers emerged that had been out of sight of the negotiators’ screen for so long because their impact was not considered as relevant as tariffs when tariffs were high. Among these were a series of legal barriers concerning intellectual property, trade facilitation, environmental issues etc., which gave birth to the World Trade Organization Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) and other agreements within the WTO context.

*The forest behind the World Trade Organization tree*

The International Trade Centre UNCTAD/WTO (ITC)<sup>87</sup> views the multilateral trade system as something wider than the WTO agreements per se and, when it assists countries in integrating effectively the multilateral trading system, it also draws their attention to the “forest”. For that purpose, ITC developed the LegaCarta system for ministries of trade (sometimes of justice). LegaCarta is a Web-based technical assistance tool whose function is to help decision makers optimize their legal framework regarding multilateral trade treaties.

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<sup>87</sup>The International Trade Centre UNCTAD/WTO is the joint technical cooperation agency of UNCTAD and WTO for business aspects of trade development.

According to our assessment, multilateral instruments affecting trade include a core group of some 232 treaties and other instruments (such as model laws), plus an additional group of approximately 450 secondary instruments and protocols.

The following list is an indication of the range of issues covered by the core 232 multilateral trade instruments:

- Contracts (17 treaties and 9 other instruments)
  - Customs (33 treaties)
  - Dispute resolution (15 treaties and 5 other instruments)
  - Environment and products (33 treaties)
  - Finance, payments and insolvency (10 treaties and 6 other instruments)
  - Illicit trade (12 treaties)
  - Institutional participation (8 treaties and 9 other instruments)
  - Intellectual property (23 treaties)
  - Investment (2 treaties and 2 other instruments)
  - Transport and telecommunications (41 treaties)
  - Treaties law (4 treaties)
  - WTO (1 main treaty and 2 plurilateral agreements)
- These treaties are overseen by some 25 different international organizations.<sup>88</sup>

The ratifications, texts and summaries have been grouped in a database and one can see from the table at the end of this paper<sup>89</sup> that the world ratification rate is 34 per cent. The rate of ratification of practically all developed economies ranges between 45 and 70 per cent. All the world's major exporters have a high ratification rate. In developing economies and least developed countries, the ratification rate ranges from 3 to 30 per cent.

The multitude of international agreements, however useful they may be in their harmonization function, makes it difficult for decision makers to decide which treaties should be ratified and which ones should be ignored altogether. Public institutions are not often provided with enough resources to investigate in detail all the existing multilateral trade instruments and analyse the economic consequences of their ratification. Moreover, information on multilateral trade instruments is widely dispersed. Finally, few developing economies currently participate in a proactive way in the international trade rule-making process.

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<sup>88</sup> Some of the main multilateral treaty bodies: Food and Agriculture Organization of the United Nations (FAO); the Hague Conference on Private International Law; International Civil Aviation Organization (ICAO); Intergovernmental Organization for International Carriage by Rail; International Institute for the Unification of Private Law (Unidroit); International Maritime Organization (IMO); International Narcotics Control Board (INCB); International Road Transport Union; International Telecommunication Union (ITU); International Tropical Timber Organization (ITTO); International Union for the Protection of New Varieties of Plants (UPOV); United Nations Secretariat; United Nations Commission on International Trade Law (UNCITRAL); United Nations Environment Programme (UNEP) and within its auspices the secretariat of the Convention on Biological Diversity, the secretariat of the Convention on International Trade in Endangered Species of Wild Fauna and Flora, the secretariat of the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal, the secretariat of the United Nations Framework Convention on Climate Change, the secretariat of the United Nations Convention to Combat Desertification in Those Countries Experiencing Serious Drought and/or Desertification, Particularly in Africa; United Nations Office on Drugs and Crime; United Nations Educational, Scientific and Cultural Organization (UNESCO); World Bank; World Customs Organization; World Intellectual Property Organization (WIPO); and World Trade Organization.

<sup>89</sup> Reproduced in this publication as annex I.

What ITC endeavours to do, in collaboration with several other organizations, is to provide decision makers with information on their country's status in a systematic way, so that policymakers and the national legal community (business lawyers, law professors etc.) may have a better understanding of policy issues related to the application or non-application of multilateral trade conventions. Accordingly, they can make informed decisions as to what treaties their country could ratify in accordance with national priorities. LegaCarta also aims to encourage countries to participate in the process of drafting international trade rules instead of merely being a recipient of them.

Reducing complexity thus implies a greater integration of the work of international organizations among themselves. Tribute should be paid in particular to UNCITRAL, Unidroit and the Hague Conference on Private International Law for having set the scene by jointly seeking to rationalize their work with other organizations in the area of capacity-building and development.

We should not underestimate the work that is required from developing countries in deciding whether they should accede or not to some of these treaties. Many of these treaties have had their own layers of history. For example, the 1999 Montreal Convention for International Carriage by Air is about eliminating the patchwork of airline accident liability regimes around the world. However, a country ratifying the 1999 Montreal Convention, currently ratified by 75 States, may also consider acceding to the previous main conventions (the Warsaw Convention of 1929, ratified by 151 countries, and the Hague Protocol of 1955, ratified by 136 countries), since it may be advisable to take account of the fact that not all countries are bound by the latest 1999 Convention.

The proliferation and dispersed nature of international conventions has been recognized as an issue for some time. In 1990, the World Customs Organization adopted its famous Istanbul Convention on Temporary Admission, which contains and merges all 10 already existing conventions on temporary admission. Due to these sedimentary layers of treaties accumulated in the past 120 years, developing economies are asked to absorb the archaeological dimension of trade treaties together with their modern implications.

Today, Governments of developing economies all over the world are intensely involved, often through their ministries of trade or commerce, in a series of trade negotiations at the international, regional and bilateral levels. An overriding concern is the social and economic impact on their countrymen and women of such negotiations and new rules. Proposals to include new trade rules, suggestions to ratify multilateral trade treaties and encouragement to pass new commercial laws must in their view pass the same impact test as applied to other economic rules they are negotiating. International organizations overseeing such treaties should be able and ready to provide measurable cost-benefit data.

*The inside-outside dichotomy: "we and they"*

Whatever our good intentions are, and while the praise of participation is confidently sung, we are often inviting Governments and people to merely participate in our plans and

follow our models.<sup>90</sup> Funds are channelled to upgrade national legal frameworks but very little money is earmarked for the participation of “developing” economies in the concept and framing of new international trade rules.

### *Overtasked decision makers*

While trade law issues involve various actors in civil society, decisions are most often taken at the level of the ministry of trade. This is particularly the case in Africa, which accounts for 33 of the world’s 50 least developed countries.

What are often underestimated are the level of commitment and the workload of those in charge of trade issues in developing economies.

Because trade negotiations are highly demanding, the permanent secretaries and directors of trade ministries are required on a daily basis to respond to an increasing number of tasks:

- (a) Preparing WTO negotiation strategies and positions;
- (b) Backstopping the Geneva national representative;
- (c) Following up at the level of the cabinet of ministers and coordination with national stakeholders;<sup>91</sup>
- (d) Participating in intensive regional integration negotiations (of the 53 African countries, 16 are part of two regional integration organizations and 20 are members of three). Some of these negotiations are pressing: the Common Market for Eastern and Southern Africa (19 countries) aims at creating a customs union in 2008; and the Southern African Development Community (14 countries) aims at creating a customs union by 2010;
- (e) Preferential agreements negotiations such as the Economic Partnership Agreement with Europe;
- (f) Country representation at numerous regional and international forums and at seminars and other events organized by international organizations, non-governmental organizations etc.;
- (g) Coordination of technical assistance activities.

This, combined with the accelerated mobility of talented civil servants who are offered various job opportunities in projects run by international organizations and non-governmental organizations, has to be taken into account.

<sup>90</sup>This tendency reinforces, and is reinforced by, an intellectuality that sees as the hallmark of intelligence the ability to identify differences, to divide and to relativize, all in the name of being scientific. Such an approach is a gross misrepresentation of science, for although it is true that science analyses, it also integrates and points out to underlying patterns of oneness. (...) Viewed from that angle [unity of mankind], development ceases to be something that one does for others. Farzam Arbab, “Promoting a discourse on science, religion, and development”, in *The Lab, the Temple and the Market: Reflections at the Intersection of Science, Religion and Development*, Sharon Harper, ed. (Ottawa, International Development Research Centre and Bloomfield, Connecticut, 2000).

<sup>91</sup>Under the WTO provisions concerning transparency, all member States are required to designate a single government authority as responsible for implementing, on a national level, the notification requirements of the WTO agreements in four areas (sanitary and phytosanitary measures; technical barriers to trade; trade-related aspects of intellectual property; and trade in services). This means in practice that four separate national enquiry points are run under the aegis of each ministry of trade.

One may take the measure of the burden for the ministries of trade of coordinating technical assistance activities by looking at Viet Nam. Between 2001 and 2006, in Viet Nam alone there were some 360 trade policy and regulations capacity-building programmes, not including trade development and infrastructure programmes.<sup>92</sup>

#### *Need for integrated and medium-term approaches to technical assistance*

One of the most effective and demanded trade-related capacity-building programmes in Africa on the multilateral trading system is the Joint Integrated Technical Assistance Programme (JITAP), implemented by ITC, UNCTAD and WTO, and covering 16 African countries. The programme was set up in 1998 and its second phase will be completed at the end of this year. JITAP aims to build capacities at the national level to assist partner countries in setting up a trade policy process that helps each country identify its interests and develop a specific approach to trade policy formulation and trade negotiations. This requires a nationwide effort involving all stakeholders, including parliaments, the private sector, media, academia and civil society. The inclusive and consultative process is key to national ownership and trade policy reform. In some countries, the JITAP programme lasted nine years, a lifespan sufficient to see the flourishing of inter-institutional committees that are official frameworks for organized national stakeholder discussion and decision-making on the multilateral trade system.

The acclaimed results of the JITAP programme are due to the recognition that capacity development is a long-term process and that the best results are achieved through a regional approach where there is constant cross-fertilization of experiences.

#### *Regional harmonization of trade laws*

A signal achievement in regional harmonization of trade laws has taken place in Central and Western Africa, where 16 countries have effectively unified their commercial laws, including company law, arbitration, transport of goods, securities etc. OHADA (standing for the Organization for the Harmonization of Business Law in Africa) even went a step further by creating a supreme court having jurisdiction on all commercial cases following a national appeal before a national State court. The OHADA Supreme Court, seated in Côte d'Ivoire, rendered its first decisions in the year 2000 and is currently examining 120 cases per year.

ITC has supported from the outset the OHADA regional harmonization process, because it was viewed as a means to facilitate regional trade and foreign investment. OHADA also produced economies of scale, even though each draft uniform law had to be examined by all 16 countries prior to its enforcement. Note that the OHADA Treaty was signed in 1993 and the first uniform laws enacted in 1998, five years later. As a comparison,

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<sup>92</sup> According to the "2006 Joint WTO/OECD report on trade-related technical assistance and capacity-building (TRTA/CB)", trade-related technical activities are either focused on "trade policy and regulations" or on "trade development" (access to trade finance, trade promotion in productive sectors such as agriculture and industry). "Trade policy and regulations" cover support to aid recipients' effective participation in multilateral trade negotiations, analysis and implementation of multilateral trade agreements, trade policy mainstreaming and technical standards, trade facilitation including tariff structures and customs regimes, support to regional trade arrangements and human resources development in trade.

in the United States, the National Conference of Commissioners on Uniform State Laws took 10 years, starting in 1940, to write the Uniform Commercial Code, and waited another 14 years, for its generalized adoption in the American states. The fact that African countries achieved in five years what the United States did in a quarter of a century, albeit in different circumstances and times, may help us revisit some of our deeply rooted assumptions.

### *Constantly reassessing assumptions*

Consideration of impact should encourage us to reassess some current assumptions, especially in the dispute resolution sector. In Africa and Asia, practically all countries are in the process of creating an arbitration centre, often under the aegis of a chamber of commerce. In the 1990s, in Latin America, a continental strategy, funded by the Inter-American Development Bank, was established to mitigate the shortfall in justice services and to improve the conditions for private sector development. The strategy consisted in setting up arbitration and mediation centres in most countries of the South American region so as to offer entrepreneurs an alternative for the settlement of their commercial disputes. The establishment of arbitration and mediation centres was intended to create a private space where individuals could settle their disputes, thus filling the void left by public justice services.

At the same time, it was expected that more extensive use of arbitration and mediation would remove a large number of cases from the courts and would therefore help to clear up the backlog. These changes were also expected to improve access to justice, as a result of the availability of new mechanisms for dispute settlement and decongestion of the courts. Some evident achievements were noted of course: legislation on arbitration and mediation was modernized and harmonized in almost all the countries in the region and they have up-to-date laws that reflect international norms. Specialized human resources were trained in almost all the countries in the region. Qualified arbitrators and mediators are available, which was not the case at the beginning of the 1990s. But levels of congestion of courts are still high.

In Africa, all 26 existing national arbitration centres except one were created after 1995 and most of them were set up under the premise that an arbitration centre would help reduce court congestion. At least half of these centres do not handle more than five cases per year. Recognizing that there was a disconnect between purpose and reality, between potential users of arbitration and arbitration institutions, ITC organized consultations between the managers of these institutions, on a regional basis, to address this fundamental issue of socio-economic impact and to see whether other experiences in the region, such as in the mediation field, would have a greater bearing on dispute resolution nationally.

What we have wished to stress in this short presentation is the need for international organizations dealing with international trade law developmental issues to organize their work in a coordinated and systematic manner, with medium- or long-term approaches, in close consultation with their partners in developing economies.

*William T. Loris, Chair*

These are startling statistics. There is a job to be done and I think it screams out for coordination if that is a message we can pull from your presentation. Thank you very much, Jean-François.

Next, the Honourable Rosa María Maggi Ducommun, who is a judge in the court of appeals of Santiago, Chile, will speak to us. She comes to this podium with a long background as first a lawyer and then a judge at different degrees during her career. She also has a very interesting recent experience in participating in the foundation of and also in teaching at a rather new judicial academy in Chile. So she will bring to us a special idea on the need for training and capacity-building for judges and arbitrators, basically to help them deal with the new realities which are brought upon them by the various reforms that are afoot; she will also give us a glimpse of her experience as a trainer in this new judicial academy.

#### *4. Training needs for judges and arbitrators*

*Judge Rosa María Maggi Ducommun*  
*Court of Appeals, Chile*

I have had the honour of being invited to put forward some ideas on training needs for judges and arbitrators, a topic which I will approach from the perspective of trade law, which is the subject of this gathering today and whose particular characteristics impose the need for a rigorous legal education, specialist knowledge and constant skills upgrading, requiring ongoing training or tuition.

However, many of the observations that will be made here are also applicable to judges or arbitrators entrusted with resolving other types of dispute in that they have to perform similar tasks and provide solutions to cases referred to them.

Continuous advances in technology and the liberalization and internationalization of economies have brought about major changes in the conditions of money circulation and in the trade in goods and services, giving rise to new forms of procurement, which often go beyond the framework of individual countries' legislation and entail new customs and practices or specific concepts of foreign law. We are thus witnessing the development of an increasingly complex scenario, making it essential for all those involved in dispute resolution to be duly trained in reaching decisions that are not only expedient and appropriate but also conform to the rules applicable to the case concerned.

These circumstances have led to a marked preference for the use of arbitration, more particularly in trade law issues, although other alternative dispute resolution mechanisms also exist, such as mediation, where judges do not make decisions that are binding on the parties but the parties themselves arrive at a solution to their dispute with the involvement of a third party who seeks to guide or help them in achieving that goal.

The new demands imposed by the current situation mean an ever-increasing need for specialization and specific training of judges and arbitrators, who will have to be able to

confront these challenges. The existence of alternative dispute resolution mechanisms also calls for specialist knowledge and training in particular skills and techniques.

Training and skills development for judges and arbitrators should therefore be aimed at meeting the needs of society, to which end they should be provided with the necessary tools to effectively and efficiently perform the delicate task of judging their peers and deciding whether their conduct was lawful.

### *Designing a training programme*

When training programmes for the judiciary are planned, there is a tendency to think that judges need to be instructed on legal institutions, substantive norms and procedural rules so that a comprehensive knowledge of such areas will facilitate their processing and resolution of cases which they have to adjudicate. That is because judges are commonly perceived as legal experts possessing an extensive understanding of laws and regulations and that a good legal education combined with training in each type of proceeding would sufficiently equip them to administer justice.

However, managing such information is not sufficient to meet the intended purpose since training for judges also has to be aimed at encouraging or developing a proper evaluation of evidence, a sound grasp of norms or principles to be applied in specific cases and an appropriate understanding of circumstances of time and place, which is the only way of effectively training judges to assess the conduct on which they are required to pass judgement.

Law schools generally, and particularly in Latin America, train lawyers, not judges. Preference is given at such schools to theory over practice and to written law over other legal sources. Our universities thus provide adequate training for lawyers, equip them to practise their profession and give them a general knowledge that contributes to their cultural education. Contrary to what might be thought, this training does not enable our lawyers to serve efficiently as judges.

The task of a judge or an arbitrator entrusted with resolving disputes calls for knowledge and skills that are not always taught at law school, such as how to pronounce sentences or conduct procedural formalities laid down by law for each type of proceeding. Also, judges need a different outlook from that normally imparted in the lecture room, where studying the law is based on analysis of norms rather than on specific cases, since an adjudicator has to follow the reverse process, being required to determine the applicable norms on the basis of a particular case.

Moreover, the conduct of members of the judiciary must, by reason of their delicate functions, be upright, free from any vice that could make them vulnerable and, to the extent possible, not tied to economic interests that might jeopardize their independence and impartiality, which is why ethical training is essential.

These considerations clearly point to the need for judicial training establishments.

*Establishments for training and skills development*

Judicial training establishments may operate under the responsibility of government institutions, universities, professional institutes or other autonomous bodies or be organized within the judiciary itself or supervised by judicial authorities.

Lawyers' associations, chambers of commerce or regulatory or oversight institutions customarily set up entities for the training of qualified professionals to serve as arbitrators or mediators or contribute to their funding. Mediators' advisory, monitoring and appraisal centres may also be organized to contribute to the effectiveness of their work.

In parallel with or in the absence of these establishments, postgraduate or inter-level cooperation programmes may be devised to enable such professionals to discharge their functions competently so that the public can obtain fair, informed and appropriate rulings.

*Training and skills development programmes*

Such programmes should be aimed at enabling judges or arbitrators entrusted with dispute resolution to reach fair and sound decisions. To that end they will need to have a sufficient knowledge of the applicable norms and to understand their true meaning and import in order to align them with the principles of justice and equity on which they are based, this being the only way in which they can apply them accurately to the case concerned, for which they will have previously determined the material evidence through appropriate evaluation of the facts adduced by the parties.

It is possible to design programmes either for training judges and arbitrators or for developing the skills of judicial staff in office. The former aim to enable professionals who show an interest in undertaking such work to fulfil academic requirements, such as a prequalification to enter the system. The latter offer ongoing instruction for professionals who are already practising in order to provide them with information relevant to the performance of their work and to upgrade their skills.

The requirement of prior training will, in addition to offering post applicants appropriate instruction for carrying out their duties, make it possible to achieve the key objective of ensuring that the selection process is based on objective criteria such as skills and performance evaluation, thus avoiding any possibility of discrimination or influence that might jeopardize the independence of the judiciary.

By contrast, ongoing training programmes are intended to meet the constant need for judges and arbitrators to improve their skills with a view to better performing their adjudication role.

While ongoing skills development and instruction will effectively contribute to preserving judges' independence and impartiality, there will always be a need for both types of programme to enhance ethical training and moral competence.

*Adjudicator profile and qualities*

While ethical instruction normally takes place in childhood within the family or at primary or elementary school, it is essential for training and skills development programmes to clearly address ethical issues that judges may face, making them aware of the risks arising from negligent conduct, breach of duty or failure to resist political or economic pressure or influence.

One effective teaching method is to depict specific situations involving ethical conflicts and ask judiciary applicants how they might deal with them. They are thus not only reminded of their ethical duty but are also alerted to a problem which they may not hitherto have fully appreciated and are safeguarded against inopportune acts by unscrupulous third parties that might catch them off guard. It is interesting to note that, even applicants' excessive good faith or trust in the rectitude of their peers can on occasion cause them to make wrong decisions or to breach the impartiality and independence that have to be observed in all their judgements.

A code of ethics which explicitly sets out the duties and obligations of judges and arbitrators can help increase their awareness of how they should perform their work and at the same time enable the public to demand that their conduct conform to uniform rules.

*Training programme methodology*

Learning that is based on real or imaginary case studies is an excellent way of achieving the goals of judicial training since it generates discussion. Students show an interest in putting forward their views, examining the legislation which they regard as applicable, interpreting it and setting out the reasons which in their opinion should be taken into consideration in resolving cases put before them.

Teaching should thus incorporate work schemes such as simulated situations, round-table discussions and workshops at which cases presented can be studied.

Examining actual judgements will always be essential since it encourages discussion and analysis of the substantive issues dealt with in them while at the time showing students how verdicts should be handed down and the requirements which they have to fulfil.

Another useful procedure is to involve applicants in practical, on-site experiences at law courts, where the student participates under the supervision of an adviser or tutor judge.

*Skills development programme methodology*

On the assumption that judges should undergo periodic instruction, it is necessary for ongoing training or skills development programmes to incorporate flexible plans which will meet judges' specific needs and also enable them to access such learning without necessarily having to abandon their duties for prolonged periods, which could hamper the administration of justice or discourage their attendance at such courses.

It is possible under these programmes to use distance-learning facilities so that those concerned can receive regular upgrading in subjects of interest to them without leaving their place of work. This distance-learning methodology can include exercises, controlled reading, replies to questionnaires, videoconferences etc.

### *Training and skills development in Chile*

I cannot complete this presentation without briefly referring to the Judicial Academy which was set up in November 1994 and is the realization of a long-held desire of my country's judiciary, which is to provide adequate training to applicants for judicial posts and supplement the academic instruction of members of the judiciary.

It is a public-law corporation operating as a legal entity with its own assets under the supervision of the Supreme Court whose purpose is specifically to train applicants for posts in the judiciary and to develop the skills of its members.

The Judicial Academy favours an active methodology and practical teaching. The preferred working method thus involves the use of seminars, workshops and group sessions at which the discussion of topics of interest is fostered in order to achieve the applicants' active participation. Actual case studies and analyses are undertaken and potential situations are simulated. Also, field work is carried out through a system of internships at law courts, whose purpose is to involve students in the daily workings of a court so that they can appreciate the work of judges and visualize the consequences of their decisions. The teaching staff comprises academics, who provide the theoretical component of the topics, and judges, who also contribute their experiences.

The training programme is aimed at lawyers with an interest in the judiciary and the programme content is designed to enable students to supplement their knowledge of issues essential for judicial practice, to understand the importance of a judge's role in society and decision-making responsibility and to acquire the skills and expertise necessary for judicial service. It includes topics such as interpreting the law, assessing or evaluating evidence, drafting verdicts, judicial ethics and reasoning, and incorporates residential internships at law courts under the direction of tutor judges who guide applicants in performing judicial tasks.

There is also a programme which leads to the legally required qualification for the posts of appeal court judge and judicial officer. Under this programme, topics concerned with the activities of second-instance courts are studied and analysed in order to expand the knowledge of judicial personnel interested in taking up such posts. Given the courts' broad jurisdiction, the programme includes discussions on legal theory in civil, commercial, criminal, labour and public law matters and the detailed study of appeals referred to these collegiate courts. The programme also incorporates residential internships at appeal courts under the direction of a tutor judge who assists interns in this experience with a view to their understanding and participating in the system of work.

In addition to these programmes, skills development courses are organized in order to provide ongoing instruction for all members of the judiciary, including secretariat personnel. Courses are run on different subjects for which staff are entitled to opt, throughout the

country, attendance at some being compulsory. The Judicial Academy normally fills course tuition posts by open competitions, for which specialized teaching bodies or groups apply.

These activities are aimed at improving the provision of effective training for judges in a constant endeavour to enhance the justice administration system.

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*William T. Loris, Chair*

I think that it is very important to have such a continuing legal education facility for each of the legal professions, either separately or in a combined fashion. Such institutions are being created in a number of countries, and I am sure your experience in setting that up and how it is run will be helpful to other countries as they try to take the same approach.

The last presentation is by Professor Chiara Giovannucci Orlandi of the University of Bologna. She has been an adjunct professor of civil procedure law at the University of Bologna School of Economics since 1994. She is also assistant professor of civil procedure law at the University of Bologna and is a visiting professor at the University of Paris X Nanterre. She is a teacher, and therefore she will talk about education. She will focus our attention on the need to strengthen education and training both in terms of continuing legal education but also at the university level to meet the demands which are being placed upon all of us in this new changed legal environment. And she also has a very interesting suggestion for UNCITRAL, which I will let her present herself.

##### *5. Legal harmonization in practice: teaching and learning uniform commercial law*

*Chiara Giovannucci Orlandi*  
*University of Bologna, Italy*

The discussion on training for the legal profession is increasingly of great importance, as demonstrated, for example, by the International Forum on New Legal Education Method in the Global Society held at the Kyoto Congress in 2006 and by numerous recent publications. What has drawn my attention and what I will speak about today is whether there are—or if there should be—specific instruments or methods for training legal professionals who are to interpret and apply uniform commercial law.

It is not a mystery to anyone that it is important and necessary to develop uniform legislation as well as to deal with the problems and difficulties connected to it. Great results have already been obtained, but we all know very well that all the efforts for producing uniform legislation can be neutralized, or at least its efficacy greatly reduced, by diverging interpretations and applications of these laws by the courts of different countries.

I will use the United Nations Sales Convention (CISG) as an example because, with its 70 contracting States, it is undoubtedly one of the most successful instruments.

Diverging interpretations and applications by different courts exist, for example, regarding article 38 (1), according to which, as you know, the buyer must examine the

goods, or cause them to be examined, within as short a period as is “practicable in the circumstances”. This latter concept aims to ensure flexibility, thus allowing the period for examination of the goods to vary from case to case. Unfortunately, courts and commentators of different countries have interpreted this latter concept differently. In effect, some courts and commentators have attempted to establish presumptive time periods within which the buyer has to examine the goods, going from one week after delivery up to a month. This does not appear to be a sensible solution since, even though this approach may appear to guarantee uniformity, it creates a rigidity that does not allow for the flexibility aimed at by the drafters of the CISG to allow for justice in the individual case.

When looking at the existing court rulings, two different approaches can be discerned: courts that attempt to ensure flexibility (as is the case in Italy) and those that, conversely, decide to use a more rigid approach by resorting to a “presumptive period” (as is the case in Germany).

As far as this issue is concerned, even the instruments provided by UNCITRAL for the promotion of the uniform application of the Convention, such as the Digest and the case law on UNCITRAL texts (CLOUT) system, can be insufficient because they merely illustrate the existing differences without taking any stand as to which solution is to be followed. Therefore, perhaps a common form of training would be a more powerful instrument for creating uniform application right from the start, that is, without having to later rectify the divergences in application.

My task here is to offer some ideas and proposals especially for lawyers, including in-house counsel, and I would also like to evaluate how UNCITRAL can have a role in legal education.

Actually, we should first address undergraduate students of law because, unfortunately, teaching uniform commercial law is still underdeveloped in most universities, and not only in Italy. For this reason, UNCITRAL, just like each one of us, should never give up suggesting and encouraging the study of uniform law instruments in undergraduate programmes. But even more so than UNCITRAL, probably the most effective measure in this regard would be a commitment made by all of the experts in this field.

In my opinion, UNCITRAL could contribute more directly to postgraduate education on two fronts: spreading knowledge of the existence of the United Nations Sales Convention and other instruments, on the one hand, and, on the other, offering “advanced” training for the legal professionals who already use these instruments and therefore must guarantee their efficacy, like judges, arbitrators and lawyers.

Two types of programmes could be set up for reaching these objectives. One would be an LLM programme, organized by what could be a kind of academy created for the very purpose of teaching uniform law, where young professionals could learn by discussing with colleagues and instructors from different countries. This would act as a starting point for a format that could then be reproduced in different parts of the world, promoting a future generation of legislators and jurists who would increase the production, spread and uniform application of shared rules: a project that certainly does not appear impossible, even if difficult. The other, a more plausible and immediate action that UNCITRAL could take, would be the creation of short courses lasting 10 days or simply workshops lasting three full-time days.

Before creating these programmes, however, we would need to start thinking about the topics to be taught in them; in doing so, we must keep in mind that there are two main elements that should characterize them, namely methodology and knowledge of instruments.

As for knowledge of instruments, along with the usual topics taught in an LLM programme aimed at participants working in the field of international commerce, courses should also be offered that deal with the main instruments of uniform commercial law both in terms of substantive law and in terms of instruments for dispute resolution. The institutions that produce such instruments are certainly known to everyone; they include, apart from UNCITRAL, the European Community, Unidroit and the International Chamber of Commerce (ICC). As regards the sources of substantive law, they obviously include conventions and model laws, but we cannot forget “codified practices”, such as the Unidroit Principles and the ICC Incoterms, and non-codified ones, such as *lex mercatoria* or international customs.

When it comes to dispute resolution, one should teach how to deal with international transactions in State court proceedings as well as alternative dispute resolution methods (both adjudicative and non-adjudicative). I do not think I have to stress the importance of a tool like international arbitration for resolving international disputes.

It is worth mentioning, however, that international arbitration has not yet reached the same level of quality everywhere. (This is true, for example, regarding the preparation and impartiality of arbitrators.) Guaranteeing a high standard would make arbitration more reliable in the eyes of the players in the international arena. As a consequence, the New York Convention as well as the relevant UNCITRAL instruments, such as the Model Law on International Commercial Arbitration, cannot be disregarded either.

Another form of alternative dispute resolution, conciliation, is not yet a “reality”, but I think the time is ripe for it to become so, as demonstrated by the elaboration of the UNCITRAL Model Law on International Commercial Conciliation and the recent drafting of a European directive.

In terms of methodology, we can consider two elements. First, it is necessary to train legal professionals to be familiar with the different legal systems of the countries where uniform norms are to be applied, to be acquainted with the different methodologies of interpretation and how to properly dialogue with each other. In this respect we should consider teaching legal systems, that is, the categories or families into which all legal systems are generally divided (such as those suggested over the years by David, Constantinesco, Zweigert and Koetz). This would allow practitioners to more easily go beyond their own legal background and the idea that their legal system is the only one capable of solving a specific problem, thus making it easier for them to apply the uniform commercial law instruments in an autonomous and uniform way.

Second, my interest in legal training has led to discussing the issue with colleagues from different sectors as well as Roman law scholars, who have convinced me that Roman law could be a useful starting point. As you know, nowadays Roman law scholars claim that their subject is not only a historical one but also one that can be used for the actual creation and interpretation of law. In short, in the ancient Roman world uniform norms regulating commercial exchanges were a constant presence: in the earliest period the Roman Republic

evolved in the Mediterranean area and its merchants did business with merchants from other Italic cities, Punic and Greek cities, and with all the countries bordering on the Mediterranean. Their relations were governed by common commercial customs enshrined in bilateral treaties that even provided how to resolve disputes. Thereafter, during the centuries of the Roman Empire, it was Roman law, the law of the dominating State, that imposed itself as a uniform law across the entire territory of the Empire in order to better protect merchants, entrepreneurs and Roman bankers wherever they worked, bypassing potential problems arising from the differences existing between different legal systems, whose survival and autonomy was guaranteed by Roman domination.

Knowledge of the long and complex Roman experience is of great importance to us because it clearly shows us that establishing uniform norms must be accompanied by a common legal culture that makes uniform interpretation possible and, thus, uniform application. In fact, legal scholars had a fundamental role in developing rules in a rational manner by working out all the local variations. This conclusion is reinforced by what took place in medieval Europe, where a common commercial law could be applied in different countries, in which legal scholars were working who had been educated in universities where the same legal culture was taught.

A group of Roman law scholars from at least 100 universities in different countries, led by Professor Corbino (from Catania University), are working on a very interesting project called European Legal Roots. The scientific bases of the project are linked to the role Roman law can have in the definition of a legal system that harmonizes, on historical grounds, the differences present in European private law due to the evolution of national civil law systems and of judicial practices. This ambitious harmonization perspective not only stems from important common historical “roots”, but it has (as it had in the past) a strong unifying ability. This is because this perspective refers not only to assimilation and standardization but also to the creation of a potential single system of subjects who retain their distinct identities without forsaking a “common” ground. In fact, the system itself is the result of different histories that come together through shared “practices”.

To close my presentation, I would like to go back to the subject of creating short courses or workshops based on the aforementioned principles of knowledge and methodology. In this case, the courses should be directed to professionals already working in the world of international commerce or who intend to work in that field: lawyers in particular, but also judges and arbitrators. The target audience for these courses may also depend on the geographic areas where they are held and the phase of development of the country hosting them.

The underlying format could be four teaching modules, one on the main instruments of uniform commercial law, such as the CISG, the Convention on the Contract for the International Carriage of Goods by Road etc.; a second one on international arbitration and/or conciliation and their related instruments, as the main means of resolving international disputes; a third one on the proper methodological approach for producing and applying uniform law; and a fourth one would depend on the needs of the local law community.

The group of instructors should be made up of an UNCITRAL representative, two professors from countries other than the one holding the seminar and a local professor.

This combination, in my opinion, would foster exchanges and encourage students and instructors to compare their experiences, which is certainly useful for reaching the aforementioned objectives.

In this way—at least in the sectors directly touching on uniform law—a shared legal culture could develop that in the future could lead to a gradual shift in the different national legal systems.

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*William T. Loris, Chair*

Thank you, Professor Orlandi, for spending the time to go into that level of detail to put this proposal out, which I am sure will stimulate some of us to think about this master's programme, but—more fundamentally—about how we are addressing the training of our young people on uniform laws, how they are coming about, what their effect is and what they are likely to be in the future. I think this is an extremely important topic as we face the future.

We have time for questions. I am going to use my position here to ask a couple myself. A couple of things, a couple of questions were begged by the presentations. If you could, please keep your answers just as short.

## 6. *Comments, evaluation and discussion*

*William T. Loris, Chair*

Charles, you talked about the CAFTA regional assessments and the assessments you did in South-Eastern Europe. Will you look at these assessments in other parts of the world?

*Charles A. Schwartz*

*Senior Commercial Law Reform Adviser, United States Agency for International Development*

Yes, as I mentioned, we have planned quite a number of assessments in Africa, broken down regionally into East Africa and West Africa. I would also like to see perhaps the Andean region looked at. Just to let you know, these are bilateral assessments, meaning that we look at countries individually, but they can be grouped together and done one after the other, so that we can also look at a region and how countries within the region can help each other.

*William T. Loris, Chair*

Jean-François, in the enormous work that our colleagues have to do in developing countries to meet the demands placed on them, part of the problem seems to me to be that the treaties that they are asked to ratify have been drafted by other people. Can you comment on that?

*Jean-François Bourque*

*Senior Legal Adviser, International Trade Centre UNCTAD/WTO*

Well, this is an area where practice runs ahead of theory. The theory is that participation is a must, which we all want to see, but what do we mean by participation? In practice, in most least developed countries and low-income countries, it means inviting countries to participate or to accede to the rules that have already been drafted and approved, sometimes decades ago. That is how it is often felt in emerging economies with regard to several multilateral trade treaties. But history does not stop. Trade law—international trade law—will continue to respond to the requirement of providing a framework to ongoing technical developments; harmonized rules in various fields will be formulated unceasingly in the future, and I think it is therefore important to view participation first as an active contribution in the drafting and formulation of norms, together with the also important but more passive accession activity to existing treaties. When I say this, I do not mean even in a veiled way to criticize UNCITRAL or Unidroit or anybody else: they continue to ask Governments for money to ensure greater representativity of certain small countries in their drafting committees. But this decision is a political decision with financial implications, and it has up to the present been shouldered mainly by each country individually. I might perhaps suggest one solution that others have talked about at multilateral talks, and that is regional representation. This also requires quite a lot of organization, coordination and funding, but it is certainly a more feasible way to address the problem of lack of genuine representation of developing economies in the formulation of multilateral trade rules, and funds for organization to come and participate.

*Zafar Iqbal Gondal*

*International Development Law Organization, Afghanistan*

One of my tasks as legal officer at an IDLO project in Afghanistan is to train judges and employees of ministries in commercial and corporate law. My question regards the importance of substantive commercial law versus procedural commercial law. There are substantive domestic commercial laws or international conventions, but when it comes to their implementation, there are yawning gaps. In my view, there is a need for more training because if there is no implementation of the law, the legitimacy of the system is always at risk and the users have no confidence in the justice system. In your view, what is the importance of procedural law in any judicial determination? What steps are UNCITRAL and EBRD taking in this regard?

*Gerard Sanders*

*Deputy General Counsel, European Bank for Reconstruction and Development*

I think you touch on a very important issue, namely that having good laws is necessary but it is critical that adequate attention be paid to ensuring that they are capable of being—and are in fact—fully implemented so that they have their best chance of delivering economic benefits. While a lot of assistance has been directed at designing good laws, improving the legal rules has increasingly come to be seen as being only part of the reform package with other key aspects, including ensuring that the laws are supported administratively and judicially and are accessible. Fostering an appropriate and supportive legal culture within which both the institutions and rules operate is also important.

At EBRD we have done assessments on both the extent to which laws approximate certain standards and how they work in practice. I recall the first survey that we did looked at certain aspects of investment laws and many countries scored particularly well when it came to having a secured transactions regime, because all the good things that you would expect to see in such a regime did exist in law, including the ability to register your interest in a particular security. But then, when you came to ask questions about “well, does the registry actually exist?”—more often than not the answer was “no”, so you have to ask yourself how useful it is to have a law like that in the first place. Obviously the economic benefits of a good law are denied to you if they are not properly implemented. But perhaps more seriously, if you have a pattern of having good laws in place that are not implemented and that those who are subject to the law come to believe that that is normal, that the law should say one thing but mean something else, then you very seriously undermine confidence of the citizenry in the rule of law.

*Innocent Fetze Kamdem*  
*University of Ottawa, Canada*

The first of my two comments is on the presentation by Jean-François Bourque. He emphasized the difficulties and the complexities which certain African countries have to face in acceding to international conventions. I understand the sympathy he feels for those States, but I think that side by side with the complexity that he talked about so well, sometimes, we have to notice a lack of will or a lack of consistency. I will explain what I mean by giving you an example, a specific one.

A uniform act relating to general commercial law was enacted by the Organization for the Harmonization of Business Law in Africa (OHADA). That uniform act contains a section entitled “Commercial sale”. Most of the provisions of that section were inspired by the United Nations Convention on Contracts for the International Sale of Goods (CISG). It should be noted that most of the 16 States that are members of OHADA have not acceded to the CISG. I think that is rather strange and inconsistent, and those States therefore ought to ratify the CISG.

My second comment has to do with what Professor Orlandi said. I understand that at present there are mechanisms that make it possible to train young lawyers in uniform trade. In this respect, there is some experience which I think is fantastic: it is the experience that happens here in Vienna and in Hong Kong with the annual Willem C. Vis arbitration moot competition every year. I am quite perplexed to see that several African countries are not represented, although South Africa is often represented. That situation is really a shame. Perhaps some of those States ought to be encouraged to send their law students. I think that would be an excellent opportunity for those young people to familiarize themselves with treaties and other documents used in international trade law.

*Ibrahim Hassan al-Mulla al-Mansouri*  
*Emirates International Law Centre, United Arab Emirates*

First of all, I wish to thank UNCITRAL for 40 years of excellent and meritorious work in the fields of justice and legal affairs. However, it is regrettable that those 40 years were marked by shortcomings witnessed in other parts of the United Nations as well.

In the first morning panel, Mr. Opertti talked about globalization and asked what the results of globalization were, and Khalil Hamdani said that there is no international body that covers and follows legal affairs. We are living the globalization experience, and globalization, my brothers, is not novel. It is very old. Some very ancient, important principles in globalization are the divine revelations—Christianity and Islam. However there is a big difference between the globalization of virtue and the globalization of sin. Why do I say that? Because we are living in the age of globalization and the spread of multinational corporations, whose mind is geared to subjugating others. There are the “haves” and the “have nots”, the powerful and the weak clients. If UNCITRAL had helped those organizations, those countries from a technical point of view, the big powers would not have swallowed them, devoured the small countries, and minds would not have been subjugated.

Secondly, assuming that UNCITRAL has no implementation mechanism, although it is assumed that it should be the heavy stick in this organization for implementation, its laws should have been more than just advisory and should be more than just a source of inspiration. The biggest problem I have noticed is that laws have moved away from the ethical criterion. The ethical criterion was prevalent even in ancient laws; primitive laws contain ethical criteria. It is my hope that UNCITRAL, when modernizing laws, would be the stick to impose implementation and that laws should have an ethical dimension so that the balance would be set right once again.

### **III. Secured transactions, company and insolvency law**

#### **A. Economic and social development through enhanced access to credit**

*Chair: Cynthia Licul*

*Acting General Counsel, International Fund for Agricultural Development*

The focus of this panel is on the role of a commercial law framework in promoting economic and social development. The presentations will discuss as their primary focus the role of secured transaction law in facilitating access to credit and measures to integrate small business entities and low-income populations into mainstream economic activities.

I am the acting General Counsel of the International Fund for Agricultural Development (IFAD). IFAD is very active in the area of rural finance. Of the 1.2 billion extremely poor people in the world, 75 per cent live in rural areas. IFAD is dedicated to enabling rural poor people to overcome poverty themselves. We are the only United Nations agency with an exclusive focus on the eradication of rural poverty. Increasing rural poor people's access to financial services is one of the priorities of IFAD and about 20 per cent of its portfolio is dedicated to this area. Most of the IFAD target group includes small-scale producers engaged in both on- and off-farm activities, living in areas of widely varying potential. Access to financial services, which include credit but also savings, insurance and remittances services can help them vastly improve the quality of their lives and those of their families.

Among the lessons learned and remaining challenges identified by IFAD through its 30-plus years of experience in this field is the need for an appropriate enabling environment. With that, I would like to introduce the first speaker, Mr. Medhat Hassanein, who will speak about the legal mechanisms to empower informal business.

Mr. Hassanein is Professor of Banking and Finance with the Management Department of the School of Business, Economics and Communication at the American University in Cairo. He was the Minister of Finance of Egypt during the period 1999 through 2004. Mr. Hassanein is a senior policy analyst with long experience in institution-building, macroeconomic policy analysis, financial economics, corporate finance and international financial management, and he is the Chairman of Working Group 4 of the Commission on Legal Empowerment of the Poor.

### 1. *Legal mechanisms to empower informal businesses*

*Muhammad Medhat Hassanein*  
*American University, Egypt\**

“The opposite of poverty is not wealth—it is justice. The objective is to create a more just society, not necessarily a wealthier one. And the great question is how do we do this?”

Leonardo Boff, Franciscan theologian, Brazil

Empowering informal businesses should be viewed as a right to be equally exercised by all men and women, including indigenous people and other vulnerable groups and those who live in the margins of the lower economic strata of society. The existence and transparency of procedures, accountability of the executive branch and public faith in the economic, judicial and executive system are prerequisites to achieving a reasonable level of empowering informal businesses. The challenge of the legal empowerment agenda, therefore, is primarily changing the systems from systems perceived as being against poor people and informal businesses to systems that serve their interests. In other words, the “legal empowerment” agenda goes beyond the narrow approach of formalization of property rights, reforming the justice system and simplifying business regulations to a more pragmatic integrated framework wherein the State is connected to its people and it is responsive to their needs and accountable for its actions. Legal empowerment therefore covers broadly the following policy objectives:

- (a) Strengthening governance from the supply side (capacity-building) and the demand side (supporting local or community-driven initiatives);
- (b) Reforming and transforming institutions (inclusion, cohesion and accountability);
- (c) Making laws (e.g. alternative dispute resolution) work for informal businesses;
- (d) Recognizing rights (knowledge and understanding of rights, asserting and enforcing rights collectively).

Business formalization normally consists of reducing the cost of establishing a business or simplifying the process of registering a business in the appropriate company registry. The focus of this traditional approach has been to make business formal but it lacks tools to use the law to empower businesses. The Commission’s aim in the area of legal empowerment of informal businesses is, however, developed on the premise that the law has a set of legal tools and institutions that, if made accessible to these “extralegal” or informal businesses, will not only simplify the process and reduce the cost of establishing a business, but also considerably enhance business opportunities, create decent jobs, make credit, capital and markets accessible and affordable, and, most importantly, make businesses visible with a legal identity.

Irrespective of how “informal businesses” are defined, an effective strategy for “empowering” them will need to engage, coherently and seriously, with the vast assortment

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\*The views expressed are those of the author and not necessarily of the Commission on Legal Empowerment of the Poor.

of rules systems in which such businesses and development processes more broadly<sup>93</sup> are embedded. In other words, an effective legal empowerment strategy for the poor will need to go well beyond orthodox discussions of “property rights”, important as these are, to incorporate elements from citizenship rights and identity verification to commercial dispute resolution procedures and local governance concerns that necessarily precede, accompany or follow them.

To the extent that there is now a broad scholarly and policy consensus<sup>94</sup> on the importance of property rights for development, that is, for encouraging investment by the poor and others in small business ventures, or, concomitantly, on the recognition that endemic corruption, costly bureaucratic delays and weak contract enforcement all undermine capacities and incentives to make such investments, it is important to appreciate that responding effectively to these concerns is not simply, or only, a matter of encouraging policymakers to “grant” property rights, “stamp out corruption” or make relevant ministries “more efficient”. In the most elementary sense, property rights must be actually given to people, who, in order to advance and defend their access to and possession of such rights, first must be able to formally verify their personal status and identity. A crucial prerequisite, then, to enhancing the quality of property rights is ensuring that residents and citizens have recognized documents, such as birth, death, marriage and divorce certificates verifying such basic information as their name, age, sex and marital status.

#### *Who are we talking about?*

City street vendors, rural milk hawkers, the small food-cart pushers, the shoeshiners, the itinerant fix-it technicians, the roadside hairdressers and food caterers—these are the informal entrepreneurs who are vibrant visible players in the poorer countries of the world. And as one observer suggests, they are “the true entrepreneurs—more flexible, efficient and resilient than the overregulated and overprotected dinosaurs of the formal sector”.<sup>95</sup> These entrepreneurs are called informal because they operate to some extent outside the realm of formal legal protection and without easy or full access to the advantages of formal financial and business support systems. They work as single-person operations or as microenterprises or family enterprises with hired workers or unpaid family workers engaged in income-generating activities. Informal income-generating activities are globally most often located in the retail trade sector. This and the personal services sectors are where women predominate. Other informal entrepreneurs are found in the agriculture, manufacturing, transport and construction sectors. Together, they comprise the vast majority of the working poor, that is, 550 million people earning less than US\$ 1 per day (International Labour Organization 2004). Estimates suggest that half of the working poor in the informal economy are self-employed, a quarter are employed by informal enterprises or households and another quarter are employed by formal enterprises.

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<sup>93</sup> Caroline Sage and Michael Woolcock, “Rules systems and the development process”, in *The World Bank Legal Review*, vol. 2, *Law, Equity, and Development*, Caroline Sage and Michael Woolcock, eds. (Amsterdam, Martinus Nijhoff; Washington, D.C., World Bank, 2006), pp. 1-29.

<sup>94</sup> Michael Woolcock, “Some initial thoughts on empowering informal businesses”, paper prepared for the World Bank, 2007.

<sup>95</sup> George A. Aryee, “Promoting productivity and social protection in the urban informal sector: an integrated approach”, report on pilot projects in Bogota, Dar es Salam and Manila—summary of activities, lessons and recommendations”, 3rd (updated) ed. (Geneva, International Labour Organization, December 2006).

*Why do informal businesses need legal empowerment?*

Today, most of the world's poor live in the informal economy, occupying land they do not own, working in small, informal businesses and relying on friends for loans. They often have limited access to broader economic opportunities, are especially vulnerable to the uncertainties, the corruption and even violence prevalent outside the rule of law and have few means to settle disputes apart from bribery or violence. Without legal rights or protections, they are in a continual state of legal and political vulnerability. Informality, therefore, limits the opportunity for economic and social development for individuals, families, businesses, communities and entire nations. Additional reasons<sup>96</sup> why informal businesses need legal empowerment include:

(a) Small informal businesses run by poor individuals or households should be seen as a central pillar of a just society and a central strategy for reducing poverty and inequality;

(b) Most policies and the global economy privilege large enterprises over small enterprises;

(c) Informality is here to stay and is growing, and it is an essential feature of the global economy;

(d) While national governments and the international community seek to create as many formal jobs as possible and formalize as many informal enterprises and jobs as possible, the transformation from informality to formality is slow and gradual at one end, while informality is likely to increase if the country lacks an enabling business environment;

(e) The real challenge is to reduce the decent work "deficits" of those who work informally, especially the working poor;

(f) Commercial rights for informal entrepreneurs/operators should be seen as an essential part of a package of rights for the working poor in the informal economy that also includes property rights, labour rights, the right to social protection and the right to be organized and represented in policymaking and rule-setting institutions and processes;

(g) Other than social protection (property, health, life, disability, old age), which is relevant for wage workers as well as the self-employed in the informal economy, commercial rights are relevant to the half of the working poor in the informal economy who are self-employed;

(h) Of the half of the working poor who are self-employed, the larger and more vulnerable group are own-account operators, including both single-person operators and those who work in family businesses or on family farms;

(i) Productivity and protection can and should be promoted together;

(j) Economic policies should address issues of redistribution.

*What does legal empowerment mean to informal businesses?*

Those empowering specific groups of informal businesses, policymakers and practitioners need to choose appropriate elements from the framework and tailor interventions to meet local

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<sup>96</sup>Martha Chen, "Legal mechanisms to empower informal businesses", 2006.

circumstances.<sup>97</sup> Consider, for example, the specific conditions of one of the lowest levels of informal businesses, namely street vendors, in which large numbers of working poor women tend to be concentrated:

<i>Common issues and challenges faced</i>	<i>What they want legal empowerment to do for them?</i>
Insecure place of work: due to competition for urban space	Secure vending sites
Capital on unfair terms: due to dependence on wholesale traders	Access to capital on fair terms: a loan product tailored to their daily need for working capital
Uncertain quantity, quality and price of goods: due to dependence on wholesale traders	Bargaining power with wholesale traders
Lack of infrastructure: shelter, water, sanitation	Infrastructure services at vending sites: shelter, water, sanitation
Ambiguous legal status: leading to harassment, eviction and bribes	License to sell and identity cards
Negative public image	Freedom from harassment, evictions and bribes
	Positive public image

In other words, informal businesses basically need the following:

(a) *Basic commercial rights*: right to work, including right to sell, right to a work space (including public land and private residences) and related basic infrastructure (shelter, electricity, water, sanitation);

(b) *Intermediary commercial rights*: right to government incentives and support, including procurement, tax holidays, export licensing, export promotion, right to use public infrastructure (transport and communication);

(c) *Advanced commercial rights*: entity shielding rules, limited liability and capital locking rights, mechanisms for perpetual succession of the firm and transferring its value, mechanisms to allow the use of standardized accounting, mechanisms to establish firm manager and employee liability rights, protect minority shareholders and default rules.

### *Unlocking barriers*

Legal mechanisms to empower informal businesses to leave the informal economy include the following:

(a) Legal and bureaucratic procedures that allow informal operators or businesses to operate:

- (i) Simplified registration procedures;
- (ii) Simplified licensing and permit procedures;
- (iii) Identification devices, including:
  - a. Identification cards for individual operators;
  - b. Business identification;

<sup>97</sup>Ibid.

- (iv) Legislation (e.g. municipal by-laws) that allows street vendors to operate in public spaces;
- (b) Appropriate legal frameworks that enshrine the following as economic rights:
  - (i) Access to finance, raw material and product markets at fair prices;
  - (ii) Access to transport and communication infrastructure;
  - (iii) Access to improved skills and technology;
  - (iv) Access to business development services;
  - (v) Access to business incentive and trade promotion packages: tax deferrals, subsidies, trade fairs;
- (c) Legal property rights:
  - (i) Private land;
  - (ii) Intellectual property;
- (d) Use rights to public resources and appropriate zoning regulations:
  - (i) Use rights to urban public land;
  - (ii) Use rights to common and public resources: pastures, forests and waterways;
  - (iii) Appropriate zoning regulations as to where and under what conditions informal operators or businesses can operate in central business districts, suburban areas and/or industrial zones;
- (e) Appropriate legal frameworks and standards for what informal operators and businesses are allowed to buy and sell:
  - (i) Appropriate laws and regulations as to what are legal versus illegal goods and services;
  - (ii) Appropriate product and process standards, e.g. public health and sanitation concerns regarding street food;
  - (iii) Marketing licences for products and services;
- (f) Appropriate legal tools to govern the transaction and contractual relationships of informal operators or businesses:
  - (i) Bargaining and negotiating mechanisms/power;
  - (ii) Legal and enforceable contracts;
  - (iii) Grievance mechanisms;
  - (iv) Conflict resolution mechanisms;
  - (v) Possibility of issuing shares; right to issue shares;
  - (vi) Right to advertise and protect brands and trademarks;
- (g) Legal rights and mechanisms to provide informal operators and businesses with:
  - (i) Temporary unemployment relief;
  - (ii) Insurance of various kinds, including of land, house, equipment and other means of production;
  - (iii) Bankruptcy rules and default rules;
  - (iv) Limited liability; asset and capital protection;

- (v) Capital withdrawal and transfer rules;
- (h) Legal right for informal operators and businesses to join or form organizations, legal recognition of such organizations and legal right of representation of such organizations in relevant policymaking and rule-setting institutions:
  - (i) Membership in mainstream business associations;
  - (ii) Membership in guilds or other associations of similar types of entrepreneurs;
  - (iii) Representation in relevant planning and rule-setting bodies.

#### *How to make the formal economy accessible and enticing*

Addressing informality is a multifaceted proposition which requires a thorough understanding of the factors that create and drive informality. Any initiatives to make informal businesses attracted to the formal economy may first need the formal sector to be redefined to accommodate many of the principles and values tolerated in the informal sector, upon which legitimacy has been implicitly conferred. Clearly, there is no single approach to reform. The fundamental challenge is, therefore, to frame: an incentive-based strategy that takes into account the complexity of the legal, social, cultural, political and economic dimensions of informality; a strategy that is both bottom-up and top-down, fully reflecting the objectives, priorities and concerns of the poor; and a strategy that is transparent, broadly owned and supported by an approach to effective implementation. Some of the strategies<sup>98</sup> that will help informal businesses to move towards the formal economy are:

- (a) Reduce the decent work “deficits” of those who run informal businesses;
- (b) Include a representative voice of the working poor in the informal economy;
- (c) Recognize and address the bias in existing commercial policies, regulations, laws and procedures that favour larger firms/enterprises;
- (d) Extend government incentives and procurements to the smallest informal enterprises;
- (e) Build backward and forward linkages on fair terms between larger and smaller firms;
- (f) Promote market access and fair trade for smaller firms and enterprises;
- (g) Promote social protection for informal operators (property, health, life and disability insurance), plus retraining, life-long learning and other support for mobility.

At the macro level, Douglass North and others suggest broadly the following framework:

- (a) A competitive economy, which needs political openness and produces a competitive economy; movement from limited to open access, which in turn requires that the rule of law be imposed on the elite; political control of the military; impersonal legal system for the elite; perpetual forms of organization for the elite;
- (b) Legal mechanisms including a competent, independent judiciary, applying the law equally and evenly to all members of the community. Essential in this regard are education of the legal profession and full publication and dissemination of legal texts, including judicial decisions;

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<sup>98</sup>Ibid.

- (c) A publicly elected parliament, independent of the executive, adopting transparent, coherent laws, including laws for the protection and facilitation of business;
- (d) Freedom of the press and adequate pay for journalists in order to shelter them from bribery;
- (e) Enforcement officers who apply the law uniformly to all;
- (f) A military that is under the control of the legitimate political arm of government;
- (g) Measures that encourage capital formation, including various business forms that are quickly and cheaply formed, to limit the owners' liability to their investment in the business;
- (h) A significant effort to reduce grand corruption and, ultimately, to reinforce social norms that constrain petty corruption;
- (i) A review of the entire tax regime to ensure that it is totally transparent and reasonably progressive (with no tax due at the lower end of the spectrum);
- (j) A legal structure that encourages potential lenders, in both the microfinance and macrofinance sectors;
- (k) A basic infrastructure (e.g. education, health care, protection for vulnerable workers, including protection of their right of assembly) operated by the State or by the private sector under State supervision;
- (l) Protecting innovation:
  - (i) By applying tariffs to imports and subsidies to exports;
  - (ii) By protecting at least to some degree intellectual property rights;
  - (iii) By requiring skills development for workers in companies or groups over a certain size, regardless of whether ultimately under domestic or foreign ownership;
  - (iv) By carefully targeting and facilitating the entry of those foreign investors who can provide know-how, and targeting those domestic industries for which the acquisition of investment is similarly facilitated (Altenburg and Drachenfels).

#### *How to make businesspeople's stay in the informal economy tolerable*

As mentioned earlier, informal businesses are continuing to grow within the informal economy in most developing countries due to the factors discussed above. Hence, it is imperative to have some kind of temporary measures to make the operations tolerable within the informal economy while not necessarily encouraging them. Briefly, some such measures are:<sup>99</sup>

- (a) Governments must first satisfy their obligations under human rights norms;
- (b) The formal, official government must work either indirectly—through any ad hoc “government” within the informal economy—or directly to provide maximum security within the physical location of members of the informal economy;
- (c) The formal courts should decide informal economy disputes under an amnesty arrangement and, to the extent possible, enforce decisions of any ad hoc judicial system

<sup>99</sup>Claire Dickerson, “Some views on legal empowerment for informal businesses”, 2007.

among businesspeople in the informal economy as though they were generally enforceable arbitral awards;

(d) Protect and encourage free association of microenterprises, including through cooperatives and collective ownership and identity.

### *Sustaining the legal empowerment strategies and policies*

The sustainability of the proposed reforms depends on public recognition of the changes and their legitimacy within the particular cultural and social conditions where they are to be implemented. A country's failure to account for relevant social realities in developing its formal governing institutions may prevent the successes of legal reforms that are otherwise cognizant of the larger policy objective of promoting market-driven economic growth. For example, failing to incorporate widely accepted informal rules, such as the customary forms used in many parts of sub-Saharan Africa, into the proposed formal legal system increases the likelihood of reforms being rejected outright by the private sector.<sup>100</sup> Therefore, in delineating what can be done to legally empower informal businesses so that they can better access the opportunities, finances, services and facilities of the formal sector, the tailoring of policies, institutional programmes and interventions to the most disadvantaged has to be taken into consideration.

*Pillar 1. Adopt an inclusive and integrated approach to economic development such that there is legal recognition and empowerment of informal businesses*

Legally empowering small informal businesses run by poor individuals or households should be seen as a central pillar of a just society and a central strategy for reducing poverty and inequality. This means that policies and global economic privileges that are geared at present to the elite and to large enterprises have to change to become inclusive of the billions at the bottom of the economic pyramid. These billions are the producers and consumers who make markets profitable for the privileged people. Their share has to be duly recognized through much greater public and private sector cognizance and support for small firms and enterprises. Informality with its flexibility and space for millions to engage productively in economies is here to stay. The official and legal response needs to recognize what works in this sector, and strengthen and integrate these innovations into an inclusive integrated approach to wealth creation.

*Pillar 2. Support legal empowerment through a package of commercial rights underlined in policies and instituted and enforced through regulatory bodies*

Commercial rights for informal entrepreneurs/operators include but are not limited to property rights, labour rights, the right to social protection, the right to be organized and represented in policymaking and rule-setting institutions and processes and the right of access to justice in a transparent and equitable manner. The rights of the more vulnerable groups, the own-account operators, including both single-person operators and those who work in family businesses or on family farms, must also be addressed. These commercial rights should address all categories of informal enterprises, and include:

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<sup>100</sup>United States Agency for International Development (2006).

(a) Basic commercial rights: the right to work, including the right to vend, and the right to a work space (including public land and private residences) and related basic infrastructure (shelter, electricity, water and sanitation);

(b) Intermediary commercial rights: the right to government incentives and support, including procurement, tax holidays, export licensing and export promotion, and the right to public infrastructure (transport and communication);

(c) Advanced commercial rights: relevant for larger, more advanced informal enterprises.

Pillar 3. *Reduce decent work “deficits” of those who work informally*

This means support for informal businesses in the form of:

(a) Participation in policy processes of a representative voice of the working poor in the informal economy;

(b) Recognition and correction of the bias in existing commercial policies, regulations, laws and procedures favouring larger firms/enterprises;

(c) Extension of government incentives and procurement to the smallest informal enterprises;

(d) Facilitation as appropriate of backward and forward linkages on fair terms between larger and smaller firms;

(e) Promotion of market access and fair trade for smaller firms and enterprises;

(f) Social protection of informal operators through property, health, life and disability insurance;

(g) Adequate and relevant retraining, life-long learning and other support for labour mobility.

Pillar 4. *Broaden access of informal businesses to financial services and support innovation in financial products and processes*

This requires that there be:

(a) Awareness in both formal and informal credit systems of the way the working poor use credit and the barriers and often inappropriate rules in formal lending procedures;

(b) Legal and administrative processes in place which make the processing of collateral, including social collateral, cheaper, transparent and faster;

(c) Legally recognized and mutually negotiated risk mediation processes in place for both lenders and borrowers in informal businesses;

(d) Support for innovation in financial products and services with a view to deepening their outreach.

Pillar 5: *Engage in evidence-based policy and regulatory reform*

There are now hundreds of good-practice examples that illustrate how the constraints of informal businesses have been successfully addressed around the world. These examples should be studied and lessons learned should be grouped according to what constraint or need was being addressed and the policy lesson which can be drawn from the experience.

The policy reform which ensues should be participatory and targeted to the realities of the different subsectors in the informal economy.

### *Conclusions*

This paper has outlined how the process towards greater legal empowerment and formalization can take different forms. These forms include expanding formal employment opportunities and creating incentives for informal enterprises to formalize. These incentives are in fact the removal of barriers. The removal of barriers can result in greater legal empowerment and movement towards formalization. The incentives would include:

- (a) Simplified registration procedures and progressive registration fees;
- (b) A supportive investment climate and a business-enabling environment;
- (c) Fair commercial transactions between informal enterprises and formal firms;
- (d) Appropriate legal and regulatory frameworks, including:
  - (i) Enforceable commercial contracts;
  - (ii) Private property rights;
  - (iii) More equitable use of public land;
  - (iv) Tax-incentives, including government procurement, tax rebates, tax subsidies and incentive packages.

These incentives to “go legal” have to be supported at the same time by appropriate and customized financial, business development and marketing services. Mechanisms and financing arrangements to provide social protection to informal producers have to be put in place, and policy and institutional reform undertaken in a participatory manner. The participation of informal entrepreneurs would be best ensured through proactive and interactive dialogue on an ongoing basis with representatives of associations of informal entrepreneurs.

## *2. Comments, evaluation and discussion*

*Zafar Iqbal Gondal*

*International Development Law Organization, Afghanistan*

My question concerns your identification test. Informal businessmen are usually simple, maybe even illiterate, which makes them easy prey for corruption or other criminal activities, for instance identity theft. I have seen people getting loans and other facilities from banks and government and international donors using identity and data of these illiterate informal businessmen. Is Group 4 taking care of the corruption prevailing in informal businesses?

*Muhammad Medhat Hassanein*

*American University, Egypt*

If I understand you correctly, you are referring to a particular risk in the construction industry. I think corruption is much too big for our group to handle, but we said that this is one of the really basic problems facing not only informal businesses but also formal

businesses. It is an issue. As long as the rules and regulations are not clear, as long as you must face bureaucracy and as long as there are manuals for operating businesses and manuals on how to get in and out (free exits and free entries), there will be corruption. I think that when these rules are well established and well announced, it will be the first step to reducing corruption and corruption means. I agree with you. Corruption is much more within the informal rather than the formal sector.

*Majeed H. al-Anbaki*

*Permanent Mission of Iraq to the United Nations (Geneva)*

Is the subject of your presentation similar to what the commercial codes in Arab countries call “small merchants” or is it something different? Our laws deal adequately with small merchants. If it is proposed to develop international harmonized rules through UNCITRAL, I think, that is going to take more time and more discussion.

*Muhammad Medhat Hassanein*

*American University, Egypt*

Certainly I agree with you. As a matter of fact, you know, in many countries, including my own, we have a commercial code that would actually apply to anyone who would like to start a business. Unfortunately, the process of getting a licence and the implication of that and the cost in terms of time and money is substantive. Therefore, it is not just the legislative part that we are looking at but also the procedural, bureaucratic and all kinds of other logistic things that we are concerned with. I am sure simplifying them would really help.

*Said Ihrai*

*Rector, University of Rabat, Morocco*

I wonder whether the speaker thought about mentioning one very important way to combat exclusion which has yielded successful experience in the world, namely microfinancing and microcredit that enable rural inhabitants to access the formal sector directly without having to go through the informal stage. For example, the experience in Morocco with non-governmental organizations has been very positive. We have enabled the integration into the formal sector of small family businesses; in particular, women have been able to gain access to the formal sector. I am wondering whether these kinds of microcredit experiences have been taken into account in the work you have been doing.

*Muhammad Medhat Hassanein*

*American University, Egypt*

I cannot agree with you more. Fifteen years ago, when I was much younger, I thought about a credit insurance company that would insure small businesses, whether they were formal or informal. As a matter of fact, such credit insurance companies are addressing themselves to informal businesses more than to formal businesses. However, we have now a gap between microfinance on the one side and banking credit on the other side. Usually, microfinance can go up to about US\$ 10,000, and banks start from US\$ 100,000. In between, there is a gap. There is “micro-microfinance” in the context of which credit sums are US\$ 100

and so on. This is a very tedious job, and this is also what we are addressing; so we are not ignoring at all the microfinance area. This is one of the very important techniques and we are trying to expand it for the poor and other sectors of the economy.

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*Cynthia Licul, Chair*

We will move on to the next speaker, Mr. M. R. Umarji, who will be speaking on the role of secured transactions to mobilize credit and the need for modernizing the law. Mr. Umarji is the chief legal adviser of the Indian Banks' Association. He is acknowledged as an authority on secured transactions law in India. He has been both a legal adviser in the banking industry as well as a commercial banker. Presently, Mr. Umarji is actively involved with UNCITRAL Working Group VI (Security Interests), representing India as an expert. The floor is yours, Mr. Umarji.

3. *The role of secured transactions in mobilizing credit  
and the need for modernizing the law*

*Madhukar R. Umarji*  
*Chief Adviser, Legal, Indian Banks' Association*

Credit can be classified into two broad categories, credit extended by moneylenders and credit extended by banks and other financial institutions. On account of the very high rates of interest charged by moneylenders and the strong-arm methods used for recovery, there is a stigma attached to moneylending. In the context of credit extended by moneylenders, credit has earned a bad name and evoked comments such as "private control of credit is the modern form of slavery" (Upton Sinclair), "debt is the slavery of the free" (Publilius Syrus), or "debt is the worst poverty" (Thomas Fuller). The replacement of the moneylending system with another system providing access to well-regulated banking services for people facing financial exclusion is an area of concern which is being addressed separately and is not within the scope of this paper.

The other lending activity regulated by central banks is undertaken by banks and other financial institutions. Credit extended by banks and other financial institutions is for various economic activities and, in order to cover their credit risk, banks are obtaining security interests in assets of the borrowers. Modern economists call credit a blessing, a driving force of the economy and an engine for growth.<sup>101</sup> Credit extended, for example, for buying a truck facilitates the sale of the truck by the manufacturer and also provides a means of undertaking transport business by the person who purchases the truck and pays for the truck in instalments. As far as the probability of default in servicing the credit is concerned, the truck itself serves as security which can be repossessed and sold in the event of default on the repayment of the credit. Such a credit transaction is a secured transaction. If an environment conducive to such secured lending is created in a country, it is possible for that country to achieve credit growth.

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<sup>101</sup> Jukka Kilpi, *The Ethics of Bankruptcy: Professional Ethics* (London, Routledge, 1998), pp. 155 and 193.

In most emerging economies, secured transactions relating to movable property are governed by the general law of contract and property and there is no specific law for secured transactions. As a result, in such legal systems, while a security interest or pledge is recognized, a non-possessory security interest where possession of the security remains with the borrower is not recognized. Furthermore, on account of absence of law, the rights and obligations of parties are not clearly defined and the process of realization of security in the event of default takes a long time. In such emerging economies, small and medium enterprises operate in a hostile environment facing numerous barriers to entering the market and growing, including credit and insurance market imperfections.<sup>102</sup> They have to operate in structures not recognized by the Government and are controlled by private racketeers. In such an adverse environment, small and medium enterprises find it extremely difficult to access credit, and lenders are reluctant to lend as the risk of default is very high. The overall effect of such an adverse environment is that growth of credit is restricted.

Various measures have been tried by emerging economies for the purpose of extending credit to small enterprises and thereby achieving growth. The banks and other financial institutions are directed to commit a specified percentage of their total lending to the priority sector which is defined by the central bank or the Government. Such directed lending has a moral hazard and is construed as a largesse to small enterprises or entrepreneurs, whose creditworthiness is very poor. Some countries have also tried setting up a credit insurance corporation to provide insurance against defaults in repayment of loans by borrowers that belong to the priority sector. It has been found that such credit insurance corporations have landed up with claims that are far in excess of the premium collected by them. Since all such efforts to increase the levels of credit in the economy have limited success, there is a need to find some alternative to encourage growth of credit in the economy. It is now well established that credit growth can be achieved by introducing a modern secured transactions law which recognizes utilization of the full value inherent in assets to obtain credit.

On the issue of modernization of the secured transactions law, a number of efforts have been undertaken. The National Law Center for Inter-American Free Trade has adopted twelve principles of secured transactions laws in the Americas. Similarly, the European Bank for Reconstruction and Development has prepared a model law for secured transactions for Eastern European countries. The latest work on the subject nearing completion is the Legislative Guide on Secured Transactions (the UNCITRAL Legislative Guide), which is under preparation by UNCITRAL Working Group VI.

Unique features of the UNCITRAL Legislative Guide are that:

- (a) It has inputs from experts of member States and academic organizations;
- (b) Its provisions for recognition and secured creditor rights over encumbered assets and the rights of enforcement have been coordinated with UNCITRAL Working Group V (Insolvency Law), which prepared the *UNCITRAL Legislative Guide on Insolvency Law*;
- (c) It incorporates relevant principles of the United Nations Convention on the Assignment of Receivables in International Trade.

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<sup>102</sup> Sergei Guriev and Djavad Salehi-Isfahani, "Microeconomic determinants of growth around the world" in *Explaining Growth: A Global Research Project*, Gary McMahon and Lyn Squire, eds., International Economic Association Conference Volume No. 137 (Houndmills, Basingstoke, United Kingdom, Palgrave Macmillan, 2003).

Under the UNCITRAL Legislative Guide, the purpose and objectives of a modern secured transactions law are:

- (a) To promote secured credit;
- (b) To allow utilization of the full value inherent in a broad range of assets to support credit in the widest possible array of secured transactions;
- (c) To enable parties to obtain security rights in a simple and efficient manner;
- (d) To provide for equal treatment of diverse sources of credit and of diverse forms of secured transactions;
- (e) To validate security rights in assets that remain in the possession of the grantor;
- (f) To enhance predictability and transparency with respect to rights serving security purposes by providing for registration of a notice in a general security rights registry;
- (g) To establish clear and predictable priority rules;
- (h) To facilitate enforcement of creditors' rights in a predictable and efficient manner;
- (i) To balance the interests of affected persons;
- (j) To recognize party autonomy;
- (k) To harmonize secured transactions laws, including conflict-of-laws rules.

When modernizing secured transactions law, any enacting State will have to assess its existing laws and decide whether modernization is to be achieved by amending existing laws or enacting a new law. If the enacting State has a federal structure and the power to enact secured transactions law lies with the States or Provinces, the better course will be to draft a model law and ask all provinces to adopt the model.

#### *Important policy issues*

Enactment of modern law on secured transactions will also involve some other important policy issues which need to be considered by the enacting States. These issues are discussed in the following paragraphs.

#### *Concept of comprehensive security interest*

The first such policy issue is equal treatment of diverse sources of credit and diverse forms of secured transactions. While banks and other financial institutions give loans against the security over specific items of movable property, there are other forms of credit extended by non-bank entities, such as financial leases and retention-of-title sales, which are not treated as secured transactions. Such transactions are in substance loan transactions in spite of the fact that the form of transaction is a retention-of-title device and different in form from a loan transaction. One major step required to be taken to introduce reforms in the secured transactions law is to treat all such title-retention transactions as equivalent to loan transactions. The consequences of such equal treatment are to confer on the financial lessor of the hired goods or the seller of the sold goods rights of a secured creditor and apply all secured transactions law rules to such transactions.

Adoption of this policy will result in enhancing the sources of credit and competition among credit providers. Encouragement of such competition will in turn result in competitive rates of credit for the borrowers. If, in a State, it is not possible to treat retention-of-title devices as fully equivalent to secured transactions, the UNCITRAL Legislative Guide provides an option to treat such transactions as separate, register them and achieve equivalence of retention-of-title devices with secured transactions, to the extent possible.

### *Widening the range of property rights*

The next policy issue which needs to be considered by the emerging economies relates to recognition of property rights. One of the objectives of modernizing secured transactions law is to allow utilization of the full value inherent in a broad range of assets to support credit in the widest possible array of secured transactions. There are certain types of property rights, such as future receivables, that are not transferable. If future receivables are treated as property, it will be possible to create a security interest over such receivables to secure repayment of a loan. Illustration: a bank has given a loan for the construction of a bridge over a river. The loan repayment is to be made by collection of toll from the vehicles using the bridge. If future receivables are recognized as property, it will be possible to create a security interest over the toll to be collected in the future and provide necessary comfort to the lender facilitating credit for such infrastructure projects. With regard to the modernization of secured transactions law, I would note that property rights need to be expanded to include a wide range of property rights. The importance of recognition of such property rights has been explained by the eminent economist Hernando de Soto in *“The Mystery of Capital”*. He observes:

“Legal property assigns to assets by social contract, in a conceptual universe a status that allows them to perform functions that generate capital.”

“Formal property is more than a system for titling, recording and mapping assets—it is an instrument of thought, representing assets in such a way that peoples’ minds can work on them to generate surplus value. This is why formal property must be universally accessible to bring everyone into one social contract where they can co-operate to raise society’s productivity.”<sup>103</sup>

The UNCITRAL Legislative Guide also recommends that deposit accounts, negotiable instruments and rights under independent undertakings (letters of credit) may be treated as property over which a security interest can be created. Enacting States need to consider their existing laws on the above-mentioned property rights and decide whether secured transactions law needs to be extended to property rights which are governed by other independent laws.

As a matter of policy, States will have to decide the extent to which property rights will be recognized for the purpose of secured transactions law.

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<sup>103</sup>Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York, Basic Books, 2000), pp. 218 and 221.

*Non-possessory security interests*

Another policy issue which will be required to be addressed by enacting States is the validation of security interests in assets that remain in possession of the borrower. In other words, States need to recognize non-possessory security interests that are usually in the form of hypothecation of goods. Such a type of security interest is most relevant for small and medium-sized enterprises that are engaged in any manufacturing activity and need revolving credit.

*Registration system*

Another important step in modernizing secured transactions law is to set up a registration system of secured transactions for the purpose of making them effective against third parties and for deciding priorities among various claimants in respect of the encumbered property. It is preferable that such a registration system is operated electronically and made accessible to the public so that it becomes a source of information for persons dealing with encumbered assets. If the registry is made electronic, it will be possible for States to adopt a system of notice filing with a rule of “first to file gets priority”. When setting up the registration system, States will have to review existing registration systems for various types of asset, such as motor vehicles, intellectual property rights and corporate assets, and decide whether to continue the existing registries or integrate them with the new secured transactions registry.

*Standardized terms*

The modernization process needs to recognize party autonomy subject to certain exceptions, such as the obligation to act in good faith and in a commercially reasonable manner when enforcing a security interest in the event of default. To facilitate secured transactions, the standard terms containing rights and obligations of parties can be provided by law which will apply in the absence of an agreement of the parties to the contrary.

*Priority rules*

The law needs to provide an efficient and predictable regime to decide priority of a security interest. While it is necessary that the law recognizes priority to a secured creditor over all other claimants, if there are any preferential rights for Government revenue or workmen’s dues, this should be clearly stated so that there are no uncertainties as far as security interests are concerned. Such rules of priority will have to be recognized by insolvency law.

*Rights of enforcement*

The most important part of secured transactions law relates to rights of enforcement to be conferred on secured creditors. Strong recognition of such rights provides comfort

to lenders and reduces the risk of default. If the judicial system in a State is efficient and it is possible to recover defaulted loans expeditiously, no reform may be necessary. But, if the system is not efficient, there is a need to empower the secured creditor to enforce the security interest without the intervention of the courts (power of foreclosure or self-help) or reform the judicial procedures to facilitate speedy recovery.

### *Conflict-of-laws rules*

When modernizing the law, it will be necessary to determine the law applicable to the following issues:

- (a) Creation of a security interest;
- (b) Pre-default rights and obligations;
- (c) Effectiveness of a security right against third parties;
- (d) Priority of a security interest;
- (e) Enforcement of a security interest.

### *Transitional provisions*

When it is decided to modernize secured transactions law, it is advisable to fix a future date for the law to become operative so as to facilitate adjustment to the change in law by all affected parties. The provisions can also be enacted stipulating the procedure for transition for the existing loans for which a security interest is created to be covered under the new law.

In conclusion, it may be stated that modernization of secured transactions law will mobilize credit while growth of credit activity in the economy will facilitate establishment of potentially efficient small businesses. The creation of an environment conducive to credit growth and removal of barriers to access credit will result in transformation of small and informal businesses into large and formal ones.

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### *Cynthia Licul, Chair*

Our next speaker is Mr. Vijay S. Tata. He will be speaking on the role of multilateral financing agencies in promoting modern standards for secured transactions. Mr. Tata is Chief Counsel for Private Sector Development, Finance and Infrastructure in the Legal Vice Presidency of the World Bank. Mr. Tata's practice group provides legal advisory services to support the modernization of legal and regulatory frameworks and institutions for financial and private sector development. Before joining the Bank in 2004, he practised in the area of international business transactions for over 20 years. Mr. Tata, the floor is yours.

#### 4. *The role of multilateral financing agencies in promoting modern standards for secured transactions*

*Vijay S. Tata*

*Chief Counsel, Private Sector Development, Finance and Infrastructure, Legal Vice-Presidency, World Bank*

There has been a consensus for some time among the multilateral development banks about the importance of the reform of secured transactions regimes in improving access to finance. A number of studies have sought to empirically establish the proposition that an effective, modern secured transactions regime can reduce the cost of funds and expand the availability of finance to those who would not otherwise be deemed creditworthy. Some of my colleagues on this panel will address this issue. Although it has been difficult to show a cause and effect relationship between modernization of laws relating to security interests and expanded access to credit because of the number and complexity of interrelationships between the variables that affect access to finance, the correlation between modern legal regimes for finance and overall economic growth and expanded access to finance appears to be well established.

The World Bank and the regional development banks, in particular, the European Bank for Reconstruction and Development, the Inter-American Development Bank and the Asian Development Bank, since the 1990s, have given particular attention to the modernization of laws relating to security interests. All of these entities developed guidelines for the reform of secured transactions regimes, including, in some instances, model legislative provisions.

These efforts focused on defining new interests in property (thereby “unlocking dead collateral”) and, more generally, enabling the creation, perfection and enforcement, with due regard to priority, of non-possessory security interests in movable property.

Moreover, in addition to the “economic development” rationale for the modernization of laws relating to security interests, the Asian financial crisis of the late 1990s exposed the heightened systemic vulnerability of financial systems whose legal infrastructure was outdated and unable to cope with the complex relationships of modern finance and commerce. In 1999, the Financial Stability Forum (a grouping of finance ministers and finance sector regulators of the Group of Seven (G-7)) identified the strengthening of creditors’ rights and insolvency regimes as one of the 12 fundamental areas necessary to support economic development and reduce the systemic vulnerability of the financial sector in developing countries. The Financial Stability Forum mandated that the International Monetary Fund (IMF) and the World Bank use standards or general principles of best practice in each of the 12 areas to develop comparative diagnostics that would reveal weaknesses and serve as a road map for reform. As part of this process, the World Bank, in consultation with a number of international bodies, including UNCITRAL and its expert working groups in these matters, developed the Principles and Guidelines for Effective Insolvency and Creditors’ Rights Regimes. These principles identified the essential elements of effective creditors’ rights regimes and articulated the purposes, goals and functions that the system needs to encompass. An effective regime for security interests in movable property is an essential element of the Principles.

At the same time, there was a growing consensus in a number of developed countries that even their own secured transactions regimes were outdated and cumbersome and that the significant jurisdictional variations among these highly developed systems was adding unnecessary costs and delays to global finance. Not only did the interdependence among economies of the various developed nations create a need for some degree of convergence on the treatment of security interests to facilitate cross-border financing, but the revolution in communication and information technology and the rapid growth of electronic finance and commerce resulted in the creation of new financial products, relationships and expectations that existing laws could not easily address. The United States, New Zealand and France were among the nations that chose to revisit and modernize their laws relating to security interests.

There are four primary drivers that explain the importance given by the international community to the modernization of laws relating to security interest in movable property: (a) supporting economic development; (b) enhancing the stability of financial systems; (c) facilitating globalization by encouraging some degree of convergence of diverse systems; and (d) addressing the new products, transactions and jurisdictional challenge arising out of the revolution in electronic commerce and the revolution in information technology. Against this background, the UNCITRAL Legislative Guide on Secured Transactions (the UNCITRAL Legislative Guide or the Guide) represents, in effect, the international community's effort to reconcile the various separate projects in this area and to respond in a single effort to these four drivers.

The World Bank shares with the other multilateral development banks the view that reform of collateral systems can improve access to finance and, therefore, contribute to economic growth. The finance sector development strategy recently adopted by the Board in April 2007 identifies the reform of collateral systems as a priority for the Bank's work in the finance sector.

With the UNCITRAL Legislative Guide nearing completion, the question now is: How should the World Bank and other multilateral development banks use the Guide?

First, let me note that the UNCITRAL Legislative Guide touches on some of the most fundamental areas of domestic law and covers matters that are and should be the subject of careful policy judgements on the part of domestic legislatures and policymakers. With that caveat in mind, the Guide can serve as a common reference point for policymakers, for developed and developing countries alike. The Guide and the detailed policy discussion and the proposed legislative solutions should be used to trigger inquiry, analysis and debate within the country among legislators, jurists and stakeholders. The Guide should not be a prescription. It should not be a device for circumventing or substituting for a deliberative, participatory legislative process within States. The very complex debates about policies and the costs and benefits of various legislative designs that took place in Vienna and New York in the preparation of the Guide will and should be replayed in greater detail and with greater specificity in the reforming countries. Our experience has taught us that for reforms to work, that is, for new rules to be accepted and implemented, the new laws must be perceived as legitimate; they must reflect the needs and expectations of the various stakeholders; and a consensus must develop on the need for the reforms, their form and the timing and method of their implementation. Moreover, law reform in this area is not only a technical legal matter, but it is more importantly a matter of

reflecting particular economic and financial realities, goals and policy preferences. In addition, the mechanisms adopted must be consistent with the capacity of the system and its institutions.

It is fortunate that we already have an example of how the UNCITRAL Legislative Guide might be used to focus debate on reform. In June 2006, a group of Swiss scholars and legal practitioners convened an academic conference to discuss the draft UNCITRAL Legislative Guide in the context of the 100-year-old Swiss secured transactions law and its modernization. The conference examined key policy positions taken by the draft Guide as well as the legislative solutions offered in light of their effectiveness from the Swiss perspective.

I commend the publication to you. The essays present an excellent picture of the Guide “in action”, that is, the consequences of its recommendations to an existing, reasonably well functioning secured transactions regime. Now consider how much more complex the reform debate would have to be in a less developed country.

There is a great degree of divergence among developing countries in terms of the stages of development, the extent of globalization, legal traditions, local practices, policy preferences and priorities for development. There is also great disparity within developing countries between the modern commercial sector and the poor. Indeed, the middle-income countries themselves account for well over half of the world’s poor, that is, those who live on less than US\$ 2 a day. Reforms in developing countries will need to take into account these economic disparities and the existing capacities of domestic institutions. It is difficult to imagine how a system that might work well in Switzerland would be able to answer the policy and development needs of significantly less developed countries without significant adaptation.

Globalization has bypassed some developing countries. Many of the problems facing developing countries require very specifically tailored solutions. In the development business, one size rarely fits all. Local problems need local solutions. Moreover, the complexity and difficulty of legal and institutional modernization and reform has taught us the importance of encouraging a participatory, deliberative, legislative process within States, a process that will require the balancing of competing interests and legislative compromises. Ideally, in the domestic law-making process, all stakeholders in a relevant jurisdiction should have an opportunity to have their views duly considered, so that the legislative solutions would be crafted by policymakers within the State to suit their particular circumstances. A legislative guide would have fulfilled its primary purpose if it empowers the domestic legislative process, that is, if the guide is consulted and discussed, and if the purposes and rationale of the more specific recommendations are duly considered, whether or not a specific legislative recommendation is itself adopted.

That said, I believe that the UNCITRAL Legislative Guide can be an important resource in any reform exercise. The general principles on which it is based, that is, the purposes, functions and goals that an effective system should encompass, can serve as a basis for comparative diagnostics of national systems. The results of these diagnostics can be used to structure the dialogue with policymakers, economists and stakeholders to identify areas of concern and develop possible solutions. It is important that sufficient political will for reform is developed and that there is sustained interest on the part of

stakeholders to support the reforms. The impact of any legislative reform on the local business environment would need to be studied, so that all reforms in related areas can be considered, and the stakeholders can be better prepared for changes to be introduced. The need for dissemination, training and capacity-building should also be considered. Attention should be given to how reforms should be introduced, that is, whether they should be limited to certain sectors or whether they should be introduced in several stages to ensure acceptance of the reforms and the development of the necessary capacity. Reform is an ongoing process, and attempts to implement wholesale reforms have not met with success. The reforms required for modernizing laws relating to security interests are fundamental and may require several years of careful implementation. It is important that the reforms address and are perceived to address immediate and local needs and that the national policymakers and legislature be in the driver's seat. Given the importance of a vigorous domestic legislative process to effective reform and given that diversity of needs, each country should craft solutions appropriate to its needs and policy preferences. If we are successful in our modernization work, we should expect well-calibrated adaptation rather than uniformity and should be satisfied with a degree of workable convergence.

5. *Promoting the implementation of the United Nations Convention on the Assignment of Receivables in International Trade and the United Nations Commission on International Trade Law Legislative Guide on Secured Transactions*

*Richard M. Kohn*

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It is a great pleasure and an honour for me to be here today. I want to begin by extending my warm congratulations to UNCITRAL on its fortieth annual session, and to express both my admiration and gratitude for the extraordinary accomplishments of UNCITRAL during its many years.

It has always seemed to me that the genius of UNCITRAL lies in its recognition of the incredible power of commerce as a force for positive change in the world, a force for changing lives by helping businesses to grow, by creating jobs, by raising standards of living and, when the commerce is cross-border in nature, by promoting understanding and economic interdependence among peoples of different countries.

The power of commerce is particularly evident in the area of secured credit, where loans and other extensions of credit can have a profound impact on the growth of business and, therefore, the growth of economies.

Over the past eight years, I have been privileged to work on two UNCITRAL projects involving secured credit: first, as an observer for the Commercial Finance Association on the United Nations Convention on the Assignment of Receivables in International Trade (the Convention), which was approved by the General Assembly in 2001, and which is designed to promote cross-border receivables financing in States that adopt it; and second, as an observer for the Commercial Finance Association and member of the informal expert group on the UNCITRAL Legislative Guide on Secured Transactions (the Guide), which provides a comprehensive blueprint for States wishing to modernize their secured transactions regimes.

My professional perspective with respect to these two projects is both as a United States lawyer specializing in representing banks and commercial finance companies in making cross-border asset-based loans to middle-market companies, and second, as Co-General Counsel of the Commercial Finance Association (which is the principal United States trade association of asset-based lenders). And by way of background, when I use the term asset-based lending, I am referring to working capital and other loan facilities to companies secured by their receivables, inventory, equipment and other business assets, including, increasingly, their intellectual property.

My subject today is the implementation of the Convention and the Guide. First, I will describe three extremely important factors that make me very optimistic about the successful implementation of both of these texts. Then, I will briefly identify a number of challenges which, if successfully addressed, will, in my view, greatly enhance their successful implementation.

The first factor that bodes well for the successful implementation of both the Convention and the Guide is what I perceive to be a dramatically increased willingness on the part of banks and other providers of secured credit to extend credit in countries other than their own.

From the standpoint of United States asset-based lenders, in recent years there has been what I can only describe as a sea change in their attitude toward making cross-border loans. Twenty-five years ago, United States asset-based lenders wanted nothing to do with cross-border lending. They would invariably ignore collateral or guarantors in countries other than the United States, and would rarely make loans in currencies other than the United States dollar. In fact, when I spoke on the subject back then, my most popular handout was a brief guide I prepared entitled “The US Asset-Based Lender’s Guide to Cross-Border Lending”. It was subtitled: “How to say ‘no’ in 100 different languages.”

However, since that time, there has been a major shift in the attitude of United States asset-based lenders, fuelled directly by the rapid globalization of middle-market business. Some United States lenders have proactively recognized cross-border lending as a fertile new market, but many other United States lenders are reacting to the needs of their customers as they become globalized. Increasingly, borrowers are saying to their lenders, “I have operations in other countries that require financing, or I wish to acquire operations in other countries, and if you do not provide that financing I will find it elsewhere.” As a result, now United States lenders are looking for ways to say “yes” to cross-border loans. And this sea change in attitude is not limited to United States lenders. I see it happening with lenders domiciled in other countries as well, as they increasingly compete for loans in the United States.

Despite this shift in the attitude of credit providers, their willingness to extend secured credit to businesses in a given country will depend, in large part, on whether the laws of that State are conducive to obtaining security interests in collateral that can be created, and enforced, in an efficient and predictable way. And that is precisely what the Convention and the Guide do in such an effective and comprehensive way. Without question, banks and other credit providers will be more willing to extend credit in countries that adopt the Convention or that enact laws based on the Guide.

The second factor that makes me optimistic about implementation is what seems to be a widespread recognition of the value of secured credit in generating working capital to foster economic growth in both developing and developed economies. This recognition is evident in the proliferation of legislative initiatives designed to promote secured credit, not only by UNCITRAL but also by other international organizations, such as the International Institute for the Unification of Private Law (Unidroit), the Hague Conference on Private International Law, the European Bank for Reconstruction and Development, the Asian Development Bank and the Organization of American States. All this helps to create an environment in which States are increasingly receptive to the importance of modernizing their secured transactions laws. It is as if the world has discovered the benefits of secured credit.

The third factor that makes me optimistic is that, in my opinion, both the Convention and the Guide reflect principles that can be accepted by States regardless of their legal traditions. Let me use the Guide as an example. One of the key sentences in the introductory chapter to the Guide, which was inserted in the text at an early stage in the project, is the following (A/CN.9/631/Add.1, para. 3):

“The Guide seeks to rise above differences among legal regimes to offer pragmatic and proven solutions that can be accepted and implemented in States having divergent legal traditions.”

Of course, when we began our work on the Guide, that sentence was merely the expression of an ideal; it remained to be seen whether the Working Group could breathe life into this ideal, especially in a project that was thought to be unfeasible only a few years ago. I watched with great admiration as, on countless occasions, delegates rose above their own constituent interests to search for common ground, transforming themselves from delegates of a particular country to delegates of the world, determined to create a guide that is capable of universal acceptance.

This has been particularly evident in the area of acquisition financing, that is, the extension of credit to enable companies to acquire inventory and equipment for use in their businesses. As you know, States approach this subject in very different ways. Many legal regimes recognize the concept of retention of title, under which a vendor of goods retains title to the goods until the purchase price is paid in full. In other countries, title is transferred to the buyer, and the seller retains only a security interest in the goods. I am pleased to report that substantial progress has been made in fashioning a solution that recognizes the functional equivalence of these two divergent approaches, while at the same time providing a framework in which countries could express that functional equivalence using their own terminology and in a manner consistent with their own legal concepts. I believe that this solution was inspired by a shared sense of the importance and urgency of our work.

There remain additional challenges that must be addressed in order for the full power of the Convention and the Guide to be realized. The first challenge is in the area of insolvency laws. As a law professor of mine never tired of commenting, insolvency laws are the crucible of secured transactions. A security right has no value to a secured creditor unless the creditor is able to realize the economic value of the security interest in the event that the debtor becomes subject to an insolvency proceeding. Thus, even the most modern secured transactions regime will not be fully effective unless it is coupled with a modern

and efficient insolvency law. Here, as in the case of secured transactions laws, it is by no means necessary that the insolvency laws of a given jurisdiction be one-sided in favour of the secured creditor. However, it is essential that insolvency laws recognize validly created security interests, and permit secured creditors, within a reasonable time, to realize the economic value of their security interests. In this sense, in addition to providing for the possible rehabilitation of companies in distress (which, I am pleased to note, is increasingly a theme of modern insolvency regimes), the adoption of modern insolvency laws can play a significant role in promoting secured credit.

That is just one of the reasons why the *UNCITRAL Legislative Guide on Insolvency Law* (the *UNCITRAL Insolvency Guide*), which was adopted by UNCITRAL in June 2004, is such a significant document. Not only does it provide a blueprint for a thoroughly modern and effective regime for the rehabilitation of debtors, but in so doing it also promotes secured credit. Once the Guide is adopted, it will work hand in hand with the *UNCITRAL Insolvency Guide* to provide an extremely potent force for the promotion of low-cost secured credit.

A second challenge for States wishing to derive the full benefit of the Convention and the Guide is to modernize their judicial systems where appropriate. Credit providers contemplating extending credit in a particular State not only want to know that the State's laws are compatible with the extension of secured credit; they also want to know that there is an efficient court system that will treat them fairly in the event they need to enforce their rights. More work in this area by international organizations could, in my view, play a significant role in promoting secured credit.

A third challenge relates to the coordination by international organizations of their work in the area of secured transactions. Great care has already been taken by UNCITRAL in this regard, by striving to assure consistency between the Guide and the Convention and between the Guide and the *UNCITRAL Insolvency Guide*. Other examples relate to the coordination between UNCITRAL and Unidroit, from the outset of work on the Guide, on the issue of securities, and the coordination between UNCITRAL and various intellectual property organizations in the area of security interests in intellectual property (both securities and intellectual property being areas on which additional work is to be undertaken in connection with the Guide). It would be beneficial for the promotion of secured credit if care could be taken by other international organizations to coordinate their recommendations in the area of secured lending laws with the concepts reflected in the Convention and the Guide, on the theory that access to low-cost secured credit would be promoted if the law in this area were not only modernized but harmonized as well. In this regard, it would be an extremely positive step if the European Commission would adopt a conflict-of-laws rule with respect to the assignment of receivables that is consistent with the approach reflected in the Convention.

And finally, I believe that credit providers and their trade associations can play a significant role in the implementation of the Convention and the Guide, by displaying a willingness to meet with legislators and other interested parties in States considering the adoption of the Convention or enacting laws based on the Guide.

At one point in the deliberations on the Guide, one delegate commented, "The world is waiting for our Guide." Once again, UNCITRAL was at its best, displaying its unique

ability to identify best practices and to express them in a manner that is acceptable in States with differing legal traditions, for the greater good of people everywhere. The world is truly fortunate to have UNCITRAL.

6. *Legal mechanisms to empower informal businesses: banking-related aspects of the UNCITRAL Legislative Guide on Secured Transactions*

*Georges Affaki*

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A legal system that ensures the effectiveness of the rights of secured creditors has an undeniable impact on a country's growth rate. The reason for this, as empirically demonstrated in numerous studies by the World Bank and the International Monetary Fund, is that countries that have such a system also have a more developed banking sector.<sup>104</sup>

Past experience shows us that whenever effective security is unavailable, particularly in the case of collective proceedings, credit becomes scarce, especially for small and medium enterprises. And even if it remains available, its cost to those enterprises is prohibitive.

The reason for this is that banks, like any other investors, expect a certain return on their capital. However, banks must also respect a number of management rules, based on compliance with accounting rules, known as prudential ratios, which ensure their solvency and contribute to market stability. Those ratios include the solvency ratio. Imposed by the national banking regulation authorities in accordance with the recommendations of the Basel Committee on Banking Supervision, this ratio obliges banks to hold a certain proportion of their risk-weighted assets as their own capital. The ratio must be no lower than 8 per cent.<sup>105</sup>

In order to achieve the level of profitability that the bank has set itself for its loans, the return on the capital invested in a given operation should be commensurate with the credit risk. Thus, if that risk is reduced by means of strong security, the return on capital will be correspondingly lower.

By way of illustration, let us take the example of a loan of a value of 3,000 that the bank is planning to issue to a borrower whose probability of default is 1 per cent.

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\*The author represented the International Chamber of Commerce in the work of UNCITRAL on the Legislative Guide on Secured Transactions.

<sup>104</sup>This introduction appears in an article by the same author on the perfectible relationship between credit and securities (Georges Affaki, "De la relation perfectible entre le credit et les sûretés", *Banque et Droit*, vol. 97, 2004, p. 26). Readers may refer to this source, including the bibliography cited in the notes.

<sup>105</sup>As is known, the Basel Committee adopted a new capital ratio (McDonough ratio, also known as the Basel II ratio) which replaced the solvency ratio (the Cooke or Basel I ratio). The minimum ratio of 8 per cent between the bank's risk-weighted commitments and its capital has not changed between Basel I and Basel II. What has changed are the rules governing the risk-weighting of commitments. Under Basel I, most assets were risk-weighted at 100 per cent. In short, if the bank issues a loan of 100, it sets aside 8 in capital. Under Basel II, the risk-weighting can range from 7.24 per cent to 702.9 per cent (see table in body of text).

Let us suppose that the bank secures the loan by means of a mortgage on a property worth 10,000. In that case, the bank unquestionably has a strong probability of recovery. This is due to a combination of three factors: the value of the mortgaged property, which substantially exceeds that of the loan; the type of property asset, which makes usury in the short term unlikely and misappropriation difficult; and the reliability of the mortgage, which is based on a registration system of proven efficiency that makes it possible to predict the outcome of a possible priority conflict with respect to the encumbered asset.

If the overall recovery rate obtained during enforcement of the mortgage is calculated at 80 per cent, regulatory obligations impose on the bank a capital consumption of 95.52.

This figure is obtained by means of a complicated calculation of the credit amount, the first step of which is to find the risk weight by cross-referencing, in the table below, the probability of default with the recovery rate, i.e. 39.8 per cent.

**Table of sensitivity of risk weights to the Basel II parameters (as percentages)**

Overall recovery rate (in percentage)	0.03	0.48	1	13.32	21.81
80	7.24	29.2	39.8	122.0	156.2
70	10.85	43.8	59.6	183.0	234.3
60	14.47	58.4	79.5	244.0	312.4
50	18.09	72.9	99.4	305.0	390.5
40	21.71	87.5	119.3	366.0	468.6
30	25.33	102.1	139.2	426.9	546.7
20	28.95	116.7	159.1	487.9	624.8
10	32.56	131.3	178.9	548.9	702.9

Source: BNP Paribas.

The risk weight of the loan in the given example is  $3,000 \times 39.8$  per cent, yielding an average risk weight of 1,194, which reflects the credit amount in absolute terms weighted by the credit, market and operational risks identified for the planned operation.

By applying the regulatory solvency ratio to the average risk weight as calculated— $1,194 \times 8$  per cent—we obtain the amount of capital that the bank must set aside in order to meet its regulatory obligations, i.e. 95.52 if we take the example of a loan of 3,000 secured by a mortgage.

That capital should yield a return according to the percentage determined by the bank as the rate of return on investment, for example 5 per cent, i.e. 4.7 in absolute terms.

Let us now vary one of the parameters in the above example by taking as the security not immovable property but an automobile of the same value, i.e. 10,000. All the other parameters remain the same. In this case the security is relatively unpredictable, particularly since the asset in question is a current asset, which renders it more vulnerable to depreciation or even

misappropriation, and in terms of the unreliability of the security in the many countries that have no registration system for this type of asset. The bank might therefore decide that the rate of recovery by means of enforcement of the security right should be 10 per cent of the value of the automobile.

If we again consult the table above, we obtain by cross-referencing a risk weight of 178.9 per cent. If that percentage is applied to the credit amount, i.e.  $3,000 \times 178.9$  per cent, we obtain an average risk weight of 5,367. The solvency ratio will therefore oblige the bank to set aside  $1,194 \times 8$  per cent, that is, 429.36 in capital against the loan. That capital should yield a return according to the percentage determined by the bank as the rate of return on investment, which is 5 per cent, i.e. 21.46 in absolute terms.

A weak security thus obliges the bank to set aside more capital against the same credit amount than it would for a strong security (429.36 as opposed to 95.52). By always applying the same return on investment of 5 per cent, the bank should receive for the same loan of 3,000 a gross return of 21.46 rather than 4.7, as a result of the difference in the strength of the security alone.

As can be seen, the cost to the bank of payment of the capital, and thus the final cost to the borrower of the loan, increases in inverse proportion to the strength of the security.

The fact that the countries of Eastern Europe have systematically promoted a modern legal regime for security rights in property as part of their transition towards a market economy has helped make those countries more attractive to foreign investors, including international financiers. This is true in particular of the 26 countries that have adopted laws modernizing their real security regimes in accordance with the EBRD Model Law on Secured Transactions of 1994.<sup>106</sup>

This naturally led UNCITRAL, after its decision in 2001 to begin work on an unprecedented scale to draft a legislative guide on security rights, to involve major credit providers, including banks.<sup>107</sup> As a result of that strategic decision, the work would focus from the outset on two central issues that would characterize the UNCITRAL Legislative Guide on Secured Transactions (the Guide):

(a) The first concerned the decision to give equal treatment to the rights of secured creditors, whether banks or credit providers;

(b) The second was to ensure adequate capture of the reality of bank credit, inter alia with regard to security rights relating to assets typically managed by banks, such as bank accounts, documentary credits and bank guarantees.

I will devote the remainder of this contribution to addressing these two central issues in greater detail by illustrating them with specific examples from the Guide.

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<sup>106</sup>Those countries are Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Montenegro, Poland, Romania, the Russian Federation, Serbia, Slovakia, Slovenia, Tajikistan, the former Yugoslav Republic of Macedonia, Turkmenistan, Ukraine and Uzbekistan. An overview of the new laws now in force in these countries can be found on the EBRD website at [www.ebrd.com/new/index.htm](http://www.ebrd.com/new/index.htm).

<sup>107</sup>This was the mandate given by the Commission to Working Group VI (Security Interests) (*Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17 and corrigendum (A/56/17 and Corr. 3)*, paras. 346-359).

(a) *Equal treatment in the Guide of security rights held by banks and security rights held by other credit providers*

The legislative system for security rights proposed by the Guide is a global, coherent and functional system.

Rather than treating a security right differently according to the party that holds that right (the bank or credit provider), the Guide proposes uniform treatment with regard to the creation, effectiveness and enforcement of any security right that has the effect of conferring upon one or more creditors a property right in one or more assets.

Hence the Guide states “equal treatment of diverse sources of credit” as one of its objectives.<sup>108</sup> Indeed, no part of the Guide envisages solutions that differ according to whether the holder of the security right is a bank or a credit provider, a national creditor or a foreign one.

Two examples from the Guide illustrate such equality of treatment. The first concerns a conflict between a seller that has a retention-of-title right and a bank that has a security right in a receivable arising from the resale of an asset. The second relates to the subordination of the right in new assets of a lender that has financed the acquisition of those assets.

(i) *Rights in receivables arising from resale*

The Guide provides for strict application of the *prior tempore* rule in the resolution of priority conflicts. In the event of a conflict between a credit provider that has a retention-of-title right and is claiming the resale price of its asset from the buyer and a bank that is obliged by that buyer to assign all its receivables, the Guide provides that the party that was first to register its right has priority in the resale price.

This clearly contrasts with the jurisprudence of the German Federal Court of Justice, which gives priority to a credit provider that has extended retention of title (*verlängerter Eigentumsvorbehalt*) to the resale price over the bank to which the future receivables of the buyer are assigned, which include the receivable arising from the resale price, including where the assignment is concluded prior to the granting of the retention-of-title right.<sup>109</sup> In defeating the rights of the assignee bank by revoking the assignment of the receivable arising from the resale price, the German courts consider that the assignee bank should have suspected the existence of extended retention of title, a quasi-systematic practice in Germany where there is no registration requirement. This solution remains the same if the assignee bank has already been paid by the debtor.<sup>110</sup>

<sup>108</sup>Objective (d). The same objective is stated in chapter IX of the Guide, on acquisition financing.

<sup>109</sup>BGH, 30 April 1959, BGHZ 30, p. 149; BGH, 9 November 1978, VII ZR 54/77 (Düsseldorf), NJW 1979, p. 365; BGH, 15 April 1987, BGHZ 100, p. 353; R. Serick, *Les sûretés réelles mobilières en droit allemand: Vue d'ensemble et principes généraux* (Paris, Librairie générale de droit et de jurisprudence, 1990), p. 37; J. M. Hauptmann, “La cession ‘Dailly’ en disgrâce auprès des juges suprêmes”, *Revue de jurisprudence commerciale*, 1992, p. 55.

<sup>110</sup>BGH, 9 November 1978, VII ZR 17/76 (Stuttgart), NJW 1979, p. 371.

Conversely, French law recognizes the right of the assignee in the receivable arising from the resale price, but only if that price has already been paid to that assignee.<sup>111</sup> However, if the price is still in the possession of the subpurchaser and still owing to the purchaser-assignor, the credit provider can claim the price.<sup>112</sup>

One therefore cannot but approve the choice of predictability and certainty that UNCITRAL has made in the Guide by establishing, as the only solution to priority conflicts, the priority of the party that completes formalities for third-party effectiveness of the assignment of the receivable or the retention-of-title right.

(ii) *Acquisition financing of new assets*

A further example in the Guide of equal treatment of the credit provider and the financing bank relates to the security right in an asset acquired through financing agreed by the creditor that holds the security right.

In this particular case, the Guide exempts both the credit provider and the bank from the *prior tempore* rule by giving the rights of both (retention-of-title right or pledge, as applicable) superpriority over the rights of any other creditor that may have previously acquired and registered a right in the debtor's total assets.

Those readers familiar with United States law on security rights will have recognized in this rule the same priority that is accorded by the United States Uniform Commercial Code to purchase money security interests.<sup>113</sup> This priority, dear to financiers of assets rather than financiers of trading accounts, belies, moreover, the warnings that allowing a comprehensive security right in the total current and future assets held by the debtor would result in an anti-competitive credit monopoly. This type of *in terrorem* argument is, of course, fallacious. The highly developed United States practice of acquisition financing of new assets secured by means of a priority over those assets bears this out and rules out the argument that a priority assigned in this way diminishes the value of the security rights held by the previous creditors, since the newly acquired security right has made possible financing that has increased the total assets of the grantor.

However, this superpriority requires the fulfilment of two conditions:

(a) It applies only to the asset whose secured financing has made the acquisition possible;

(b) It is effective against third parties only if the creditor with superpriority has completed the necessary formalities for third-party effectiveness. Here again, UNCITRAL has favoured transparency and predictability.

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<sup>111</sup> Com. 11 December 1990, Bull. IV, No. 322. The solution remains the same when the payment is made by means of the submission of accepted bills of exchange, Com. 9 January 1990, Banque, No. 504, 1990, p. 428, comment, Rives-Lange.

<sup>112</sup> Com. 20 June 1989, Bull. IV, No. 196.

<sup>113</sup> Uniform Commercial Code, article 9 (§ 9-103 and § 9-324).

(b) *Treatment in the Guide of banking-related security rights*

(i) *Bank accounts*

Rarely does a security right cause as much contention regarding its validity as in the pledge of a bank account. In many countries, it is still conceptually impossible to take a security right in a bank account. The reason for this, the argument goes, is the incompatibility of the standard requirement of dispossessing the grantor of the pledge and the principle of the current account that continues to work to the advantage of the account holder until such time as it is closed voluntarily as the result of bankruptcy or a measure of execution. It is also argued that the principle of the specificity of the object of the security right poses an obstacle to taking a security right in the bank account, since the balance of the account is likely to fluctuate throughout the period of validity of the security right depending on the deposits and withdrawals made.

The result of this is the unsatisfactory application of tripartite withdrawal agreements whereby the client gives irrevocable instructions to the bank to follow the instructions of the creditor that is acquiring the security right in the bank account. The effect is to create a claim against the client and also, where the account-holding bank has an undertaking, against that account-holding bank, but not a property right in the bank account that would be effective against third parties involved in a seizure or against the administrator of a bankruptcy.

The same line of argument has long been followed in France. The result was the cash pledge. Albeit effective, this praetorian security has nonetheless developed in parallel to the legislative system of security rights in property. Cash pledges, moreover, appear remarkably to have survived the reform of 23 March 2006 that introduced into the Civil Code of France a new article 2360 providing for the possibility of taking a bank account as a pledge.

In the United Kingdom, the *Charge Card* decision concluded that it was conceptually impossible for a bank to acquire a security right (lien) in a receivable arising from the return of funds in a client's account, since the securities of the debtor of the receivable arising from account funds are incompatible with those of the secured creditor.<sup>114</sup> Misunderstood in that it applied only to this right of retention,<sup>115</sup> the decision caused an outcry that led several countries of the Commonwealth of Nations to promulgate their own anti-charge card legislation permitting a bank to take a security right in a bank account that it holds for its client.<sup>116</sup>

This did not prevent another court of appeal in the United Kingdom in 1996 from adopting as its own the conclusion of the *Charge Card* ruling in one of the many legal disputes brought about by the collapse of the Bank of Credit and Commerce International (BCCI). The court was even going to extend the aforementioned conceptual impossibility

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<sup>114</sup> *Re Charge Card Services Ltd* [1987] Ch 150; [1989] Ch 497 (CA).

<sup>115</sup> This is equally absurd in relation to a receivable.

<sup>116</sup> For example, Hong Kong Law Amendment and Reform (Consolidation) Ordinance, chap. 23, section 15A ("For the avoidance of doubt, it is hereby declared that a person ('the first person') is able to create, and always has been able to create, in favour of another person ('the second person') a legal or equitable charge or mortgage over all or any of the first person's interest in a chose in action enforceable by the first person against the second person, and any charge or mortgage so created shall operate neither to merge the interest thereby created with, nor to extinguish or release, that chose in action."). Similar provisions have been promulgated in Singapore (section 9A, Civil Law Act, Cap. 43), Bermuda (Charge and Security (Special Provisions) Act 1990) and the Cayman Islands (Property (Miscellaneous Provisions) Law 1994).

to any security right in any receivable with respect to which the secured party is also the debtor: “a man cannot have a proprietary interest in a debt or other obligation which he owes another.” It came as no surprise when the supreme court, the House of Lords, brought an end to the dispute in 1997 in the *Morris v Rayners* (BCCI) ruling to restore, in English law, security rights in bank accounts.<sup>117</sup>

Fortunately, no debate of this kind has disrupted the work of UNCITRAL to develop rules appropriate for a security right that could encumber a bank account. Starting with its introduction, the chapter on security rights in bank accounts of the Guide recognizes the importance of bank accounts as a preferential object of security rights. Indeed, this is one of the security rights most commonly used in secured financing, irrespective of the underlying asset. Examples include property financing through the collection of interest on an account able to be pledged; project financing by crediting the proceeds of sale of the production of the project to an account pledged to the creditor; and the financing of international trade, in which the bank account of the credit applicant is often taken to secure the issuance of a documentary credit.

The Guide rightly classifies bank accounts as intangible assets: a receivable arising from the repayment of assets deposited in the account. This avoids debates on the nature of this type of asset, which some have classified as a tangible asset.<sup>118</sup> Anyone familiar with the functioning of the operational circuits of bank accounts will know that monetary, fiduciary or scriptural assets that are deposited in an account cannot remain isolated in a receptacle that is strictly identified in the name of the depositor. That money becomes part of the bank’s capital and, at the request of the depositor, is reimbursed in equivalent value, thus freeing the depositary from its repayment debt to the depositor.

This right to repayment is a receivable that can be given by the depositor as a security.

As regards the formalities of third-party effectiveness of the security right in the bank account, the Guide has opted to retain the concept of “control” as set out in the United States Uniform Commercial Code. Thus, in addition to the possibility for a creditor to register his security right in the general security rights registry, that creditor can make the security right effective (in so far as it relates specifically to a bank account) in one of the three following ways:

- (a) Automatically, where the secured party is the account-holding bank;<sup>119</sup>
- (b) By concluding a control agreement whereby the bank undertakes to follow the instructions of the secured party and not those of the account holder;
- (c) By assigning the account to the secured creditor. This can be done by replacing the name of the initial depositor with that of the creditor in the registries of the bank.

<sup>117</sup> *Morris v. Agrichemicals Ltd* (*Morris v Rayners Enterprises Inc.*) (BCCI No. 8) [1997] 3 WLR 909, [1997] BCC 965, [1998] AC 214, [1997] 4 All ER 568, [1998] 1 BCLC 68 439 40.

<sup>118</sup> Didier Martin, “Des techniques d’affectation en garantie des soldes de comptes bancaires”, *Dalloz* (1987), p. 229.

<sup>119</sup> In some countries, including the United Kingdom, the bank creditor can achieve a similar result by means of a set-off. However, this does not concern a real security.

In the event of a dispute, priority will be assigned to the creditor that has made its security right effective against third parties by one of these means of control, to the detriment of the creditor that has made its security right in the total assets of the debtor effective simply by registering it in the general security rights registry.

There remains the question of the law applicable to the creation, third-party effectiveness, priority and enforcement of the security right in a bank account as well as to the rights and obligations of the account-holding bank. The UNCITRAL Working Group has not yet come to a consensus regarding the conflict-of-laws rule that is appropriate in the following cases:

(a) The law of the place of business of the account-holding bank, including, if applicable, the law of the place of business of the branch of that bank; or

(b) The law chosen by the depositing client and the depositary bank as governing the account agreement.

Today, the law of the place of business of the account-holding bank is the rule retained in most European, Middle East, African, Asian and Latin American countries. That is doubtless the law that would result from article 4 of the Convention on the Law Applicable to Contractual Obligations (Rome, 1980) as the law of the country that is most closely linked to the situation under discussion. It is also the law chosen by many other European instruments relating to bank accounts.<sup>120</sup> Lastly, it is the law to which creditors instinctively refer when attempting to seize an account. Predictability would most certainly be reduced to nil if the priority conflict between the third parties involved in the seizure and the secured creditor that had a security right in the account was resolved not according to the law of the location of the most obvious element of the object of the conflict, namely the account, but according to the law governing the account agreement. This, after all, is known only to the depositor and the depositary and is generally stipulated in a document protected by bank secrecy.

Conversely, the choice of the law governing the account agreement is supported by the persuasive argument that the choice of the conflict-of-laws rule must be in conformity with the rule chosen by other international organizations in the same or similar spheres. However, in the case in point, reference was made to the choice of law governing the account agreement in the Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary of 5 July 2006 ... for securities accounts held indirectly by intermediaries!<sup>121</sup> Yet conceptually nothing is further removed from a cash account held by a depositor at the branch of a bank than financial instruments held by a

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<sup>120</sup>For example, article 9 of directive 2002/47/EC of the European Parliament and of the Council of the European Union of 6 June 2002 on financial collateral arrangements (*Official Journal of the European Communities*, L 168, of 27 June 2002), article 9 (2) of directive 98/26/EC of the European Parliament and of the Council of the European Union of 19 May 1998 on settlement finality in payment and securities settlement systems (*Official Journal of the European Communities*, L 166, 11 June 1998) and article 24 of directive 2001/24/EC of the European Parliament and of the Council of the European Union of 4 April 2001 on the reorganisation and winding up of credit institutions (*Official Journal of the European Communities*, L 125, 5 May 2001).

<sup>121</sup>Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary of 5 July 2006, article 4 (1): "The law applicable to all the issues specified in article 2 (1) is the law in force in the State expressly agreed in the account agreement as the State whose law governs the account agreement or, if the account agreement expressly provides that another law is applicable to all such issues, that other law." Two States have signed the Convention to date: Switzerland and the United States of America. There have been no ratifications as yet.

chain of multiple intermediaries (and thus multiple accounts).<sup>122</sup> The obligations of the depositary, the transfer of the title to the assets in deposits and the operation of the account are also radically different in the two cases. Moreover, it is instructive that the new Basel Accord assigns different risk weights to deposits of financial instruments and deposits of cash in a bank account.

Lastly, it should be recalled that the holding of an account obliges the depositary bank to comply with accounting, fiscal and regulatory obligations, including the obligation to carry out the checks necessary to obtain sufficient information regarding the account holder and the activities of that account holder. All these obligations are based on strictly national regulations. Yet it is often difficult to separate such regulatory obligations entirely from those that could be imposed on the same depositary bank as a direct result of its taking a security right in that account, whether for the benefit of the bank or a third party. The choice of two conflict-of-laws rules, which could potentially lead to the application of two different laws, would therefore be a source of considerable legal risk for the activity of that bank.

UNCITRAL should be wary of the easy way out of leaving the choice between the two conflict-of-laws rules to the national legislator on the grounds that its text is merely a legislative guide. It should, however, ensure that the final choice is not made at the expense of established banking practices and the legitimate expectations of the parties. Two previous UNCITRAL texts are today paying the price for unfortunate choices that went against established banking practices. The first is the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, article 20 of which recommends a requirement with respect to provisional orders that is less strict than that required for fraud. The second is the United Nations Convention on the Assignment of Receivables in International Trade, article 22 of which proposes the resolution of conflicts of priority in the assigned receivable according to the law of the place of central administration of the assignor, thus disregarding the autonomy of bank branches. The first of these texts has received only eight ratifications, and the second only one.

(ii) *Independent undertakings*

A certain proportion of independent undertakings, documentary credits and stand-by letters of credit are issued by enterprises, generally to secure their subsidiaries or for their own needs, in the latter case the roles of credit applicant and issuer being the same. Independent instruments are most commonly issued by banks, however. Moreover, the practice tends to refer to what is termed a “bank guarantee” (rather than “independent guarantee”) and “confirming bank” (rather than “confirming party”).

The rights arising from these undertakings are assets that can provide a very valuable basis for the taking of security rights. This applies to both the benefit of the undertaking,

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<sup>122</sup>During the UNCITRAL debates on the choice of the conflict-of-laws rule with respect to a security right in a bank account, the delegation of one member State considered itself obliged to declare itself in favour of the law governing the account agreement in view of the general conditions governing banking operations in force in that State. Research proves that if indeed those general conditions expressly stipulate the choice of national law, contractual autonomy in the case in point is nothing more than an illusion! Indeed, the choice of national law in accordance with those general conditions is directly linked to the place where the bank account in question is located. In fact, those general conditions limit contractual autonomy with respect to the choice of applicable law to the national law of the country where the account is held. The choice is therefore clearly made in favour of the law of the place of business of the account-holding bank.

that is, the drawing right, and the proceeds of the undertaking, i.e. the right to payment once a standard drawing request has been made by the initial beneficiary.

Only security rights in the proceeds of an independent undertaking are covered by the Guide. It is indeed considered that the transfer (by novation) of the contractual position of the beneficiary of the undertaking to a creditor takes place most frequently in chain transactions of goods, in which the intermediaries of the transaction open transferable documentary credits in order to be able to offer “their” documentary credit to their own provider as an instrument of payment. This is why it was decided that the Guide would not cover the transfer of independent undertakings.

However, once the beneficiary designated in the undertaking has submitted a payment demand to the issuer of the undertaking, and the latter is satisfied with the demand, a right to payment arises that is similar to the right to payment of the price held effective by a seller against the buyer. That right is therefore a receivable sizeable by means of a security right, with, however, specific characteristics attributable to the autonomous nature of the undertaking of the issuer.

These specific characteristics led to a debate at UNCITRAL that, fortunately, was resolved by a consensus in 2006. At the heart of the debate was the question of whether the Guide should recommend the automatic creation—that is, without the need for a separate document for that purpose—of a security right in proceeds under an independent undertaking as the consequence of creation of a security right in the receivable arising from the underlying commercial contract.

In other words, would a creditor that was made to assign a receivable arising from the price of a contract of sale payable by documentary credit automatically acquire a right of assignee in the proceeds of the documentary credit without needing to request from the beneficiary of that documentary credit a separate document of assignment of the proceeds of the documentary credit?

Also, if that creditor completed the formalities necessary to ensure the effectiveness against third parties of its right of assignee in the receivable of the price of the contract of sale, would its right of assignee in the proceeds of the documentary credit be automatically effective against third parties, again without the need to complete separate formalities for third-party effectiveness?

If so, this would present an undeniable advantage with respect to bulk assignments of receivables that could apply to tens of millions of receivables, as in the case of securitizations of credit card receivables. Obviously, it would be ideal if receivables arising from independent undertakings were required to be treated separately, for example through their assignment by means of a separate contract or their separate notification or registration.

Some analytical minds have sought, in addition, to establish a legal argument for such automatic creation, pointing out that since the issuer of the independent undertaking continues to do business with the initial beneficiary, given that the security right is in the proceeds of the undertaking rather than any other benefits of that undertaking, that issuer would have no objection to paying an assignee. In any case, as they have also pointed out, the Guide recommends that every possible measure should be taken to ensure that such

automatic creation is not to the detriment of the legal situation of the issuer of the undertaking. They refer by way of example to the right of the issuer to pay the proceeds of the undertaking to the initial beneficiary until such time as the issuer accepts the assignment.

However interesting it may be, this is not a convincing argument. Jurisprudence over many years has taken the rule of the accessory to argue that a security right in an asset may automatically encumber another asset. This is notably the case for pledges and bonds that are given to secure a receivable. The assignment of that receivable entails the automatic transfer to the assignee of the rights of the assignor in respect of the bond and in the pledged object. But what we have here, in actual fact, is a relationship that is exactly opposite to the rule of the accessory, since the undertaking in question is by definition independent.

It must be admitted that no justification can be found in the classical theories of law. Automatic creation can therefore be achieved only by means of a law that is imposed as a peremptory norm. An example of such legislative intervention intended to create the necessary receptacle to meet requirements of practice can be found in the outcome of the debate on subrogation with respect to documentary credits. Repudiated under Swiss law,<sup>123</sup> accepted by French jurisprudence,<sup>124</sup> the automatic subrogation of the issuer (*solvens*) to the rights of the beneficiary (*accipiens*) against the applicant was introduced in United States law through an amendment to article 5-117 of the Uniform Commercial Code, with pragmatism as its only justification.

## 7. *Comments, evaluation and discussion*

*Yuejiao Zhang*  
*Shantou University, China*

According to my own experience, modernization of secured transactions law is a demand-driven process. In 1998, when I worked at the Asian Development Bank as Assistant General Counsel, I was responsible for law and policy reform projects. At that time, immediately after the Asian financial crisis, all member countries badly needed a sound secured transactions law. We had a regional insolvency law reform programme that involved 10 countries. It was very successful.

The second remark relates to the need for a participatory approach. Government agencies, experts and the judicial system should all be involved.

Thirdly, we need political will. The modernization process cannot succeed if the country does not want it.

Fourthly, the process has to be comprehensive. Not only secured transactions law but also insolvency law has to be modernized. In Indonesia, we found many cases, many claims, but no courts. So, the Asian Development Bank provided technical assistance to

<sup>123</sup> Federal Court, 1 June 2004, *Emirates Bank v. Crédit Lyonnais*.

<sup>124</sup> This is the result of the firmly liberal interpretation by the Court of Cassation of article 1251-3 of the Civil Code, cf. Première chambre civile, 27 March 2001, Bulletin No. 90; Première chambre civile, 3 July 2001, Bulletin No. 200; Deuxième chambre civile, 1 February 1981, Bulletin No. 33; Com. 5 October 1993, Bulletin No. 324. Regarding application to independent guarantees, Paris, 8 D, 25 September 1996, *Paribas v. ARM Conseil*, unpublished.

establish a bankruptcy court in that country and also to support banking reform. We did the same in Nepal, where there were no economic tribunals. I therefore think comprehensive reform is needed. Local capacity-building is also crucial for the success of the reform process. I think the training of judges and legislators is very important. After leaving the Asian Development Bank, I worked for the African Development Bank, and so I know how poor the people there are (many living without enough food and drinking water). When I was asked whether the registration system should be an electronic system, my response was in principle affirmative but it would not be an easy task in those poor regions. I also think that it will be difficult to identify preferential creditors that would have priority even over secured creditors in the case of insolvency, as was mentioned with regard to India. I highly appreciate the contribution of UNCITRAL to the resolution of all these problems. That is why we addressed security interests in China's property laws, including security interests in receivables and inventory. We are now working on the registration system. I strongly support the inclusion of secured transactions rules in our property law, because my personal experience and experience from developed countries indicate their importance for capital market development. But their adaptation to meet the specific needs of each country is very important.

*Madhukar R. Umarji*  
*Chief Adviser, Legal, Indian Banks' Association*

About the preferential claims of the Government and the workman, I would note that in India insolvency law was also amended. As a result, the dues of workmen are not given priority over the rights of secured creditors in the assets of insolvent companies (they are treated *pari passu*). So, the workmen have to file their claims with the insolvency administrator along with the secured creditors and when the assets are sold the proportionate amount is paid to the workers.

*Vijay S. Tata*  
*Chief Counsel, Private Sector Development, Finance and Infrastructure, Legal Vice-Presidency, World Bank*

I would like to acknowledge that the experience of the World Bank is indeed very similar in terms of the need for a demand-initiated comprehensive approach, in which the country and its policymakers themselves are involved in the process, informed by international best practices and supported by technical assistance from the multilateral development banks.

## **B. New horizons for secured transactions**

*Chair: Kathryn Sabo*  
*General Counsel, Department of Justice, Canada*

Our first speaker will be Professor Neil Cohen. He is the Jeffrey Forchelli, Professor of Law at Brooklyn Law School. He teaches domestic and international commercial law, contracts and constitutional law. He has also served as a Professor of Law at Seton Hall University School of Law and is a visiting professor at Columbia Law School. For over 15 years, Professor Cohen has been a key participant in major domestic and international law

reform projects relating to commercial transactions. He is currently the director of research of the Permanent Editorial Board for the Uniform Commercial Code in the United States. He was the reporter for the American Law Institute's restatement of the Law of Suretyship and Guaranty and revised article 1 of the Uniform Commercial Code. He has also been involved with the revision of article 9 of the Code and also with that drafting committee's task force on international secured transactions and a drafting committee that revised articles 2 and 2A. Professor Cohen has been a long-standing member of the delegation of the United States to the UNCITRAL working groups that prepared the United Nations Convention on the Assignment of Receivables in International Trade and the UNCITRAL Legislative Guide on Secured Transactions (the draft Legislative Guide). He is a very well-published academic. I am not going to go into all of the details.

Professor Drobnig was entirely too modest in the bibliographical note that was submitted. He is Emeritus Professor at the Faculty of Law at the University of Hamburg. He is past Co-Director of the Max Planck Institute for Comparative and International Private Law in Hamburg and he is working on an elaboration of European rules for personal security that has been published and on proprietary security.

Our third speaker is Oscar Alcantara, who is a principal in the law firm of Goldberg Kohn in Chicago. He is the Chair of the firm's Intellectual Property Practice Group and has been the long-standing Chair of the International Property Section of Meritas Law Firms Worldwide, which is an affiliation of 200 commercial law firms globally. He is a member of the Emerging Issues Committee of the International Trademark Association, which is focusing on the use of trademarks in secured transactions. On behalf of the Commercial Finance Association, he has participated in the work of UNCITRAL Working Group VI, which has been developing the draft Legislative Guide. He is also a composer and a choral ensemble director and qualifies as a voting member of the National Academy of Recording Arts and Sciences.

*1. Practical problems of integrating various international standards of secured transactions*

*Neil Cohen*

*Brooklyn Law School, United States of America*

Over 30 years ago, UNCITRAL retained Professor Ulrich Drobnig of the Max Planck Institute for Comparative and International Private Law to "make a study of the law of security interests in principal legal systems". One function of the study was to assess the need and, perhaps, prospects for accomplishing harmonization in this area of law.

The study, published in 1977, comprehensively examined the laws of 19 nations, noting the similarities and differences in their treatment of the basic legal issues of secured credit. Not surprisingly, the differences were great. More important for our purposes today, the Drobnig report also contained assessments to "help to confront the necessity or desirability of framing rules in this field at the international level, especially for the international movement of goods subject to security interests".

As part of these assessments, Professor Drobniġ catalogued prior attempts to achieve some degree of international uniformity with respect to security interests. These attempts included:

- (a) A uniform conditional sales act enacted by three Scandinavian countries (Norway, Sweden, and Denmark) during 1915-1917;
- (b) Unidroit draft provisions of 1939 and 1951 concerning the impact of reservation of title in the sale of certain goods;
- (c) Provisions regarding the effect in bankruptcy of reservation of title in the sale of goods in the draft European Economic Community Bankruptcy Convention of 1970;
- (d) Model reservation-of-title clauses contained in several General Conditions elaborated by the Economic Commission for Europe.

These attempts were all ineffective in achieving uniformity in the law governing security interests.

Professor Drobniġ also analysed at some length two recent (at the time of his study) proposals for the harmonization of secured credit law that had been submitted to the Council of Europe. The first such proposal was made by Unidroit in 1968; the other was submitted by the Service de recherches juridiques comparatives of the National Centre for Scientific Research of France in 1972. Together, these proposals put forth a range of possible unification schemes, from the “maximum” solution of creating a uniform security interest for international cases to the much narrower suggestion of a uniform document accompanying motor vehicles on which security interests could be entered. In addition, Professor Drobniġ noted the existence of a proposal to the European Community for establishing a central register for security interests.

Noting that none of these efforts had succeeded or appeared likely to have significant influence, Professor Drobniġ was, to say the least, not optimistic about the likelihood of framing international rules governing security interests. With respect to a uniform law convention, he concluded:

“It would seem that international legislation in the form of a convention providing uniform rules of substantive and conflicts law is not appropriate in this case. As against international sales or international transportation or the international circulation of negotiable instruments, transnational incidence of security interests is as yet relatively moderate. It would probably be difficult to obtain sufficient government support for an international conference dealing with the relatively technical topic of security interests; and even if the text of an international instrument could be agreed upon, national parliaments would probably be slow and perhaps even reluctant to ratify such a text.”

With respect to the advisability of developing recommendations to nations for the adoption of rules that would promote uniformity, Professor Drobniġ was dismissive: “Mere recommendations, even if emanating from an international organization of the highest repute, will not command sufficient moral or other support for adoption by any sizable number of States.”

Only with respect to the possibility of developing a model law in this area was Professor Drobniġ’s view less bleak. Even there, however, his relative optimism was tempered with

doubt: “Perhaps moral persuasion or intellectual insight into the virtues of the model rules will move some States to adopt them. Others may need persuasion by more effective means, such as insistence on the part of international financing institutions.”

The international landscape has certainly changed in the three decades since the publication of the Drobnič report. Secured transactions reform has become a very popular topic of efforts by various international law-making organizations, regional organizations, development banks etc. Moreover, a major participant in these efforts has been Professor Drobnič himself.

Indeed, in the last decade, each of the three major international organizations that develops law for international transactions—UNCITRAL, Unidroit and the Hague Conference on Private International Law—has completed a project bearing on international secured transactions. UNCITRAL, of course, developed the United Nations Convention on the Assignment of Receivables in International Trade. Unidroit developed the Cape Town Convention and its Aircraft Protocol. The Hague Conference promulgated its Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary.

While the conventions described in the previous paragraph have met with varying degrees of acceptance—indeed, only the Cape Town Convention and its Aircraft Protocol have entered into force—the ability of the organizations to muster sufficient consensus in these difficult areas has emboldened the international organizations to engage in new efforts.

For example, UNCITRAL has moved from the United Nations Receivables Convention to a much more ambitious Legislative Guide on Secured Transactions. Unidroit, in the meantime, has prepared a Rail Protocol to the Cape Town Convention and a preliminary draft Convention on Substantive Rules regarding Intermediated Securities, and it is working on a model leasing law and a space assets protocol for the Cape Town Convention.

The proliferation of international instruments regarding secured transactions has the potential to lead to a problem that could not have been anticipated at the time of the Drobnič report and, indeed, might well have been labelled an unrealistic fantasy only a quarter century ago. The problem is the possibility of a confusing multiplicity of instruments emanating from different organizations with overlapping but not congruent scope and with rules that may or may not be consistent with each other but are articulated in ways that defy easy comparison.

While the lack of international standards for the law governing secured transactions likely reduces the availability of credit at lower cost, too much law (rather than too little) can have costs as well. Replacing a void with chaos does not represent the sort of progress that we should be seeking.

How can such chaos be avoided? The answer must necessarily have two parts—one retrospective and one prospective.

With respect to international instruments that already exist, greater guidance must be provided to the primary audience for those instruments—States that might consider adopting those texts—so that those States may assess not only the substantive merits of each instrument but also the relationship between the instrument and other similar-seeming instruments that have been promulgated. Each of the instruments has been drafted by experts who painstakingly craft both the reach of its provisions and its substantive rules, and the borders of an instrument may be nuanced and highly technical. Yet, however beneficial the results of that crafting if and when adopted by a State, the result can be a document that does not easily reveal its nuances to a State with a legal system that is quite different and might seem to overlap in scope with either domestic law or other international instruments.

Accordingly, it would seem that there is a need for a comparative guide to the existing instruments. Such a guide, especially if prepared by or with the imprimatur of all of the organizations whose instruments are compared, could, in a brief and accessible format, set out the scope and applicability of each instrument, note any overlaps, indicate any areas of inconsistency and indicate whether the adoption of any of the instruments reduces the changes that would be brought about by the adoption of another instrument. By way of example of the last point, if a State is a contracting State with respect to the United Nations Receivables Convention, some of the rules recommended in the UNCITRAL Secured Transactions Guide with respect to the effect of anti-assignment clauses will already be the law in that State with respect to assignments of receivables that are governed by the Convention. Such a guide would not only make it easier for readers to compare various instruments that they have identified as secured transactions initiatives but also draw readers' attention to the existence of instruments that do not, on their face, proclaim that their scope includes security interests. This is particularly important with respect to instruments such as the Hague Convention and the Cape Town Convention that apply to security interests but are not limited in scope to security interests; rather, their scope is defined primarily by the type of property that is the subject of covered transactions.

Probably the most important aspect of such a guide would be a brief analysis of the scope of each instrument covered. Information to be presented that would guide a reader to an informed understanding of the coverage of an instrument, and how that coverage might relate to other instruments, would include: property covered, transactions covered, whether the scope is limited to international transactions, stated exclusions from scope, deferrals to other international instruments and possible overlaps with other international instruments.

With respect to instruments that are now in the process of being prepared or might be prepared in the future, similar efforts, early in the drafting process, to place those instruments in the context of other existing or planned instruments would be beneficial, and would likely also have the additional benefit of imposing an early check on the drafting process should it stray too far into the territory of other instruments. In addition, the sponsoring organizations should place a high priority on coordinating their activities related to secured transactions so that any overlaps or lacunae are planned rather than accidental artefacts of uncoordinated drafting. While this already occurs on an informal basis, this coordination could be the subject of a more formal and detailed process.

## 2. Security interests in intellectual property rights

*Oscar Alcantara*

*Goldberg Kohn, United States of America*

### (a) Introduction

#### (i) The basic transaction

The owner of, or a party in the process of, developing intellectual property seeks funding, and offers its intellectual property as collateral in connection with a loan.

There are many manifestations and variations, including the following:

(a) Lender is financing the acquisition of a company's entire assets, including intellectual property assets;

(b) Lender is financing the borrower's ongoing operations and takes a lien interest in all of the borrower's assets, including intellectual property assets;

(c) Borrower's intellectual property assets are central to its core business, e.g. software developer;

(d) Borrower's intellectual property assets are many, but are ancillary to its core business;

(e) Borrower regularly licenses out its intellectual property, and its earnings include royalty payments;

(f) One of the borrower's valuable assets is a contract right constituting an inbound license of intellectual property;

(g) Borrower seeks financing for the creation of a single intellectual property asset, as in film financing;

(h) Borrower owns intellectual properties in many jurisdictions.

#### (ii) Development and unification efforts

Despite the increasing value of intellectual property assets in financing transactions, uncertainty in the law, in particular in transactions with cross-border implications, is widespread.

UNCITRAL has been leading efforts to unify and develop the laws that lie at the intersection of intellectual property law and the law of secured finance.

Although progress is sometimes slowed because of competing interests, two very different legal cultures and two sets of legal language professionals from both the intellectual property bars and the finance bars appear to be dedicated to working together on "future work".

Today's Congress is an opportunity to comment on the "forest" before planting, climbing and chopping down the "trees".

(b) *“Intellectual property” is property: questions on the scope of a modern secured financing law*

(i) *Should a secured transactions regime cover intellectual property assets?*

Lenders, borrowers and their counsel all want coverage.

In financing transactions, intellectual property owners want to access the value that their intellectual property assets represent.

Lenders want to be sure that they can execute upon valuable intellectual property assets in the event of default.

(ii) *Excluding intellectual property from the scope of secured transactions law is not an option*

Excluding intellectual property is not practical from a business standpoint.

Excluding intellectual property is not possible from a drafting standpoint.

(c) *Liening and the tower of Babel*

Discussions between finance professionals and intellectual property professionals frequently stall early because the participants speak different languages.

Getting past *faux amis* (“assignment”, “publicity”, “registration”) is not easy. There are also cultural differences. Misunderstandings between the various constituencies in these discussions arise not only from simple conflicts in the meaning of words, but from differences in business and legal cultures.

Success will depend upon “cultural exchange” and mutual understanding of each other’s “language”.

(d) *Security and insecurity: recognition of a true “security interest” will be paramount to future work*

(i) *One tree in the forest: title and maintenance requirements*

Many treatments of the issues surrounding intellectual property and secured lending make at least some mention of the uncertainties that may arise in identifying title to a piece of intellectual property and meeting the requirements for renewing or otherwise maintaining a registration.

(ii) *Recognizing a true security interest*

Recognition of a true security interest—not an assignment used to approximate a security interest—will resolve such issues.

(e) *“Between you and me”*: balancing the rights of third parties

One controversy that has drawn, and will continue to draw, significant attention is the question of where to file notice of a security interest in order to make it effective against a third party: in a commercial registry, in a domestic intellectual property office or in a specialized international office? How should we deal with unregistered intellectual property rights? Which State’s laws shall apply to which transactions and/or interests in intellectual property rights?

Is the source of the controversy the fact that intellectual property assets are frequently the subject of specialized filing offices that make them unique among commercial assets?

The controversies that arise when discussing the issues of notice and the rights of third parties in intellectual property are an indication of a more deeply seated conflict. Specifically, in some jurisdictions, a security interest becomes effective against third parties at the time of the creation of the obligation between grantor and grantee, while in other jurisdictions, a separate notification to third parties becomes necessary.

Building widespread, ground-level buy-in on the underlying issue of “effectiveness” in secured transactions generally will lead to accord on the more detailed issues of notice filings, intellectual property offices and conflicts of laws.

(f) *Diverting a royalty stream*

A controversy has arisen regarding the priorities over streams of royalty payments that arise from the licensing and use of intellectual property. Finance attorneys are accustomed to dealing with a wide array of different types of payment streams and how a lender can be assured of receiving those funds in the event that its borrower defaults on its loan obligations.

But intellectual property rights are in many ways unique among other commercial assets, and intellectual property attorneys often assert that the owner of an intellectual property enjoys the absolute right to receive such royalty payments, even if such payment streams have been offered as collateral in a financing transaction.

However, the law, even in the most developed countries, is far from certain, and in fact there is authority on both sides of this argument. Currently, the fact that a royalty or account flows from the use of intellectual property does not necessarily give the intellectual property owner some sort of superpriority right to payment on that account.

Intellectual property owners and their counsel should recognize that one of the goals of a modern secured transactions regime is to create certainty over such issues as the priorities among conflicting interests in a stream of payments. Intellectual property owners will ultimately be able to take advantage of the certainties created by current efforts.

(g) *Concluding remarks*

The United Nations ethos and expertise in transcending barriers of language and culture will be significant in any progress to be made in harmonizing the laws of intellectual property and secured finance.

3. *Open issues in the field of secured transactions*

*Ulrich Drobnig*

*Max Planck Institute for Comparative and International Private Law, Germany*

The draft UNCITRAL Legislative Guide on Secured Transactions definitely is a great achievement—as far as it goes. One may, however, ask whether it goes far enough.

Let me point out two areas where I think that it does not go far enough.

The draft UNCITRAL Legislative Guide deals with only one of the two branches of security, i.e. proprietary security. It leaves aside personal security, i.e. transactions such as suretyship, independent guaranties, co-debtorship for security purposes, comfort letters etc.

It is true that UNCITRAL earlier did work on independent guarantees and produced the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit of 1995. This has been ratified so far by eight countries, mostly developing countries. So, some work has been completed in that area of personal security which is of greatest commercial relevance. Conversely, in the basic transaction of suretyship, the incidence on consumers is considerable and in this area UNCITRAL is disinterested. This may explain to some degree the disregard of personal security.

Nevertheless, an opportunity was missed, i.e. to elaborate the common traits of personal and of proprietary security, as well as to deal with practical problems arising from combinations of personal and proprietary security. Probably it is too late to revert to this issue now.

My second point is located in the field of proprietary security proper. UNCITRAL spared any work on security in securities, such as bonds and shares of companies, irrespective of whether held directly or indirectly. In fact, draft recommendation 5 says: “The law should provide that it does not apply to [indirectly held] securities and ...”. In practice, this has meant that coverage of any securities, irrespective of whether held directly or indirectly, has been excluded from consideration. The reason for this reservation was that Unidroit in Rome is presently working on a convention on indirectly held securities, and this work has made promising progress.

It was not until the end of the last session of UNCITRAL Working Group VI that the gap between the two projects was discovered. Neither one covers security interests in directly held securities.

This is an economically important area, especially for the financing of medium and small enterprises. It comprises shares and participations in enterprises which are not quoted on a stock exchange, such as in partnerships and limited liability companies. Of course, the precise limits of this sector will have to be determined. And it will also have to be examined whether the general rules of the draft Legislative Guide are adequate or will have to be modified or supplemented in order to take into account any special aspects.

\* \* \*

*Kathryn Sabo, Chair*

Before we open the floor for questions, I think just to sum up, UNCITRAL will be completing the Legislative Guide at its resumed fortieth session in December. There were many elements that could have been added to the Legislative Guide but one has to stop somewhere, and the Commission decided last week that in terms of future work it is going to look at security interests in intellectual property. This will likely appear as an annex to the Guide. Very happily, given Professor Drobnič's comments, the Commission will also have a working group look at securities, particularly I think, directly held securities, non-traded securities, and there is some definitional work to be done in that area.

Now we have suggestions that personal security and perhaps security in immovable property should also be looked at. Another suggestion has been that the recommendations in the Legislative Guide might be developed into an actual model law. There has also been some suggestion, I think, that security interests in the context of resolving insolvency disputes could be looked at, but I think that this is something that might be discussed in a later panel.

#### *4. Comments, evaluation and discussion*

*Neil Cohen*

*Brooklyn Law School, United States of America*

I have one comment on Professor Drobnič's presentation and one question for Mr. Alcantara about his. With respect to Professor Drobnič's suggestion that the draft Legislative Guide in some ways is incomplete because it does not address issues of guaranty or suretyship, Professor Drobnič of course has put his finger on the important economic point that is at the core of all of this, which is that both security rights and guaranty are really part of the same economic phenomenon: credit enhancement. By lowering the risk of loss to the creditor upon default, that enables the greater availability of credit at lower cost. My sense is that while the law of personal guaranties differs quite a bit from State to State, as a general matter it is more functional in a greater number of States than is the law of secured credit. So, while a comprehensive treatment would certainly require treatment of both, I wonder if the case here is that UNCITRAL has simply chosen that segment of the field in which there is a greater present need, rather than artificially segmenting them and simply ignoring the law of personal guaranties, because as Professor Drobnič pointed out, it is extremely important.

My question for Mr. Alcantara is really a practical question. He pointed to controversies in this area and to both the extreme economic importance of intellectual property and its

growing role as wealth and therefore as possible collateral. But he also pointed out that there are those who believe that it is so unique that only unique principles could possibly apply to the area, and that general principles that apply to security interests in other types of movable property in general or intangible movable property simply would not apply and that there are those who would say that general principles simply should not apply to intellectual property until a more specialized instrument is available. What do you think it would do to the value of the UNCITRAL Legislative Guide on Secured Transactions if intellectual property simply were excluded and not have the treatment that is proposed in the Guide?

*Oscar Alcantara*  
*Goldberg Kohn, United States of America*

What would it do to the value of the Guide? I think that what would likely happen is that in trying to implement and execute the Guide, you would find soft spots where intellectual property assets would complicate matters, and who knows from jurisdiction to jurisdiction how those would play out. It may be that lenders will be unable to realize the value if they attempt to take secured interests, it may be that even prior to that lenders will simply not make funds available on intellectual property and that will obviously serve to the detriment of the intellectual property community not to have that source of funding available. That would certainly diminish the value of the Guide unfortunately for the very intellectual property owners who believed they would be protecting their own interests.

*Don Wallace, Jr.*  
*Chairman, International Law Institute, United States of America*

This is a question to Professor Drobniig with respect to immovable property, or real property as we call it in the common law. Could you just take a minute to explain how you see the relationship between security interests in personal property on the one hand and security interests in real property on the other, and maybe more specifically would you envision some day a common registry of security interests in both personal and real property?

*Ulrich Drobniig*  
*Max Planck Institute for Comparative and International Private Law, Germany*

I did not say or even suggest that the present Guide or addition to it should deal with security interests in real property, because it is clear that firstly the demand for unified systems is much less there and secondly, and I think more importantly, the traditional roots of real property and security in real property are so strong that I do not think it would have chances of early implementation. I merely said that the title “Legislative Guide on Secured Transactions” is a bit misleading because it does not cover this important segment. That was all I said. But in the future, in 50 years, why should efforts not be made to unify interests in real property? There is in Europe a discussion on creating an addition to the existing national mortgage systems or a euro-mortgage—that means a unified instrument which would add to the existing ones. But whether that has a future is not yet very clear; at the moment it is not very realistic for the next 10 or 20 years, even in the European context to expect such a euro-mortgage.

*Aboubacar Fall*  
*Executive Secretary, African Law Institute*

As the Executive Secretary of the African Law Institute, which is modelled on the American Law Institute, allow me to begin by saying that the African Law Institute is an independent legal think tank set up with the technical and financial support of the African Development Bank. My intervention is related to the issue of secured transactions. This is a crucial area for Africa and the Institute has decided to carry out two pilot projects—one which is currently under way in Senegal, a civil law country, and another to be started next week in Ghana, a common law country. The objective is to find common legal grounds, in other words, to see whether in the two legal traditions, as represented by these countries, there are common principles which can form a basis for future harmonization in the area of secured transactions. The idea here is that the work that would be achieved in these two pilot projects could lead to the adoption of a model law which could then be applied throughout African countries irrespective of their legal culture. It is a very ambitious project which is very closely related to what UNCITRAL is doing in international trade. The Institute has the support of the Governments of Ghana and Senegal as well as the national banking associations. Recently, the Institute participated in a high-level international workshop organized by the International Finance Corporation on the topic of secured transactions and presented a paper by Professor Kojo Yelapaala on the two pilot projects. It is important to mention that these projects are also supported by the Investment Client Facility, which was set up after the Gleneagles Group of Eight summit in order to create a conducive environment for private sector development in Africa. I thought that the Institute's secured transactions project was worth mentioning in the context of this important and international gathering. Of course, the Institute will take into account the work of UNCITRAL in this area. It is with that in mind that we would like to be associated with the work under way in UNCITRAL and we would also like to establish close relations so that you can be informed of the work which we are undertaking, particularly the two pilot projects that I have just mentioned.

*Kathryn Sabo, Chair*

That sounds like a very interesting project and I would like to encourage you very warmly to use the UNCITRAL Guide, as Mr. Tata from the World Bank mentioned the possible use of the Guide as a tool. I think that there are perhaps links to be established there and it is my conviction that the UNCITRAL secretariat would be very interested in working together with you and finding out about your pilot projects.

*Madhukar R. Umarji*  
*Chief Adviser, Legal, Indian Banks' Association*

I wanted to make a comment on the question whether it is possible to include real property security interests in the Guide. In India, the real property law is a uniform law for the whole country. It is not a state or provincial subject. Since the law is uniform, we included the security interest over real property also in the law and we made it enforceable without the intervention of the court in the event of default. It is very much relevant to include real property security interests in the UNCITRAL Guide from the point of view of lending to

small and medium enterprises. Inclusion of security interest over real property in the Guide will facilitate creation of an enterprise mortgage where all the assets belonging to the unit can be charged to the lender and, in the event of need for enforcement of security, the enterprise can be sold as a going concern for a better realization of the security.

*Ulrich Drobnig*

*Max Planck Institute for Comparative and International Private Law, Germany*

It is a very interesting idea and of course enterprise mortgages are very well known in some countries, but the question is whether they would work beyond the borders. If the borrower company is located in London but has real estate in Ireland or in Germany, would you think that the enterprise mortgage would cover the mortgage which encumbers a German real estate of the company, without following German procedures, entering in the land register etc.? I think they would have major problems.

*Kwang-Hyeon Seo*

*Ministry of Foreign Affairs and Trade, Republic of Korea*

My question is directed to Mr. Alcantara, and it is about secured interests in intellectual property rights. My concern is how you are going to deal with intellectual property which is not there yet but about to exist or which we cannot be sure will exist or not.

*Oscar Alcantara*

*Goldberg Kohn, United States of America*

I think the question was about intellectual property that does not yet exist and intellectual property that is being built, like a film in production. This is an interesting question and basically the current state of affairs is quite mixed internationally even domestically within the United States. The ability to grant and perfect a lien on a film for example, is not absolutely clear. There is certainly a history and a pattern. But it is a fine question. Although frankly the concept which we receive from the secured lending side of a grant of a security interest in future or after-acquired property is one which can easily be transported into the realm of intellectual property. So there is a model that comes from our secured lending heritage.

*Yuejiao Zhang*

*Shantou University, China*

It is very important to facilitate the access of investors to credit by using their property. However, with respect to intangible property such as intellectual property, I have three questions. First, the evaluation of patents or trademarks is very difficult. Second, enforcement is difficult, because sometimes the user rights or the holder's rights are transferred as security; if title is used and then there are geographic-territorial restrictions, the secured creditor-transferee has to go back to the patent office where the transfer was registered. The last one is the difficulty associated with third-party infringement claims. If a third party claims that there has been an infringement of intellectual property, who is liable for infringement?

*Oscar Alcantara*  
*Goldberg Kohn, United States of America*

You have concisely articulated many of the concerns which have been raised in our discussions and which will be the subject of our future work. I think that in the time allotted, the most I can do is to invite you to participate in our future work because your views will be welcome.

*Charles A. Schwartz*  
*Senior Commercial Law Reform Adviser, United States Agency for International Development*

I very much enjoyed all the presentations. I wanted to mention something about what Mr. Alcantara spoke about, that is, intellectual property. When he asked rhetorically, “Should it be covered by the Guide?”, my first thought was two words: why not? Then, I came around to one word: absolutely. In USAID, intellectual property has been added to the list of things we look at, just as yesterday I mentioned commercial dispute resolution. That is because although we go to less developed countries, intellectual property is becoming an issue everywhere, and certainly even in the developing world it is something that is important to countries even though their intellectual property is not as vast yet as of developed countries. But as countries move along the development scale, intellectual property becomes more and more important, which is a reason why it should be covered by the UNCITRAL Guide, even for the less developed countries. I know that, in the United States and probably in other countries, intellectual property is actually being sold by large corporations, for example, to offshore subsidiaries. It is just becoming the source of another form of financing and so it just seems to me that it is part of the whole group of considerations about assets, what you consider as an asset, what can serve as security and what can serve to help finance. There may be issues of risk, as Professor Cohen pointed out, but the more you can lower the risk, the more intellectual property transfers and securitization will become prevalent. I wanted to mention how I did like all the presentations and the point about intellectual property is one that is quite important to us.

*Mary Hiscock*  
*Bond University, Australia*

I wanted to pick up a point that Professor Drobnig made about personal security. The work that I have done over many years in the Asia-Pacific region shows that personal security is often one of the factors that makes a project bankable when collateral is perhaps a little inadequate, and so the relationship between personal security and an extended access to collateral is going to be very important for any country that is looking at adoption of reforms in this area. The critical question is interrelationship of who has the choice as to the order in which you proceed. Do you proceed first against the guarantor or do you first proceed against proprietary collateral, whether it is personal or not? In many cases, the real purpose of the personal security—the surety—is that it is a critical part of the process of enforcement, because if you have a culture which still has a dominance in a sense of financial patronage, the influence of that person is really quite critical sometimes, where the systems of civil procedure or other enforcement are not really appropriate. It is always tempting to proceed against a surety that has obvious assets, but I think in this situation, if we are looking at the concerns of the small and medium enterprise, although

one may not wish to tackle the whole field of suretyship, some of these overlapping concerns I think are genuinely matters of deep division in different countries.

*Andrej Dolinšek*  
*Ministry of Finance, Slovenia*

My question goes to Mr. Alcantara and pertains to the public procurement area, which actually will be on the agenda on Thursday. Slovenia recently adopted a national law in accordance with the public procurement directives of the European Community. Currently, there is strong domestic interest in further improvements to the law, for instance as regards the innovation concept. I would like to hear Mr. Alcantara's views on situations where the innovator as a supplier or a contractor comes in together with the contracting entity on the other side. What is their relationship in that matter, and to whom does title belong if there is some risk involved in this relationship and how is this risk shared? What we have heard from the previous speakers is a rather new area for us, and the European Community institutions are thinking about how to make a triangle between public procurement, small and medium enterprises and the innovative push. In this regard, the European Union's Lisbon Strategy sets out how to stimulate innovation in the procurement area.

*Oscar Alcantara*  
*Goldberg Kohn, United States of America*

Let me begin this way. It harkens back to Mr. Schwartz's comments earlier about developing countries and developed companies, where often in fact the most valuable asset that those companies have is a piece of intellectual property. I have plenty of clients whose most valuable asset is a brand that they have developed or an invention. It is essential that those companies and individual inventors first of all have absolute right to ownership in their properties and to bring this into the financing context. I think again any system which uses the fiction of forcing an intellectual property owner to assign its rights over to a lender, whether it be a public lender or a private lender, that is fraught with issues—title issues. In everyone's view, the question is whether the intellectual property owner retains title and grants a true security interest. That resolves risk associated with ownership clearly in favour of the intellectual property owner of some sort of strange unintended transfer and frankly lenders do not want to accept that risk. Lender liability is something we have not mentioned a lot, but why would a lender want to accept an assignment of an inventor's lifeblood if doing so is going to likely lead to lender liability? And the alternative of taking true security interests is a much more favourable position.

*Paul Marca Paco*  
*Permanent Mission of Bolivia to the United Nations (Vienna)*

I would like to nuance this discussion on intellectual property, if I may, and I have a question for Mr. Alcantara. We know that in WTO there is something about traditional knowledge of indigenous peoples in some countries, and I am wondering what would be the effect of security interests in this context. Intellectual property as defined within the WTO has a special character, but if a collective population wants to create its own living or environmental habitat, and wants to acquire a loan and when you are setting up a security interest, what would happen if there was a default? Would this involve all the people living

in that habitat? At what point is this situation going to be discussed? Intellectual property exists when it is in a public registry. But traditional knowledge is disseminated throughout the population. So how could we apply the usual standards of intellectual property, and this is in connection with security interests, to that kind of an undertaking which will probably transpire or perhaps has already transpired in some indigenous populations?

*Oscar Alcantara*  
*Goldberg Kohn, United States of America*

A few thoughts on that issue. First of all, I already referred to this possibility in a reply to an earlier question about intellectual property rights that have not yet come to be.

What about intellectual property rights that are still in the process of being developed, such as indigenous peoples' rights? Or traditional knowledge?

I think I revert to a phrase that we used a few times in our last UNCITRAL meeting on intellectual property, which is the phrase *nemo dat quod non habet*. Basically, what that means is that the lender's rights in the property are really limited to whatever the property is. When that right comes to be, such as it might be formed or limited, that is the nature of the right that the lender may be able to access. No greater and no less. So, as we see these new forms of intellectual property start to develop into true property rights, then and only then will they become meaningful within the context of a commercial law transaction.

*Majeed H. al-Anbaki*  
*Permanent Mission of Iraq to the United Nations (Geneva)*

My question goes as well to Mr. Alcantara. It is about intellectual property. I still do not understand how some types of intellectual property can be used in secured transactions, like for instance neighbouring rights such as the special movement of a singer or a special movement of a musician when he performs a piece of music. So far, as I gathered from the discussion we heard just now, this movement may be the subject of an intellectual property right that can be used as collateral.

*Oscar Alcantara*  
*Goldberg Kohn, United States of America*

Neighbouring rights are a very interesting set of rights and the United States is behind the rest of the world in that area. As a matter of fact, I am involved right now in the process of certain lobbying efforts in Washington, D.C., relating to musicians' performance rights. Your question dovetails nicely with the question about indigenous rights. There are a large number of rights that are referred to as intellectual property rights that are not registered. Earlier somebody mentioned the point that intellectual property rights are always tied up with registries and that is simply not the case. We have just heard two examples here and there are many others which exist and which will develop in the future. The question of unregistered intellectual property rights is significant. It is one of the most controversial areas in intellectual property and in the interface between intellectual property and secured lending. Solving that problem, I again invite you and others to help us in that effort in our future work in UNCITRAL Working Group VI.

### C. Legal issues on corporate governance

*Chair: Eric Bergsten*

*Pace University School of Law, United States of America; and Secretary of the United Nations Commission on International Trade Law, 1985-1991*

Many of the speakers have mentioned the changes that have taken place in the 40 years since UNCITRAL was created. Let me say: go back not 40 years, but just 15 years, to the first Congress that UNCITRAL held in 1992. One of the items that was not on the agenda—and I cannot imagine possibly would have been on the agenda—was the programme that we will now have: corporate governance. That was far outside of anything that UNCITRAL was thinking about at that time. One can see this in a number of other areas that have been on the agenda of UNCITRAL as programme items, much less items that have been talked about and will be talked about in this Congress.

The questions of corporate governance have been very much in the news and when I say the news, now I am talking about front-page news: scandals which have been based quite often on some element of fraud; these have been in several different countries. I suppose the most recent one of that large variety has been Parmalat in Italy—this has been front-page news. And these frauds of course affect so many people—other stockholders, creditors, employees, communities where these companies are located, and just society in general, especially when they are very large, as some have been.

A second form of matter that has been in the front-page news and that relates to our subject this afternoon has been the impact that corporations are alleged to—or sometimes really—have had in regard to corruption, environmental damage and things of that nature.

Fifteen years ago, if we had had an item that related to any of this on the agenda of the UNCITRAL Congress, it probably would have been in regard to corporate abuse. We would have been talking about the corporation, especially multinational corporations in the international context, and what they were doing—or should not be doing—and that would have been the focus. That is not our focus today. Our focus is on corporate governance, which is a radical change; and what does that signify? During the last 15 years, it appears there have been a number of steps taken which have more clearly defined the responsibility of the corporation. The OECD Bribery Convention perhaps is the strongest of the hard-law texts of that type, but there have been a host of others, of codes of conduct and similar soft-law texts. So now we come to the question: is the corporation governed in such a way as to meet these standards? That is a different question and it is an interesting development of its own.

There has been a lot of discussion in more recent years about corporate restructuring of one form or another—whether we are talking about mergers and acquisitions or cross-border mergers and acquisitions—to an extent that was not taking place before. The term “locust investors” (*Heuschrecken*) is used in this part of the world, perhaps more in Germany than in Austria. The term is obviously pejorative. It relates to the restructuring that is but one element of the impact of globalization of the economy. These subjects do not reach the front page of the newspaper as often as the scandals. They are more often in the business news. However, they are very much part of the news.

So we have our panel today. Our first speaker is Mr. Seward Cooper; he is the Chief Counsel for Good Governance at the African Development Bank. He has other duties at the Bank: he is the editor-in-chief of the Law for Development Review and the editor of the Law for Development Bulletin. Prior to joining the Bank, he worked as a practising lawyer, as head of the international practice group of an American law firm, as managing partner of Liberia's largest firm and as an adjunct professor of business law at the University of Liberia. He is the former president of the Liberia Chamber of Commerce, former Deputy Agriculture Minister of Liberia and a member of the Board of Governors of Liberia's National Bank. He serves as a founding member of the Board of Governors of the African Law Institute. He is a member of the Technical Committee of the All-Africa Conference on Law, Justice and Development. He is a graduate of the College of West Africa, the University of Liberia, and holds his law degree from the University of Wisconsin. It may be no surprise to know that he is an attorney in the Supreme Court of Liberia, of the State of Wisconsin and of the Supreme Court of the United States.

*1. Corporate governance in developing countries: shortcomings, challenges and impact on access to credit*

*Seward M. Cooper*

*Chief Counsel, Good Governance, Office of the General Counsel, African Development Bank*

“Good economic and corporate governance including transparency in financial management are essential prerequisites for promoting economic growth and reducing poverty.”

New Partnership for Africa's Development Action Plan

*Overview*

Good corporate governance is imperative to inspire investors' confidence, expand the private sector and stimulate economic growth.

It has been predicted that the “proper governance of companies will become as crucial to world economy as proper governance of countries”.

It might be too early for some to agree, but evidence suggests this prediction, if it is not obviously true now, is very likely to come true in the near future.

There is global recognition of the impact of corporate social irresponsibility. The Asian financial crises, corporate scandals in Enron and WorldCom in the United States of America and in Parmalat and Siemens in Europe, and crises in financial circles in several major African countries over the last decade, in each instance, negatively affected the well-being and lives of thousands, including employees, pensioners, depositors and ancillary enterprises. These raised alarms for effective regulation of corporations and led to panic in marketplaces, a fall in stock prices, a run on financial institutions and quick-fix remedial actions.

On the other hand, in many developing countries, especially in Africa, heightened recognition of lost opportunities to mobilize financial resources on domestic and international capital markets through good corporate governance excited the interest of African Heads of State. This inspired the Heads of State to include corporate governance as one of four thematic areas subject to review under the African Peer Review Mechanism. The African Peer Review Mechanism is a unique mechanism under which 26 African leaders have agreed to submit their respective countries and themselves to review introspectively by their compatriots and Africa-wide by their peers in selected areas of governance. The selected areas are (a) political governance and democracy, (b) economic governance and management, (c) socio-economic development and (d) corporate governance.

This need to closely examine the operation of corporations is justified for several reasons. Potential gains or losses which hinge on proper management of corporations could be financially profitable or economically devastating. Interest among the general public in developing countries in investing in listed corporations is rising. For example, during June 2007, in Kenya, a country with a long tradition of a stock market that is also undergoing the African Peer Review, an Internet provider (AccessKenya), the first Internet firm to be listed in East Africa, saw its listing on Nairobi's stock exchange oversubscribed by 363 per cent. This oversubscription came from every category of investor—from individuals to institutional investors.

Such a rise in public interest means more is at risk. While this particular market participation in Kenya is through equity participation and not credit, financial resources are nevertheless being put at the disposal of the corporation with an expectation that those resources would be managed properly—that means managed efficiently, transparently and responsibly. The assigned subject of this speech places the accent on access to credit. This example is relevant however because equity investors expect their money back plus dividends, just as creditors expect their principal back plus a return (under sharia) or interest.

With that overview in mind, I shall now speak briefly on the assigned topic of “Corporate governance in developing countries: shortcomings, challenges and impact on access to credit”.

A threshold question is that of how to define corporate governance. The definition of corporate governance employed by the African Development Bank is most apposite for this discussion. The Bank defines corporate governance as: “The mechanism that frames duties and powers of corporations to deliver benefits to investors and those directly impacted by the corporation's activities.” Note that this definition is not limited to a mechanism that delivers benefits to investors. Without rejecting principles of maximizing shareholder values, the definition goes further and includes consideration of “those directly impacted by the corporation's activities”. In corporate debacles, not only shareholders but many others, including governments, form part of stakeholders that are directly impacted by corporate activities.

The emphasis in the assigned topic is on developing countries. Given the wide range of countries categorized as “developing countries” that are at various stages and levels of development—their different legal traditions; their diverse cultural practices; the existence of capital markets in some countries and the absence of capital markets in others; the

presence of credit rating agencies and credit bureaux in some countries but not in others; the several forms of corporations existing in almost all developing countries, such as state-owned enterprises, publicly listed corporations, cooperatives, closely held corporations and family-owned corporations—one must be careful, as always, not to generalize. It is important to bear in mind that while here our focus is on corporate governance, in many developing countries, particularly African countries, of equal if not wider relevance would be enterprise governance (which encompasses a greater part of the private sector) since most businesses are not incorporated.

Be that as it may, I propose to discuss the topic by taking some common threads that run through corporate governance in many of these developing countries to identify (a) selected shared shortcomings and (b) common challenges. I also identify some specific legal issues and deal briefly with the impact on access to credit.

### *Selected shared shortcomings*

Corporations do not operate in isolated environments or in vacuums. They are subject to State-imposed rules and regulations as well as events and forces around them. As a result, corporate governance is affected by overall public governance. If economic and political governance at the country level is weak, the impact of that weakness almost invariably trickles down onto corporations operating within the country. It is logical therefore that corporate governance may be viewed as a compartment of broader, overall country governance. Arthur Mitchell and Clare Wee of the Asian Development Bank's Legal Department put it elegantly in their article on corporate governance in Asia when they contend: "It is not possible to establish an island of good corporate governance in a sea of poor or underdeveloped public governance."

In countries that have chosen the private sector as a main catalyst to economic growth and development, this choice should necessarily place good corporate governance near the top on the list of national priorities. Good corporate governance, however, can only be achieved if certain shortcomings in overall country or public governance are addressed. That requires strong political will and appropriate resources.

Analyses of circumstances in many developing countries confirm certain common systemic shortcomings. These shortcomings are perhaps most affected by law and the way laws are enforced. This is not surprising. The proposition is commonly acknowledged that at the base of good governance is a predictable, equitable, effective and efficient legal and judicial system. Such a system must cater to the general needs of the people and the specific needs of economic operators participating in or desirous of taking part in the economy.

This emphasis on the rule of law is not overstated because law does form the basis of societal order. In a democracy, law is the popularly agreed communal compact upon which the society is governed.

Indeed, it is through a fiction of law that corporations are created and given existence. Through this legal fiction corporations are recognized as artificial persons with limited liability through which activities authorized by the State and expressed in the corporation's charter may be undertaken. Understandably, therefore, the inadequacy

of a legal framework under which these activities are executed has been aptly referred to as part of the “rule of law deficit”. A deficit in the rule of law affects public governance and transitively corporate governance.

This rule of law deficit manifests itself in systemic shortcomings that affect corporations and their access to credit. The shortcomings are sometimes commonplace and include overall defective legislation; malfunctioning judicial systems burdened by huge case backlogs resulting from, among other things, inadequate physical infrastructure; antiquated laws (both procedural and substantive), including laws on debt collection, insolvency and shareholders’ rights; poor terms and conditions of service for judicial and related administrative personnel; weak accountability mechanisms including, and sometimes reflected in, ineffective service by securities regulators and banking supervisory regulators; failure of law enforcement and prosecutorial authorities to pursue claims arising from violations of securities or other financial laws or white-collar abuses and crimes; and weak auditing and disclosure laws.

### *Challenges*

Interesting results have emerged from regional round tables on corporate governance sponsored by the Organisation for Economic Co-operation and Development (OECD). The 25 meetings of the round tables brought together participants from 38 non-OECD economies. They revealed interesting common themes and challenges in corporate governance. The round tables covered countries in Latin America, Eurasia and South-East Europe. Although other developing regions, including Africa, were not participants in the round tables, the lessons learned, experiences shared and challenges identified are similar to those in many African and other developing regions. Those common challenges identified from the round tables are grouped as follows: (a) enforcement; (b) ownership and control; (c) shareholders rights and equitable treatment; (d) responsibilities of the board; (e) Transparency and disclosure; and (f) the role of stakeholders.

#### *Enforcement*

With respect to enforcement, a major challenge arises from the general lack of effective enforcement of existing laws and regulations. Meeting this challenge requires recognition that the structure and capacity of regulatory and judicial frameworks are integral parts of the corporate governance environment. The challenge is to narrow the gap between “formal” provisions and actual implementation. This is critical because adherence to corporate formalities constitute the bedrock of corporate law and corporate accountability. Corporations in most jurisdictions are mandated to adhere strictly to statutorily stated formalities. Adherence to these can be very time-consuming and financially costly.

#### *Ownership and control*

The round tables noted that in many parts of the world, ownership and control are highly concentrated in individual companies or groups of companies. Potential problems could arise from the combination of concentrated ownership, weak shareholder protection

and insufficient disclosure. The challenge is to improve transparency and disclosure, make boards of directors more effective and develop means to ensure equitable treatment of shareholders. The related challenge is to promote development of equity markets and avoid limiting access to financial resources, which frequently occurs when controlling shareholders are permitted to extract private benefits from the corporation at the expense of minority shareholders. Although rules exist in many jurisdictions to protect minority shareholders or for shareholder derivative suits, these are rarely used. For example, in Liberia, a popular international corporate domicile, the Associations Law provides for shareholder derivative suits. Yet, no case has been brought before the Liberian courts invoking this provision of the statutes. As elsewhere, shareholders might be unaware of the law or prefer simply to vote with their feet by selling their shares.

#### *Improving board of directors effectiveness*

A recurring challenge is to activate boards of directors to take independent decisions as fiduciaries of corporations and not as rubber stamps of controlling shareholders. The challenge is to increase the pool of technically competent potential directors capable of making informed and objective business judgements. This requires establishing training facilities and programmes for corporate directors and developing strong audit committees of boards of directors. At the African Development Bank, financial support has been given to help build the capacity of directors in regional member countries. In Mozambique, the Bank provided funding to the institute of directors for training purposes.

#### *Transparency and disclosure*

A main challenge identified is to introduce improved standards based on international best practices. In Africa, the African Development Bank was given the lead role by Heads of State in the African Peer Review Mechanism to recommend appropriate standards and codes for corporations and for the financial sector. The Bank's recommendations have been based on international standards being implemented in more developmentally advanced economies. While the wherewithal to meet all the standards is not present in most African countries, achieving these standards remain an aspiration. The desire, indeed the challenge as revealed by the round tables, is to close the gap between standards and actual practices. Disclosure of ownership in related-parties transactions needs to be pursued to encourage arm's-length deals that do not lead to the mulcting of corporate assets. In a project in one of the Bank's regional member countries, the principal contractor also owned controlling shares in the financial institution through which the contractor channelled project payments. No disclosure of this relationship was made; neither were the transactions between the corporation that was project contractor and the corporation that was the financial institution done at arm's length. Problems with the project caused the Bank to freeze payments to the project corporation. This adversely affected the financial institution, which—to the detriment of other shareholders and depositors—collapsed.

In summing up on challenges and looking specifically at Africa, it can be said that inadequate administrative systems compounded by heavy bureaucracies stifle corporate development and governance in many African countries. For many African countries the main challenges are to reduce the bureaucratic impediments to business and corporate

registration; improve and decentralize business registries; establish and integrate registries for secured transactions; strengthen and attract competent human resources back into African countries and the corporate sector; improve regulatory oversight; elevate more African corporations to the level where they can get internationally recognized credit ratings; improve the legal and judicial frameworks; and develop effective compliance mechanisms. In its corporate governance strategy paper, the African Development Bank point out some of these challenges and note, in particular, that:

“[I]nstitutions that are intended to provide checks and balances within the system (including prosecuting systems) are generally under-resourced and lack requisite skills, infrastructure and independence.”

It merits restating that the status of corporate governance reform in developing countries is not homogenous. Countries are at various levels of reform. In Africa, for example, the African Development Bank has found that in the East African region, Kenya, Uganda and Tanzania have made tremendous progress in putting in place self-regulatory institutions to promote corporate governance; in Central Africa there has evolved a uniform framework for companies laws, yet much needs to be done to strengthen institutions to promote good corporate governance and to create an enabling environment; in West Africa there is a commendable orientation towards harmonized implementation of good corporate governance standards for the banking sector and, through OHADA, uniformity of companies laws is being achieved in the francophone countries; in North Africa much progress has been made in harmonizing standards of corporate governance; and in Southern Africa, where a common benchmark (the King Commission report) is being used, strong efforts are being made to improve the policy, legal and regulatory frameworks.

### *Some legal issues*

On the basis of these common challenges and other observations, several legal issues require consideration. Let me point out a few. What measures should be promoted to avoid or solve deadlocks in corporate boards of directors, especially in closely held corporations, which are the most popular corporate form in developing countries? What mechanisms should be employed to protect the rights of minority shareholders in listed corporations? What measures are most effective to inform those minority shareholders of their rights? How broadly should rules pertaining to financial disclosure of interests by members of boards of directors to prevent conflicts of interests extend? Should provisions of codes of conduct for directors be enacted into law? What is the fiduciary obligation of a Government official appointed by virtue of his/her office in Government to the board of directors of a state-owned enterprise or other corporate entity in which the Government has an investment? How can the gap between laws on the books and implementation of the laws be narrowed? What is the appropriate role of shareholders in managing the business of the corporation? To what extent does the corporation owe a duty to stakeholders who are not shareholders and with whom the corporation has no formal contracts? Given the backlog of cases and inadequacies in many judiciaries in developing countries, what extrajudicial dispute resolution mechanisms are appropriate for shareholders to protect the corporation from malmanagement?

*Impact of corporate governance on access to credit*

Good corporate governance principles apply to corporations, such as financial institutions, that provide credit as well as to corporations that seek to access credit from these financial institutions. Banks are the most important sources of credit for most corporations. Banks are also the main depositories of savings for those participating in the money economy. In developing economies, almost always, banks maintain a dominant position in the financial system. Whatever happens in the banking sector affects the overall investment climate and multiple stakeholders. Ineffective regulation of banks or inadequate prudential guidelines for their governance affect the nature and level of credit and have the potential of destabilizing the national economy.

In surveying the situation in Africa, a recent report on firm competitiveness states:

“Firm competitiveness in Africa continues to be constrained by the high cost of finance and limited access to it. The financial sector is largely failing to meet the private sector’s needs. Financial markets on the continent are less developed than the worldwide average, even after taking into account average per capita income and inflation. Africans also have disproportionately high offshore deposits. Interest margins are high . . . . Most organized securities markets are small and inactive; institutional investors often concentrate on bank deposits and real estate instead.”

These statements reflect the link between confidence in the governance of corporations providing financial services, levels of deposits and availability of credit. Proper governance of corporations can reduce these costs. Corporations that are properly governed can expand their resource bases and attract capital domestically and internationally.

At the African Development Bank systemic due diligence exercises to ensure full compliance with corporate governance principles by partners involved in Bank-supported projects are fast becoming standardized. The African Development Bank knows that the business environment must be attractive to get the investments of local and foreign operators. The Bank also recognizes and reports that lack of transparency in the governance of firms and shortcomings in regulatory frameworks present major constraints for credit to small and medium-sized enterprises, which also have little recourse to financial markets to raise funds.

*Conclusion*

The status of corporate governance in developing countries is not the same. There are, nevertheless, certain shared shortcomings and common challenges. These bear directly on the availability of and access to credit. Governance of publicly-listed corporations, state-owned enterprises and small or medium-sized closely-held corporations differ. But certain minimum standards must be maintained by all corporations.

Corporations do not operate in isolation. They operate alongside others in national, often global, economies. All corporations are affected by overall country or public governance. They are affected by the political and economic milieu within which they operate. Assuming the existence of the requisite political will for good governance in many developing countries,

some changes could be made to improve corporate governance. These changes include greater transparency, improved recourse mechanisms for all stakeholders, better trained and independent boards of directors, effective legal regimes (including for debt collection and secured transactions), independent judiciaries with capacities to adjudicate matters speedily and reliable credit reference bureaux. With these in place the private sector will serve more efficaciously as a catalyst for economic development.

Finally, let me end as I began with a quotation. South Africa's Mervyn King says:

“Good corporate governance makes good, hard-nosed business sense ... [S]trong corporate governance practices attract capital.”

I agree entirely.

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*Eric Bergsten, Chair*

Our next speaker is Kathryn Gordon, who works on investment issues and multinational enterprises at the Organisation for Economic Co-operation and Development (OECD) in Paris. Her most recent responsibilities include analysis of the private initiatives in support of corporate responsibility and the study of multinational enterprise activity in conflict zones. She also participated in negotiations that culminated in adoption of the revised OECD Guidelines for Multinational Enterprises, which are non-binding recommendations by Governments to multinational enterprises governing nine areas of business conduct. She has been involved in other studies and work in the same general field at the OECD. Prior to moving to OECD, she was a professor at the École Supérieure des Sciences Économiques et Commerciales in France and, although she is a citizen of the United States, she has been a resident of France for 26 years. She obtained her PhD and MBA in finance from the University of California in Berkeley.

## 2. *Responsible investing in weak governance zones*

*Kathryn Gordon*

*Senior Economist, Investment Division, Organisation for Economic Co-operation and Development*

Seward Cooper has just given us a definition of corporate governance which stresses the fact that corporations do not operate in isolated environments. They do not operate in a vacuum. They need market signals, political signals and signals from civil dialogue to determine their production, financial and other decisions.

I have been asked to report to you on the most recently adopted OECD governance instrument. This is a tool designed for investors in so-called weak governance zones, that is, in countries where some of the key systems for generating signals for the corporate governance system, that is, legal guidance, political discourse and civil dialogue, do not exist. Before I get into the OECD Weak Governance Zones Tool, let me briefly describe to you what OECD does, because its functioning is really quite different from the United Nations.

The OECD is a club—a club of governments—that share the view that market economies, supported by effective public policy and a well-developed framework of rights, are a major force in raising economic, social and environmental well-being. The primary mission of OECD is to support economic development and to help Governments run public policy more efficiently and more effectively. It provides guidance in monitoring to its 30 members that helps them to adhere to norms for government responsibility. Is the public sector clean, efficient, transparent and responsive to public needs? OECD houses some of the most well-known international instruments in the anti-corruption, corporate governance and public management fields. In addition, it has an influential government-backed code of conduct for international business, the OECD Guidelines for Multinational Enterprises. The Weak Governance Zones Tool and the intergovernmental work that produced it are part of the OECD follow-up on the OECD Guidelines for Multinational Enterprises, its code of conduct for business. It is perhaps because of these OECD strengths in the public policy and corporate governance fields that OECD was asked back in 2002 by the Security Council to look into the problem of investments in weak governance zones. I should also add that the 2005 Gleneagles Group of Eight summit declaration provided a context in which Group of Eight heads of State asked OECD to produce this tool; thus the tool has impeccable multilateral credentials. It is not an academic study; it is not a statement by the OECD secretariat; it is a public statement—a political statement by member Governments.

There is another United Nations connection to this work. The initial impetus for the OECD weak governance zones work occurred in 2001, and it was done in parallel with the International Labour Organization (ILO) process in relation to forced labour in Myanmar. So OECD handled corporate ethics issues not related to forced labour, while ILO was dealing with regulatory and corporate issues in relation to forced labour. So this is a long-standing OECD process that is closely related through the Security Council and through ILO to United Nations processes.

In response to these requests and pressures, OECD developed and adopted at a very high political level a tool for investors operating in weak governance zones. The tools benefited from extensive consultations, including a major pan-African conference held in Addis Ababa in 2005 of which the New Partnership for Africa's Development (NEPAD) and the United Nations Global Compact were co-organizers.

OECD defines a weak governance zone as an investment environment in which Governments cannot or will not assume their responsibilities. These government responsibilities include providing a legal and, let us say, political and civil framework in which human rights of all sorts, including property rights, can be respected. Government responsibilities include providing public services and ensuring that public sector management is efficient and effective. Government failure is the defining characteristic of a weak governance zone. The relevance of this issue is broad. According to one estimate, some 46 countries with an aggregate population of some 900 million people, or 14 per cent of the world's population, live in such environments.

Investments in weak governance zones pose some of the most serious ethical challenges confronting international business today. In addition to the human suffering that they cause, severe government failures place companies in an uncomfortable world of second best. Given

that host Governments are not assuming their responsibilities, what—if anything—does this mean for company rules in terms of their own responsibilities? And what additional serious challenges does government failure confront companies with? I give you examples that weak governance zone investors have identified in the course of our consultations: security forces—these are life-and-death issues for both the employees of investors and for local populations; dealing with extortion and solicitation; conducting business with public officials that have serious conflicts of interest that would never be tolerated in OECD environments; and arranging joint ventures with state-owned enterprises that are operating essentially without a workable corporate governance framework. These are some of the ethics issues that have been identified.

The Tool covers six main areas; they are: obeying the law and observing international standards; heightened managerial care (I will tell you what that means in a moment); political activities and dealing with public officials with serious conflicts of interest; knowing clients and business partners; speaking out about wrongdoing; and, more broadly, business roles in weak governance zones—a broadened view of self-interest.

In the 15 minutes allocated to me, I will only have time to describe the first two of the subjects, but they contain the core message of the Weak Governance Zones Tool. And this core message is that companies operating in weak governance zones have broadly the same responsibilities as they do in other investment environments. There are no differences in responsibilities, really, between all the different investment environments in the world, weak governance zones or not. Companies are expected to comply with their legal obligations and to observe other relevant instruments, such as the Universal Declaration of Human Rights, OECD and United Nations anti-corruption conventions and major corporate governance standards.

Because legal systems and political dialogue by definition do not work well in weak governance zones, international standards that provide guidance to companies on acceptable behaviour are doubly useful in weak governance zones contexts. In a nutshell, the message of the Tool is that there can be no double standard—one for weak governance zones and one for other investment environments—in adhering to basic human rights, anti-corruption and corporate governance rules. Indeed, internationally recognized standards are, if anything, doubly relevant in weak governance zones, since they are one of the few sources, indeed they might be the only source, of legitimate guidance on business conduct that is available to companies operating there.

So the message of the Tool really is that business responsibilities are the same in weak governance zones as in other investment environments. But there is heightened risk encountered in weak governance zones in terms of the ability of companies to live up to these international standards; these heightened risks create a need for heightened managerial care. That is the essential message. Companies do not do different things in these zones; they do not have different responsibilities. In order to live up to these responsibilities, they need to take extra managerial care in managing the operations. The term “heightened care” is a variant of the risk management term “due care”. Due care is defined as the effort that an ordinarily reasonable and prudent person would use, given prevailing conditions, to avoid harm to the company or to another party. Heightened care means that when managing investments in weak governance zones, companies need to

redouble their efforts in terms of applying risk management techniques that they would use in other contexts. These techniques include board-level involvement; boards are responsible for the main strategic decisions and direction of the company. If a company decides that it is going to invest in an area like Myanmar or the Democratic Republic of the Congo, with all the risks that this entails, then that needs to be a board-level decision, with board-level responsibilities accompanying that decision.

Companies need to gather information about the investment environment. The company needs to be well informed about the risks that it is going to be taking on in its weak governance zone investment. It needs to be well informed about the framework of international standards, much of which is housed in the United Nations system. It is impossible to overemphasize the importance of United Nations standards in providing signals to companies operating in these environments.

Companies need to be well informed on what these expectations are. They need to have in place verification and follow-up record-keeping and documentation, so that information about what is happening on the ground with their investments can move up the chain of command so that it can be made available to law enforcement authorities and so that they can report in a reliable way to civil society. They need to have in place accurate record-keeping and information systems, especially for these investments.

They need to select competent, non-criminal business partners and employees. That is already a very important thing on which the private sector is working. And they need to train them to respond to the risks that they are likely to encounter in weak governance zones and to present them with a set of incentives that genuinely motivate them to make appropriate decisions in the field—no room for doubletalk here. If you want them to adhere to standards, give them a set of incentives that will make it possible for them to want to promote these standards.

Thus, you can see that the OECD approach to investment in weak governance zones does not necessarily ask companies not to invest, but it does ask them to assume their responsibilities and manage carefully the risks that they assume when they do invest in weak governance zones.

I am about out of time here, so I will conclude by letting you know that the Weak Governance Zones Tool was too long to be reproduced for this Congress, so if you want to get the Weak Governance Zones Tool, you will have to consult the OECD website. I would also like to say that in issuing the Weak Governance Zones Tool, OECD has taken a major step that both complements and reinforces related efforts that are taking place: the African Peer Review Mechanism that was already noted by Seward as extremely important, or the Extracted Industry Transparency Initiative by the World Bank and IMF. Thus, the Tool is part of a broader global effort.

The issue of weak governance zones has gone from essentially being a non-issue back in the 1990s to being the subject of Hollywood movies by 2005. So I guess that is one measure of the speed of progress, but the fact of the matter is that while Hollywood has now moved on to other cinematographic projects, the long-term project of making economic and political systems work better in weak governance zones is still with us. It

is up to the international community to continue working on this. Of course, it is host country actors in weak governance zones that will have the starring roles in this process. We, as international organizations, can only play the supporting roles by communicating with our companies and by sharing our experiences with them.

The OECD intends to play this supporting role to the extent that it is able to do so. You will perhaps have noted that in the Heiligendamm 2000 Group of Eight summit declaration the OECD Weak Governance Zones Tool was yet again mentioned by the Group of Eight Heads of State, so we do have a mandate to continue working on this. We will be working on a phase II. We will be in Zambia at a NEPAD-OECD joint conference at the end of the year, seeking African inputs on what phase II should look like. We have already received authorization and funding to provide a Web portal that will be made available to companies and other interested parties that will call to their attention the basic performance standards that are applicable to them in the United Nations system, in OECD and elsewhere as well as management standards that are relevant for weak governance zones operations. I would like to conclude by saying that we would very much appreciate—speaking for the OECD member Governments—receiving any inputs that you might be able to give us today as to what follow-up on this Tool needs to look like. Many thanks.

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*Eric Bergsten, Chair*

Thank you, Ms. Gordon. Professor Doralt is our last speaker in this session. He is a Professor of Law at the University of Economics in Vienna, adviser to the Government of Austria on company law legislation, a European Union counsel in various working groups on this subject and chairman of the Austrian Takeover Commission.

### 3. *Company restructuring and accountability*

*Peter Doralt*  
*Chairman, Takeover Commission, Austria*

When I first read that I should talk about company restructuring, I thought the panel organizing the Congress had made a mistake and taken me for an experienced insolvency expert. I am not, though I have some experience, unfortunately. What we are talking about is not reorganization in insolvency, but sometimes near-insolvency. It is, broadly speaking, restructuring in order to raise profitability, and frequently and increasingly under pressure of new types of ownership. The new types of owners have received wonderful names.

I have brought illustrations with me. The first one—familiar to all of you—is of the barbarians at the gate, with their fists at the gate or with their spears and swords and trying—what are they trying to attack actually? A firm producing cigarettes in the 1980s—well, at that time there was not such militancy against cigarettes. And the other main

product was biscuits—Nabisco was the firm. That was something: US\$ 20 billion. About 10 years later, they were called “pack of wolves”; in 2005 a famous German politician called them “locusts” coming over to Germany munching and eating, feeding on the wonderful German firms, and recently, the particular species of private equity funds has been called “Master of the Universe”.

To understand what we are talking about—everybody does, of course, but just a quick glimpse—there are basically two schools. Professors of economics usually—at least some 80 per cent—would adhere to the first school and say, “Well, a company is about wealth maximization of shareholders—that is it.” Some professors would argue, “No, a company is an institution balancing the interests of all stakeholders.” Well, this was actually the theory in the twenties and thirties of the last century. If there are some Americans here who would argue it is clearly not our theory, I want to remind you that you still talk about “good corporate citizens” who do all sorts of things which are not clearly value-enhancing, like supporting the Metropolitan Opera. When I am in New York, I enjoy the sponsorship of these people. And something which is more important, if you would adhere to clear-cut capitalism and shareholder wealth maximization, there would not be such a defence as “poison pills”. But we are not going into details.

Who are the stakeholders about whom the other party speaks? It is not only the shareholders. It is also other investors like the creditors; it is the employees, consumers, suppliers and the general public. And in some countries, to some extent for example in France, in Austria and it used to be the case in Germany, these stakeholders are even enshrined in company law. All over the world—and the first speaker addressed much of his speech to the issue—one of the most important targets of company law is how to achieve efficient use of capital and assets. How do you discipline managers—the economists call them agents—to act in the best interest of their shareholders? One of the things to do is to have good corporate governance rules enshrined in company law, enshrined in soft law, in the code of corporate governance and the articles of association, or to use all sorts of devices to align the interests of the shareholders with the interest of the managers. Sometimes you find out five or seven years after they have become popular that the medicine was worse than the disease. Many people believe that stock options were the reason for the exuberance and the collapse of many American firms around 2000.

At the moment, some people are talking about shareholders having all the power: a famous American lawyer recently called it “the age of the imperial shareholder”, who is in a position to disrupt business, who does not understand the strategy of the managers, who loves short-termism, who looks at the quarterly results and nothing else and who incites managers to take too many risks. The shareholder has turned into somebody active. The activist shareholder is very often not an individual person, but a hedge fund who at various occasions pinches the chief executive officer and the board. One of my cartoons shows a devil—the chief executive—and more or less innocent saints torturing the poor devil through their shareholder activism. Well, if they are powerful enough, they will force the managers to restructure by persuasion, by threat and sometimes by some sort of legal force. German-speaking people experienced the wonderful drama or tragedy of hedge funds bringing down the powerful chairman of the German stock exchange two years ago. They push for influence on the board; they vigorously demand higher yields,

higher dividends, buy-backs of shares and little cash reserves, or—to put it differently—highly leveraged balance sheets.

In addition to this, there are simpler modes, more forceful perhaps, more blunt. The simple rise and fall of stock prices has always been a disciplining measure. Those of you who have read *Barbarians at the Gate* will remember that the fall of the stock price of Nabisco was the very beginning of the whole tragedy. The threat of hostile takeovers has changed corporate life and actual takeovers make an enormous change. Taken altogether, the increased pressure on boards makes transfer of control of firms easier and thereby improves allocation of assets.

In practice, we observe two different types of takeovers. Most of you know them. Recently, the day before yesterday, I think, the Australian conglomerate Wesfarmers acquired Coles, a retailer. Wesfarmers together with Coles will now be the largest Australian retailer. Germany and Austria are still seeing the repercussions of the Italian bank UniCredit acquiring the largest Bavarian bank and the largest Austrian bank two years ago. Restructuring in these cases sometimes might be the result of former poor management, but very often it is not; very often it is just a result of an attempt to get hold of all the synergies involved.

A different story is told by financial takeovers. They are now at the forefront of our attention. The bidder is a financial institution; the target usually does not like to have too many debts. Well, sometimes if you look at the bottom line, it is near bankruptcy. But the normal situation is that they are very soundly financed, have a large share of equity (unfortunately, because of little debt, little leverage and a low return on equity) and usually they have some poorly performing divisions or poorly performing assets. For example, they enjoy the luxury of owning the premises where they sell things to the public or where they produce things rather than leasing them.

Who are the private equity firms? Now they are household words. Twenty years ago only very few people knew them in Europe: KKR Blackstone. They raise money, originally more from wealthy people and private investors, but increasingly from institutional investors like pension funds. What fun it is to see universities who are very risk-prone and very efficient in making a lot of money from their donations—unfortunately only in the United States. I think Yale got around 14 per cent over the last decade; my university got around 3.5 per cent. So we might as well have a savings account. When we take a very brief look at their organization, we have to distinguish between the fund which is owned by the investors and the fund which is owned by the managers. And to be a manager is a good thing to do. My son recently turned from a well-paid journalist with the *Financial Times* into a manager. When I asked him, “How much will you earn?”, he said, quite correctly, “That depends.”

Well, on what does it depend? It depends on how much assets they have under management; that would be 2 per cent. So the larger the sum of the assets per year is, the better the fee of the managers. But if they are profitable, it can be 20 per cent of the profits, sometimes 20 per cent above a certain threshold. It depends on the market situation. However you put it, there is a very strong incentive to risk something—other people’s money. And usually the main impediment not to risk too much is the loss of reputation and the loss of

incoming capital. The day before the weekend there was a nice article in the *Financial Times* talking about Lazarus resurrecting after dying. Well, that Lazarus was put out of action by the financial market authorities in England and then resurrected in Geneva, applauded by his former investors. So you may even resurrect in this wonderful world of private equity.

By philosophy, but also because the market plays along for a couple of years, a high portion of the finance necessary is financed by debt; and for some time we have had very liquid credit facilities, very low interest. But increasingly the question being asked is whether this situation is sustainable. We usually have all-cash deals in this group of private equity takeovers, while in the typical industrial takeover we usually have at least a share portion of share deals, exchange of deals. We have very aggressive restructuring after the acquisition, and we usually have exit after three, four, five or eight years via an initial public offering or a resale to another investor or a resale to a competitor or somebody who can make good use of the firm—a trade sale.

There is an increasing and very strong discussion about the pros and cons. Some of the pros are enumerated here; one, for example, is that going private allows long-term policy. About half a year ago there was a *Business Week* edition, I think it was called “Gluttons at the Gate” instead of “Barbarians”, showing that the resale was carried out three months after the acquisition. So that is not quite exactly what you would call “long term”. But sometimes there is a long term—five, six or seven years.

A record of increasing efficiency, adding value and, it is argued, at least in the long term, increasing employment: if you look at the literature of economists, the evidence is not clear. Actually, in none of the arguments—pro or con—is the evidence clear. We know the cons: they depend too much on debt; the leverage is too high to be sustained; low equity finance results in unstable finances; they are bankruptcy prone; and aggressive restructuring and cost-cutting without regard for all sorts of vested interests, like sudden sale of assets, closing of factory and sites with no regard for employees and for the region where the sites are, and sacking of employees, disrupting all sorts of relationships with suppliers and outlets.

You could sum it up thus: little accountability to stakeholders. Why is this? Stakeholders, different from shareholders, usually have no clear legal title to defend their interest. And you could argue that is for good reason. I do not take sides. Why? Because public opinion for a long time went along with it, increasingly critical, increasingly with political resistance. In Austria, it is funny to see that the same people who about a year ago were very much in favour of Austrian local shareholders had to defend themselves against those shareholders which sold out to private equity. Increasingly, at least in some European countries, there is economic pressure against restructuring; even in peaceful countries, workers at least consider seriously going on strikes, and people and the legal community think about enforcing the legal instruments of stakeholder protection.

What should be done? Well, the first message which I want to get across is that in general, I think, governments should not be allowed to stop takeovers. In so far as we consider public interest at stake, it should be protected by law and clear-cut legal rules, rather than interference with the parties administering the law. I have been at this job for three and a half years, and I have been very surprised by the pressure occasionally being put on the Commission. One of the targets which is important for efficient capital markets,

I think, is the protection of minority shareholders, in particular in small countries, because our capital markets rely very much on credibility vis-à-vis institutional foreign investment. In my opinion, due to a fact which you can explain more with political science theory, the tax situation urgently needs reconsideration. It is very funny how in various countries big money gets tax breaks under various legal constructions. When I recently talked about the issue in Austria, some people told me, well, we do not have tax relief for them. In actuality, a private equity group that is still organized as a sort of foundation—something between a foundation and a trust—gets a deferral of its tax debt up to 100 years. So if you discount it properly, it is something like between 0.3 and 0.6, depending on the rate of interest which you use.

But that is not enough. Very often the buyer can put on his balance sheet goodwill which he depreciates in Austria within 15 years. In comparison to me as a private shareholder, who sells his share at least within one year, I would have to pay taxes; I only get a tax relief if I really have had the share for some time and do not make any business out of it. They pay. The shareholder selling does not pay anything; the private equity owner who earns money and goes for the initial public offering or for the trade sale and the firm acquiring gets an additional tax relief by depreciating the good will. Around two weeks ago the leading practitioner journal *Der Betriebs-Berater* had a first-page article and an editorial asking for clear-cut tax relief for private equity investments. Now things have changed. Now the argument goes, “They must pay taxes at least like their cleaning women”.

A fair distribution of social cost: in particular in small countries, you see the social security cost at work. I have been on the board of a firm which went together in a friendly takeover with a German firm, and of course we raised some synergies by closing down factories somewhere. Guess where we closed down the factories? For example, in Belgium: about 1,200 people became redundant and the Belgian social security system had to pay for the redundancies. This is, I think, a gap in the situation and at least Europe should try to solve it. It is not economic efficiency. If somebody wants to increase the protection of employees, then it should be done by law rather than by strikes.

I have said that there has been a change in public opinion on tax law and during the past weeks there has been a surprising development. About a year ago, it was considered—at least outside Luxembourg, France and Belgium—almost in bad taste to try to prevent or speak against Mittal’s taking over Arcelor. Now, the German Government is strongly pushing forward an agency for control at least of the acquisition of shares by State-funded investors. Now if you look closely at the end of the reports, it always says “but it should be extended to other undesired foreign investors”. A week ago the statement was made by the German Chancellor. Pressure to increase transparency was also put forward by Germany, and recently I read that Blair and Bush were just able to prevent it. The argument I think is not too far-fetched. Collapse could be a danger for the system as a whole, and if you look at the situation, the last issue of *The Economist* had a wonderful picture: private equity was depicted by a Wall Street guy, standing with one foot on the top of a sharp mountain and the other foot in the air. And on the same date, White and Case published a study claiming that about 60 per cent of the top mergers and acquisitions lawyers they asked consider the present-day condition as unsustainable. So perhaps within a year from now, the pressure for restructuring coming from private equity funds will have diminished because the credits are no longer available as they are available today.

#### 4. *Comments, evaluation and discussion*

*Andrés Ortiz*  
*University of Guayaquil, Ecuador*

I have two questions. I would like to know who invented or where the idea of social interest and corporate interest came from. In the last 10 years, in Europe and the United States, the idea is to maximize shares but with social accountability; in other words, create value for the shareholder but with social accountability. This is what has reached us in Latin America and I think all three panellists referred to this. But I would like to know whether the major scandals that broke out with respect to corporate governance have actually happened in the United States and Europe? You have not had them in Latin America. You have not had them in Africa. But I am wondering whether this idea of maximizing shareholder value is not what is giving rise to greater emphasis on corporate governance, for instance because a feeling developed that something had to be done in order to curb the excesses of the maximizing shareholders value.

*Seward M. Cooper*  
*Chief Counsel, Good Governance, Office of the General Counsel, African Development Bank*

I think that the question is very pertinent. It relates to the whole notion of corporate social responsibility and where that is emerging. I am not sure it is accurate to say that corporate scandals have not happened in Africa. I know for a fact that in financial circles in some African countries, because of related-party transactions, there have been serious bank failures. So, in terms of corporate governance from that perspective, bad corporate governance has happened in certain other parts of the world as well. But then the whole idea of corporate social responsibility is related. Corporate governance is not narrowed to the financial control and the finances of the corporation. But corporate governance also is concerned about massive corruption, imposed or used by corporations. We have seen corporate corruption in Europe—the effect of what happened with Siemens. We have seen it in African countries, in Lesotho for example, with Lahmeyer in the Lesotho Highlands water project, where there were payments of bribes. All these tend to undermine the effective use of corporate resources or resources provided for development. Environmental degradation, labour rights and all of that relate to corporate governance, corporate social responsibility. So within that context, I think it is appropriate to say it is not an isolated occurrence. The impact is felt not necessarily within the borders in which the corporation is incorporated, but may extend far beyond to places where it does business.

*Kathryn Gordon*  
*Senior Economist, Investment Division, Organisation for Economic Co-operation and Development*

I would like to confirm Seward Cooper's response about the alleged absence of corporate governance scandals in Africa. That was one of the regions cited. What is definitely true is that, based on our study of what happened in the natural resources sector

of the Democratic Republic of the Congo, there were corporate government scandals that took place; they took different forms than the ones we saw in the United States and in Europe. And basically the corporate governance story being told in the minerals sector of the Democratic Republic of the Congo prior—we are not necessarily talking about the current situation in the Democratic Republic of the Congo—is largely an assets stripping story which is also a corporate governance story. It is a story about related-party transactions; it is a story about the complete absence of a workable governance framework for the state-owned enterprises that were and to some extent still are at the heart of the Democratic Republic of the Congo's extractive sector. So it is not true to say there were not scandals. They just took a different form.

Part of the tone of the comment there was that we have OECD, rich-country kind of corporate governance standards that are not working. It is true that we have had several standards coming out of OECD; our second version of the OECD Corporate Governance Principles was specifically designed to respond to the scandals we observed in our own countries. But what is also interesting to reflect on is the fact that there are alternative corporate governance models that are emerging. There is not just the OECD standard, which is of course an extremely influential model, but Seward mentioned the King II report, which is an extremely influential South African standard that is closely linked with the Johannesburg Stock Exchange, and that is interesting in the sense that it represents a very progressive model. I hope I will not be getting myself into trouble by saying that relative to the OECD Corporate Governance Principles it represents a much more comprehensive view of corporate responsibility; it integrates aspects of sustainable development etc. So we have these different models that are emerging in different regions of the world and I am sure, I do not say this at all to produce a warm fuzzy feeling in the room, I do think there is significant scope for OECD to learn from the African experience in this area, and vice versa.

*Peter Doralt*

*Takeover Commission, Austria*

It is hard to answer a question of such complexity in one minute. I have been told by my friends in economics that in emerging countries you might start out with privatization with a totally dispersed ownership, but for some reason or another, not very nice reasons, usually after a couple of years you find yourself with a strong core shareholder and minority shareholders which usually do not have an awfully happy life. If they come from outside the country, gradually things change. How does the foreign capitalist react? Well, I tell you, when Austria privatized, and Austria was a very wealthy and well-organized country then, in the early 1980s, in large parts of its nationalized industry the price-earning ratio was three and a half, or to put it easier for a layman, the Government sold the shares for the profits of three and a half years. So, the steel company earned, say, 110 in three and a half years; that was the price for the share. That was extremely inexpensive. Now, 15 years later, the price is at about a 20-22 price-earning ratio, that is, sevenfold the other. Now when you look at Russia, usually the price-earning ratio is very low, or put differently, investors do not rely on the correctness of the local capital market; they are afraid of being expropriated or skimmed off. You must be aware therefore that as long as you do not have proper gatekeepers, proper corporate governance, you will

have very expensive capital. I was educated 12 years of my life in Catholic schools, and I still take it seriously; therefore I am a gatekeeper and not a practising lawyer. Generally speaking, people who talk about corporate social responsibility usually should have in their logo a fig leaf.

*Philip Newman*

*Chambers of Philip Newman, London, United Kingdom of Great Britain and Northern Ireland*

In the United Kingdom, the role of non-executive directors (having legal duties) is a key element within good corporate governance. I perceived something, and I would appreciate any comments from the panel members on it: companies need good-quality individuals as non-executives who are truly independent. But companies want, as you see from the adverts in the *Financial Times*, individuals who are entrenched insiders within the industries or spheres of activity, presumably to obtain commercial advantage. How does one fix in any way, if one can, that friction between the want and the need?

*Seward M. Cooper*

*Chief Counsel, Good Governance, Office of the General Counsel, African Development Bank*

Let me say that I assume you are talking about publicly listed corporations. The reason I thought so is because smaller, closely held, family-owned corporations are not likely to be looking for independent, non-executive external directors. It is not often, it might happen, but I do not think it is the norm for such corporations. In some jurisdictions where there are publicly listed corporations, it is statutorily required that there must be an independent non-executive director. For example, with audit boards, audit committees of the boards, there have been laws passed requiring non-executive independent board members on the audit committee. So usually it is in response to legislation; but my colleagues might have some other thoughts.

*Kathryn Gordon*

*Senior Economist, Investment Division, Organisation for Economic Co-operation and Development*

Very quickly, during our preparatory work for the Weak Governance Zones Tool, we did a study of who exactly were non-executive directors on the boards of investors and major oil companies in the Democratic Republic of the Congo. And there I have to admit, I do not know if your statement is empirically based or anecdotal, but it is true that for the major (that is, very large) companies that were operating there, the typical profile for at least one non-executive director is that they would have one person who could vouch for the broad ethical quality of the board. So in the case of one major British company, it would have been someone who was the director of the Bank of England; there was a well-known clergyman in one of the American majors. It was the sort of person whose presence there speaks for the high moral tone of the board. So we did not exactly come up with the same finding as you did.

## D. Round table: Developing effective and efficient insolvency regimes

*Chair: Wisit Wisitsora-At*

*Director-General, Office of Justice Affairs, Ministry of Justice, Thailand*

Good afternoon, ladies and gentlemen. They put the bankruptcy panel as the last one of the day, because we normally come last when businesses go bust.

Let me tell you something about the bankruptcy projects in UNCITRAL over the last 15 years. My recollection is that when we proposed doing work on bankruptcy laws, there was a tendency to consider such a project somewhat impossible. Bankruptcy law seemed to be something which was involved too much with social issues, with social values, and involved too much with the judiciary, where they have rather wide discretion. But UNCITRAL was not stopped by those considerations and pursued the project on bankruptcy. The first project produced the UNCITRAL Model Law on Cross-Border Insolvency and later on we came up with the *UNCITRAL Legislative Guide on Insolvency Law*. Those two products are now in use and have become part of the insolvency world.

UNCITRAL Working Group V has not stopped there. The mandate was given to Working Group V to consider the topic of corporate groups in insolvency and related open-ended issues. The topic that we are going to discuss not only tests the products that UNCITRAL has already given the world, but also seeks input from the panel, and from participants, to the current work of Working Group V and also of the Commission for the future.

We have a panel which I am very proud to introduce—we come from many different parts of the world. I will start off with the introduction of the panellists, if I may, and then, with the help of our facilitator, Mr. Neil Cooper, we will go on with the discussion of the hypothetical question.

On my right is Dr. Irit Mevorach; she is Lecturer in Law at the School of Law of the University of Nottingham. She was a legal practitioner in Israel, has a doctorate degree from London University and was adviser to the delegation of the United Kingdom at UNCITRAL Working Group V.

On my left is Mr. Sumant Batra, from India. He is now working as a partner with Kesar Dass B and Associates, India, and is the vice-president of INSOL International, the very well-known organization, helping UNCITRAL with the work on insolvency.

On the far left, we have Dr. Eva Hüpkes, who is currently working with the Swiss Federal Banking Commission. She has legal experience with the Legal Department of IMF and has been giving a lot of advice on banking law to IMF.

On the far left, at the podium, the last person that I will introduce is Mr. Neil Cooper. He is a past president of INSOL International, and has been involved with UNCITRAL work since 1993—he has become like a grandfather to the work of UNCITRAL. He worked with UNCITRAL on the Global Symposium on Insolvency Law in 2000 and 2005

and, since 1997, on the UNCITRAL/INSOL multinational judicial colloquiums. What I would suggest is that we pass the responsibility to our facilitator. Mr. Cooper, you have the floor.

*1. Discussion of a hypothetical reorganization of a cross-border corporate conglomerate that includes insurance and financial institutions whose restructuring will involve secured transactions and conflicts of laws issues: how are these issues currently treated; what major problems exist; and what further work on harmonization would assist in achieving effective and efficient insolvency regimes?*

Speakers:

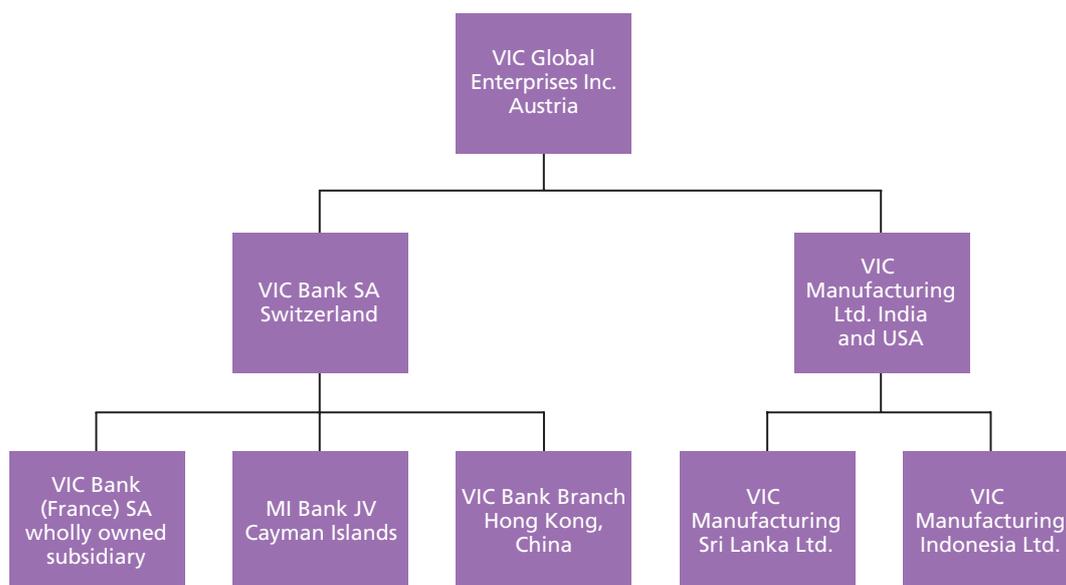
*Sumant Batra, Kesar Dass B and Associates, India*

*Neil Cooper, Kroll, United Kingdom of Great Britain and Northern Ireland*

*Eva Hüpkas, Swiss Federal Banking Commission, Switzerland*

*Irit Mevorach, Lecturer, School of Law, University of Nottingham, United Kingdom of Great Britain and Northern Ireland*

### VIC Bank Hypothetical



*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

We are here to listen to the sad story of the VIC Group. The VIC Group is undercapitalized. You can think of this discussion today as the meeting of creditors if you like, although in truth I suspect that we are all debtors to the work of UNCITRAL in particular. The VIC Group comprises, as you will see on the slide, two subgroups—the banking subgroup and the manufacturing subgroup. There was some inter-group dealing, but the extent of it is not known at this stage. The manufacturing side is headed by VIC Manufacturing Ltd., which has head offices in both the United States of America and India. This is not at all unusual

these days. Components for the VIC machine, which is world-renowned, are manufactured in both of those countries, and by their subsidiaries in Sri Lanka and Indonesia.

The Group is worth a considerable amount if it is able to be rescued or sold as a going concern, but it is highly unlikely that a purchaser would want to buy individual bits of it. There may be some exceptions; we will hear about those. And we know now that we need urgent advice. So, first of all: Irit, can you tell me, is this a case of one group or of multiple companies that will each need a solution to their problem?

*Irit Mevorach*

*Lecturer, University of Nottingham, United Kingdom of Great Britain and Northern Ireland*

The crucial question here is how this Group—I refer to the manufacturing subgroup on the slide—how this group was operating before it entered into the insolvency situation, whether it was actually a single enterprise or whether it was only a bundle of separate entities—like a pure conglomerate working in different industries and so forth. The ideal practice would then be, when we consider appropriate insolvency solutions, to imitate or replicate the way the Group was handled when it was solvent. Of course, if fraud was involved, you would not want to imitate that, but if the Group was living as a unified business undertaking it should die or be reorganized or administered as such.

However, we do not want to do any more than that. That is, we would not want to pool assets and debts together if separateness between the entities was kept in the ordinary course of business. But we also do not want to do any less than that. We would not want to have separate insolvency proceedings handled in complete isolation, as this was not the way the Group was managed before its financial difficulties.

I will assume that the separateness between the entities comprising the manufacturing group was kept, that there were separate accounts and that it is possible to identify the assets and debts belonging to each of the entities.

We can also identify significant linkages between the entities comprising this Group, which suggest that this Group is an integrated one. Essentially, this would be because the manufacturing took place in a complementary fashion, and therefore these entities were coordinated via the two centres in the United States and India. And those two headquarters were also coordinated. In addition, there was high interdependence between the entities operationally, as they all took part in the greater process. In the case of an integrated group, a unified solution can increase the revenues available for distribution to the various stakeholders and enable a global solution to take place (such as a global sale of these assets). Since the whole is worth more than its parts in this case, this will be beneficial for the stakeholders of this Group as a whole. It will also reduce costs if we have one representative for the entire Group, or subgroup, or several representatives working in close cooperation. This will facilitate cooperation, communication and delivery of information regarding the various affiliates. So, coordination and cooperation will enhance cost-efficiency.

But what most likely happened in this case is that these sorts of cooperation systems were not available, as most of these jurisdictions involved in our case do not have a developed law of cross-border insolvency. We also lack an accepted notion of a global multinational corporate group. Therefore, separate proceedings of different sorts were

opened at different times by different creditors against these various entities. Let us assume that, first of all, insolvency was opened against the Indonesian company in Indonesia by creditors in Indonesia, but also in the United States by a United States creditor against the same entity because the head office was in the United States, and then, as a result of the domino effect, other entities fell into insolvency. Liquidation was opened in Sri Lanka and then restructuring in India and also Chapter 11 in the United States against the parent company and perhaps also insolvency proceedings in another country where the parent company was incorporated, say Bermuda. So what we have is actually multiple proceedings and no cooperation, at least at this stage, and—if this situation continues—we will have increased costs, and devising a global solution or a package sale will probably be impossible.

*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

You put your finger on it just a minute ago because you said, “the way in which to get the most value”. Even where you have separate proceedings taking place across the world, there are ways in which the value can be preserved and, equally, destroyed. So that, for example, when the KPN Quest organization failed, you ended up with the French company being wound up under French law, the Belgian company being wound up under Belgian law, the Dutch company ... I could go on, but you get the picture. So, all around Europe you had separate proceedings relating to this telecoms group, which weeks before had been worth hundreds of millions of dollars. But because no-one coordinated the proceedings, that value was lost. Because bits of a telephone system are of very little use: it is like owning the only telephone in the world. With the VIC Group, having got to the point where you have different proceedings starting in different countries, is it possible to have a unified process, that is to say, a global sale, or a global reorganization? Is that necessarily the best for the creditors of all the subsidiaries?

*Irit Mevorach*

*Lecturer, University of Nottingham, United Kingdom of Great Britain and Northern Ireland*

This is a very important question, because I mentioned elements of cost-efficiency and I have said that the whole is worth more than its parts. Therefore, it will be more beneficial for the stakeholders as a whole to have such a global solution, but we should be cautious. We should bear in mind the various corporate structures and potential scenarios and the fact that life can be more complicated. Just for a single company, we have different creditors that may have different interests; even more so in the case of a corporate group, where we have different creditors belonging to different entities that may have different interests. And let us assume that this was the case here. For instance, the Indonesian company—its components could be sold on a stand-alone basis. They had an alternative. And indeed a local purchaser approached the representative of the Indonesian subsidiary and offered to purchase the components of the Indonesian subsidiary for a reasonable price. But for the rest of the entities their components are worthless as stand-alone. And indeed the United States representative is actually negotiating a deal with a potential purchaser that wants to buy the entire operation, and asks whether this is at all possible. The question is: what can we do? What should we do if the Indonesian subsidiary prefers to go for the local deal? I think we need to strike a balance between enterprise considerations and entity law, the need to respect the corporate form. I think that if we have an integrated group, then we should

be able to assess what is best for the stakeholders as a whole. On the other hand, we may need to think about giving some discretion to courts or equip them with compensation mechanisms so that if creditors of particular subsidiaries were harmed from such a global sale, it would be possible to compensate them but still go for the global solution.

*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

And that is the answer. One way or another, we have to find mechanisms which respect the interests that creditors have in the particular company which owes them money, while at the same time developing mechanisms whereby the value of the whole can be preserved. We did this last year with the sale of the Collins and Aikman Group in Europe, where we had, I think, 23 manufacturing plants in 14 countries with about 25,000 employees. When the group was sold, it was necessary to work out which of the creditors would have got what amount from each of those individual proceedings in order to do the total deal. But the total deal was still done for far more money and the employment was preserved as against dealing with individual proceedings. You see, groups of companies are the economic reality. If you think about everything on your desk—your watch, your Blackberry, your briefcase—these are all typically made by multinational groups of companies, and these can collapse, the same as VIC, but probably not for the same reasons. So Irit, would it be beneficial to concentrate the proceedings against the Group in a single jurisdiction, and who should take control of this?

*Irit Mevorach*

*Lecturer, University of Nottingham, United Kingdom of Great Britain and Northern Ireland*

The short answer, the starting point is, yes. One proceeding is better than multiple proceedings. If the group was integrated, especially if it was centrally controlled, we could have one or two insolvency proceedings—main insolvency proceedings—taking place in the centre or centres of the group instead of having multiple proceedings (five or more in this case) against each entity and sometimes even several proceedings against the same entity. Consider the position with respect to the parent company of the VIC Group—proceedings took place in the United States, in Bermuda and in India. So, yes, concentration is a good thing, because we can have fewer proceedings and it will be easier to communicate and to deliver information regarding the parties. We can also subject the concentrated process to a single regime, a single set of laws, and this would make it easier to resolve disputes. But I would also say that we should again remember the diversified nature of multinational corporate group structures. We can think, for instance, of a situation where the group was significantly decentralized or the particular subsidiary was significantly autonomous with an independent management, local contracts and local creditors. It actually might be the case that most of the creditors who dealt with this subsidiary were not aware of the group operation. Cost-efficiency may suggest that we should have a local process, but this may still be supervised or subjected or work in close cooperation with the centralized process, if this group was integrated, so that we can achieve maximum cooperation.

*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

There is a new term of art that has entered the English language, and that is “COMI”, which stands for “centre of main interests”. This phrase was first adopted by those people

negotiating what was then the European Bankruptcy Convention, which became the European Insolvency Regulation. And it found its way into the UNCITRAL Model Law on Cross-Border Insolvency. And COMI is essential. Irit, do you think it is possible from what we know so far that you can determine where the COMI of the VIC Group is?

*Irit Mevorach*

*Lecturer, University of Nottingham, United Kingdom of Great Britain and Northern Ireland*

The COMI of a group is not an easy concept, because it is a group, a bundle of separate entities, each of them with their own COMI or own company domicile or centre of main interests. On top of that, each of the jurisdictions may have a different way of understanding what constitutes a company domicile. It can be based on the real seat or the place of incorporation or the place of central business, main assets or any other test. In the context of groups, the question is whether we can identify a group COMI or a group domicile. We can consider different connecting factors as a basis for jurisdiction. For instance, the place of incorporation that I mentioned is not a very helpful connecting factor for a group, because the group is not incorporated as such in a particular jurisdiction; each entity is incorporated in a different place. We could say that we should have the proceedings being handled in the place of incorporation of the parent company. But this can actually be a place with no real connection to the group as a whole, as we have in this case—it was Bermuda, with no real workforce or activities whatsoever. We can think about another connecting factor: the head office criterion—the place where the head office is located. This can be helpful in most scenarios, because normally in an integrated group the head office will be the meeting point—the head and brains—of the integrated group. But again we should remember that we have different structures of corporate groups; in this case we have two head offices, in the United States and in India. Maybe we can identify one of those places as the centre of gravity of the entire group, one place where the main decision-making was taking place, where major creditors had their dealings or where most of the contracts were concluded and had the law of that place as their governing law, and so on and so forth. But if this is not the case, if we actually have two centres, then it might be more sensible to have two principal proceedings working in coordination with each other. Perhaps the rule of thumb is again to imitate or replicate the way the group was handled before the commencement of insolvency proceedings. If the group is not centrally controlled by one centre, but rather by two centres working in coordination, then that should be the way forward in the context of insolvency as well.

*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

At the minute, this Group is in the process of failing, but it turns out that they have not started insolvency proceedings in all of the jurisdictions. Does that complicate things at all?

*Irit Mevorach*

*Lecturer, University of Nottingham, United Kingdom of Great Britain and Northern Ireland*

Of course this is a further complication, and a very realistic one because we are dealing with a group and different creditors may open proceedings at different times against the various entities. Earlier I said that initially creditors in Indonesia opened proceedings against the Indonesian subsidiary and only then did other entities fall into an insolvency

procedure of some sort. This makes it much more complicated for a court to consider a global solution or to establish cooperation at the outset of insolvency. For instance, the Indonesian court considering the petition of the Indonesian creditors may have not been aware of the group situation—the relationship of this subsidiary to the rest of the group. Perhaps you could think here about rules of evidence requiring group members that are subject to insolvency proceedings to give information regarding their relationship with affiliated companies within the group. This could facilitate the possibility of devising unified solutions or appropriate economic solutions on a group scale at an early stage.

*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

We have to hope that the UNCITRAL Working Group on Insolvency Law, which is currently working on the insolvency of groups of companies, makes some progress shortly, because it sounds as though we need it.

As we have learned, the VIC Group has effectively two head offices. The news has just come through that they have filed for protection under Chapter 11 in the United States, and in India the directors have been advised to seek the protection of the Indian court. We are told that there is considerable value in this Group, but a purchaser is not likely to wish to acquire less than most of it. So it is quite clear that we are going to need some degree of judicial cooperation between these two courts and maybe even a protocol. Sumant, what would you advise here? What action should be taken and by whom? Are there any models being developed that would assist the protagonists in this case?

*Sumant Batra*

*Kesar Dass B and Associates, India*

In India you could actually have two extreme situations. In the first situation, if all the creditors including the local creditors agree, and the regulators do not object, and labour does not cause problems, it may be possible to sell the entity to a buyer who is proposing to buy the whole Group. That would perhaps be independent of any direction that may be given by the court in the United States under Chapter 11 proceedings. So it is possible and it could be straightforward, but it all depends on the cooperation of these local stakeholders. However, if you are hoping that there would be the possibility of a sale, based on an order passed in a jurisdiction outside India, it would be a non-starter altogether. One of the reasons for that, as most of those who have been keeping track of developments in India in the recent past would be aware, is that the insolvency law unfortunately has not really kept pace with international developments, although of course a lot is being done at the moment and is expected to be done. So the law is a bit outdated and at the moment it does not really support any kind of international cooperation as far as insolvency is concerned. Although I must add that there are provisions which exist in the general law which enable the courts in India to recognize the decisions of courts overseas based on reciprocity and the treaties that may have been entered between India and the other nation. At the moment, such a treaty exists with less than 20 nations, most of them, for historical reasons, being Commonwealth countries.

So if a Chapter 11 proceeding starts in the United States, it is going to be absolutely of no significance as far as the Indian courts are concerned. At the same time, there is a

recognition in Indian judicial circles that with globalization there will be a need, in times to come, to develop tools and techniques for cooperation so that this kind of eventuality can be resolved happily for all the parties concerned. But I guess we need to make a lot of progress in that. The biggest dilemma for the policymakers is that at the moment they are struggling with the first-generation insolvency reforms, that is, the domestic reforms—domestic insolvency law reform. And there is sometimes the belief that if they start considering second-generation reform, which is what they perceive cross-border cooperation in insolvency to be, there might be some criticism from within the political establishment to the effect that having not put your own house in order, why take the second step forward. There is also another concern which arises perhaps more from a lack of understanding of the way cross-border cooperation in insolvency works, which is whether Indian companies, or the Indian creditors, would be placed in a disadvantageous position as against those which are based outside India. But there is a definite need, not just in India but in the South Asia region as a whole, where in fact if there were two manufacturing units, they would be located in India and Sri Lanka. As far as I understand it, the situation in Indonesia is no different. So a lot needs to be done to develop cooperation, perhaps by first taking some baby steps. The recommendation at the highest level by the experts in this region is to look at the UNCITRAL Model Law on Cross-Border Insolvency straight away, and not link it to the progress with domestic law reform. Both processes can carry on simultaneously. But it may take a little more time for countries to mature to that level. In the meantime, there is a definite appetite for some form of cooperation mechanism and the market is ready to accept whatever international standards and means and tools can be introduced to provide a balanced approach and not place any particular country system or stakeholder at a disadvantage. That is where organizations such as UNCITRAL, INSOL International and other bodies playing similar kinds of roles can play an active role in discussing with the policymakers how to fill in this gap.

*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

Fortunately, the judges from India and the judges from the United States that are charged with this met very recently at the UNCITRAL-INSOL Judicial Colloquium and although they did not know that they were talking about the same case, they both agreed that judicial cooperation was a good thing. Now, because the United States has adopted the UNCITRAL Model Law on Cross-Border Insolvency, Chapter 15, there are opportunities for the person that the Indian court appoints to administer the case to go seek recognition in the United States. Additionally, a group of judges are currently discussing cross-border insolvency protocols. This work was commenced by UNCITRAL in November last year to give courts guidance as to how cross-border protocols might be used and what they should include in the future. The importance of this is that, when you are doing a restructuring, time is not on your side and anything that can accelerate the process is a good thing. So, there is hope that although the VIC Group has these two head offices, we may be able to get some dialogue going between the two proceedings.

Wisit, it is quite clear that at least one of these countries needs a complete reform of its insolvency law. Does the *UNCITRAL Legislative Guide on Insolvency Law* provide any assistance there? Is it of use to a developing nation?

*Wisit Wisitsora-At, Chair*

When I mentioned the products of UNCITRAL, I said that there were two products: one is the Model Law on Cross-Border Insolvency and the other is the *Legislative Guide on Insolvency Law*. The Guide actually incorporates the Model Law and proposes it as a good law to use. I think the Guide provides the standard for benchmarking insolvency law. But I would recommend that the insolvency system does not stop at the law; it should also include institutions, and institutional capacity-building is very important. Coordination between the parties concerned is also very important. I think those organizations concerned with global assistance should assist each country to develop a good law by using the Guide and to improve the capacity of the judiciary to participate.

*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

We now turn our concentration to the other side of this Group. You need to pay attention to this, because like all things associated with banking, it is complicated. On the banking side, the operations of Swiss VIC Bank S.A. span quite a number of jurisdictions. A number of the back-office functions have been outsourced to the Hong Kong bank. The French subsidiary bank was set up to benefit from the single-licence regime and conduct business across the European Union. All payment operations, including those of the Swiss parent, are conducted through the subsidiary. However, client relations, you will not be surprised to learn, are handled by the Swiss parent. Therefore, and this is actually quite usual, neither the French subsidiary nor the Swiss parent, can operate on a stand-alone basis. The second fact which is not surprising is that the Swiss Federal Banking Commission (SFBC) is no longer satisfied with the ownership structure. Well, it would not be. The parent company is threatened with insolvency. So it has received an order that the VIC Bank should find a new shareholder and, to ensure that there is no deterioration of the financial situation to the detriment of the Swiss creditors, it appointed an administrator. The French regulator asks the Swiss parent to recapitalize the subsidiary. I can imagine this happening, letters going backwards and forwards. Because it is based on the letter of comfort that the Swiss parent has given the French subsidiary, the request is denied on the basis that it will weaken the position of the Swiss creditors. Meanwhile, the Hong Kong bank regulator has imposed some restrictions. And since a new strong shareholder cannot be found, SFBC has started reorganization proceedings. An administrator is appointed, and he oversees the operations of the bank for a while and elaborates a plan. This plan involves the imposition of haircuts, a marvellous euphemism, on both the creditors and the owners. But since the Swiss Bank has failed to recapitalize the French subsidiary, this subsidiary becomes the subject of bankruptcy proceedings in France. You can see the parts tumbling away in front of you. In insolvency, the French courts impose a stay on all operations, and this actually brings the reorganization attempts in Switzerland to a halt. SFBC finds that there is no prospect of reorganization, so it initiates bankruptcy proceedings. And then it acts as bankruptcy judge and the supervisory authority is responsible for the creditors committee. The liquidator is appointed by SFBC and that authority starts the administration. The French liquidator is now claiming assets located all over the place—Switzerland, Hong Kong and Cayman; and so is the Swiss liquidator. So we have a battle on our hands. Eva, will the Swiss system recognize the French bankruptcy and, if so, what is the result of this?

*Eva Hüpkes*  
*Swiss Federal Banking Commission, Switzerland*

SFBC, that is, the Swiss bank regulator, not only has the sole authority to act as bankruptcy authority, it also has the exclusive competence to recognize foreign bank bankruptcy decrees. A prerequisite for recognition is that there are assets or a branch located in Switzerland. The recognition is subject to a number of conditions: the decree must be enforceable; the recognition must not result in a violation of the Swiss *ordre publique*; and there must be reciprocity. In case of recognition, there will be liquidation proceedings in Switzerland and the creditors—domestic and foreign creditors—who have collateral in Switzerland will be paid as well as domestic and foreign creditors that enjoy a privilege under Swiss bankruptcy law. The remainder of the assets will be turned over to the foreign proceedings in France. The provisions governing the recognition of foreign bank bankruptcy decrees are found in the Swiss Banking Act; they came into force in July 2004. Given that this provision is still relatively young, there have been few decisions so far. One recent decision on recognition relates to AA Aktienbank in Germany. You can find the decision published on the SFBC website.

*Neil Cooper*  
*Kroll, United Kingdom of Great Britain and Northern Ireland*

The French bank customers, who are booked to the subsidiary in France, are a bit annoyed because they think that they are customers of a Swiss bank. Swiss banks, as we all know, never fail. They feel hard done by. However, the French creditor claims are not admitted since they are legally contracted with the French subsidiary. The Hong Kong bank creditors, by contrast, will be admitted. This does not seem fair.

*Eva Hüpkes*  
*Swiss Federal Banking Commission, Switzerland*

The treatment of the depositors depends on many factors. As you know, financial institutions in today's world are operated along business lines, cutting across legal entities and jurisdictional borders. Treasury functions, liquidity management, back-office functions or payment processing may be outsourced to another jurisdiction or centralized in one jurisdiction. For a number of factors, such as the tax regime or to save regulatory capital, assets may be located in one jurisdiction and booked in another jurisdiction. Intra-day exposures may be booked to a local subsidiary, whereas end-of-day net exposures, which may be more moderate, may then be booked to the foreign parent. Depending on when the curtain falls, and insolvency is declared, the situation for creditors may be very different. For that reason, and because financial groups are operated in an integrated fashion, regulators look at a financial group as one economic entity according to the concept of comprehensive consolidated supervision. But this concept applies only in good times. Good times are different from bad times. There is a mismatch between the global consolidated supervisory approach and the legal-entity-based standards applied in insolvency. So what about those creditors and depositors? It all depends on who their respective counterparty is. Depending on whether it is a subsidiary or a branch and where that subsidiary or branch is located, they will be treated differently. Some jurisdictions may treat a branch as a separate legal entity and place it in liquidation. The levels of deposit compensation differ among jurisdictions. Deposit compensation may not be extended to depositors at foreign branches. Some countries, such

as Australia, Switzerland and the United States, have depositor preference, so deposit claims rank with priority. In other jurisdictions, depositors may not enjoy priority treatment. So the depositor of the Hong Kong branch may be treated differently and not be paid the same amount as the depositor of the VIC Bank SA in Switzerland or the depositor of the VIC France SA.

*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

So now when we go to a bank we ought to make sure whether we are banking with a subsidiary or with a branch. That is the first bit of valuable advice we are getting. What about the prospect of a sale? It would seem as though there are parties who are interested in acquiring the VIC Bank Switzerland; it is a potentially valuable asset of VIC Global Enterprises Austria. Is the regulator going to have a say in who buys this if there is a chance of reorganization?

*Eva Hüpkas*

*Swiss Federal Banking Commission, Switzerland*

Yes, the regulator is going to have a say and may veto the transaction if the acquirer does not meet the “fit and proper” and solvency requirements. But there is not one regulator, there are several authorities involved. And regulators are accountable to the national legislators for protecting, first and foremost, the interests of the domestic financial system and the interests of the depositors in their jurisdiction. So they have an incentive to intervene early. In many jurisdictions, the regulator can already take action when an institution is still balance-sheet solvent, and, for instance, impose asset maintenance requirements to ensure that assets remain in the jurisdiction; take over the institution; appoint an administrator; and also agree to a sale of this still-operating, solvent but weak entity. A reorganization or sale in one jurisdiction of an entity belonging to a group of companies may be frustrated by bankruptcy actions in another jurisdiction.

*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

What we have learned is that if you want to take over a bank, it is like being the suitor for the hand of the daughter: the regulatory authority is going to want to make sure that the suitor is both solvent and appropriate—responsible (quite unlike the sorts of people that your daughter chooses). You mentioned the joint venture that we have in the Cayman Islands, a marginally irresponsible bank. There is a regulator there, but this is only a joint venture. Have they got the same authority over us?

*Eva Hüpkas*

*Swiss Federal Banking Commission, Switzerland*

According to the principles of consolidated supervision, there should be a clearly identifiable home regulator, who looks at the entity on a global basis, and then a host regulator, who looks at the local activities. When competencies are not clearly defined, there is a risk that early intervention will not happen, and that is probably what happened in our situation. More generally, there is a risk that the larger and the more complex a

financial group is, the more disorderly will be the wind-down, because we have regulated entities that may be subject to special insolvency regimes, and unregulated entities subject to general regimes. You have different priorities and different treatments of intra-group transactions. If we have a disorderly wind-down, there is a great risk that, if the institution is large, it will have a negative impact on the financial system and the economy as a whole. There may be contagion if an institution has a dominant position in a market and can no longer operate. For instance, if there is massive close-out netting, other market participants will suffer. The Government may be inclined, under those circumstances, to use taxpayers' moneys to bail out these financial institutions. The larger and more complex an institution is, the greater may be the expectation that the Government will step in and bail out the institution. This may create the perverse incentive for that institution to take on even more risk. This shows how important it is to have an effective and foreseeable insolvency framework. The absence of a credible bankruptcy procedure may undermine crisis prevention efforts. The challenges in the financial sector are formidable. With the emergence of more and more global financial institutions, regulators, central bankers and finance ministers are worried. There is a pressing need to address these issues. I believe that UNCITRAL can make an important contribution here. Other international forums are also involved in a stocktaking exercise to help regulators understand what the crisis resolution and the insolvency frameworks in critical home jurisdictions look like. Unfortunately, the UNCITRAL Model Law on Cross-Border Insolvency does not apply to financial institutions. But what principles should apply? Well, that is maybe something that in the next stage UNCITRAL may be looking at, in particular with respect to groups of companies.

*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

Of course the Model Law on Cross-Border Insolvency can apply if a nation chooses. We just expected that most nations would want to opt out with respect to banking. With your expertise, what is the prognosis for these four banking companies? What do you think is going to happen? Will the creditors get anything?

*Eva Hüpkes*

*Swiss Federal Banking Commission, Switzerland*

In the previous session we heard about private equity firms and hedge funds. If the markets are good and liquid, maybe then a hedge fund or a private equity firm or another investor or financial institution may step in. The banking operations of Switzerland may have some value. If these operations are closely integrated into operations in France and are liquidated separately, then value may be lost. So I can only underline what Irit said earlier—it is desirable to resolve a group in an integrated manner, if that group was operated in an integrated manner.

*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

Now Irit, we have seen that the companies in this Group are going to be subject to many different and probably conflicting laws. And those conflicts will have to be addressed in dealing with the very real problems that you face in sorting out a group such as this

hypothetical one. How far would uniform choice-of-law rules assist us in a case like this? Leading on from that, should we be looking for harmonization of laws or is that a dream too far?

*Irit Mevorach*

*Lecturer, University of Nottingham, United Kingdom of Great Britain and Northern Ireland*

Again, I suggest being cautious, at least a little bit, because choice-of-law issues go beyond establishing a framework to actually influencing what remedies will be used in a particular case. So it is not surprising that the UNCITRAL Model Law on Cross-Border Insolvency refrains from harmonizing choice-of-law rules, at this stage at least. Nevertheless, we should consider what would be the benefit of doing so. First of all, it is a matter of certainty and predictability. We want people dealing with companies and creditors to be able to assess what would be the law that would apply to the debtor if it becomes insolvent. Currently, jurisdictions have different private international law rules; perhaps the most common one is the law of the forum, the law of the jurisdiction in which the proceedings are taking place. But different jurisdictions have different sets of exceptions to these general rules, and this will defeat certainty, so having uniform choice-of-law rules will be of great help in this regard. Talking about cost-efficiency, I mentioned earlier that we would prefer to have the proceedings subjected to a single set of laws because it would make it easier to resolve disputes; it would make the life of the insolvency representative easier and therefore it would reduce liquidation expenses. So if we cannot have the same laws everywhere, the least we can do is to have uniform choice-of-law rules that direct us to a single set of laws, for instance, the law of the forum. So in the case of the VIC Group, if it is an integrated group and if it could be concentrated, then we can have it subjected to a single set of rules; for instance, here it could be the law of the United States or India. Indian law could be applied to this case. Otherwise, the creditors who have dealt with the Indian division could be very confused regarding the law that would apply to a transaction with, for instance, a Sri Lankan entity, or with several entities. It could be the Sri Lankan law or another law to which Sri Lankan laws will direct us. The result can be highly unpredictable. Harmonizing all aspects of insolvency can be a far-fetched idea, but if we want to have an effective, fair, reputable system of international insolvency, we may want jurisdictions to comply with some widely accepted notions regarding issues pertaining to the insolvency, so we can deal with various issues that may arise in the course of insolvency in a fair and efficient way, no matter where the proceedings are taking place or to which place a particular choice-of-law rule will direct us. And this idea can perhaps be promoted by using global mechanisms such as the *UNCITRAL Legislative Guide on Insolvency Law*.

*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

Sumant, anything to add to that? Harmonization? Is it a good idea?

*Sumant Batra*

*Kesar Dass B and Associates, India*

I do not disagree with Irit that there is certainly a level of challenge involved in achieving that kind of harmonization, but in my opinion a level of harmonization is no

longer a choice but a necessity and in fact an inevitable necessity, something that is absolutely unavoidable in a world where geographical borders are fast disappearing. Today, you pick up the phone to ask a question about what is wrong with your IBM laptop, and you do not know who you are speaking to, in a different part of the world, whether that person is sitting in Indonesia, India or Sri Lanka. And these structures could be much more complex than what you see on the slide here. I guess it is a matter of time before the market realizes that there is certainly a need—an urgent need—to address this issue. The second issue, I guess, is that the private sector has to come forward to play a very important role because it is one of the biggest stakeholders. They are the ones who are directly impacted and I think they should be driving the policymakers to some extent. Thirdly, very quickly, I do believe that some of the countries, especially the emerging nations, should act as a role model and I would include India in that. They need to set examples, irrespective of the state of their domestic law at the moment, and of course after having done something to bring them to par with international standards. This is an effort which needs to go on simultaneously. If the UNCITRAL Model Law on Cross-Border Insolvency is adopted by a nation such as India or China or some of the other emerging nations, I am sure that it will act as an inspiration for various other emerging nations. In particular, it will probably also foster cooperation among various other countries which trade with those emerging nations, have a huge investment at stake and would like to provide a level playing field. Fourthly, this is not going to happen tomorrow; we must recognize the reality that this would take some time, but in the meantime we need to continue our efforts through platforms such as the UNCITRAL-INSOL International-World Bank judicial colloquium and similar forums, which play a very important role in bringing the policymakers and the judiciary together and also providing some kind of thinking on how to resolve these issues integrally.

*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

We have used this little hypothetical, which as Sumant points out, is far more simplistic than real life will ever be, just to illustrate and talk about the UNCITRAL Model Law on Cross-Border Insolvency, the *UNCITRAL Legislative Guide on Insolvency Law*, the work that we are now doing in UNCITRAL on corporate groups, the judicial colloquiums, and the work on protocols. Wisit, can I ask you to finish off by considering where UNCITRAL Working Group V (Insolvency Law) that you chair should be going next?

\* \* \*

*Wisit Wisitsora-At, Chair*

I think today we have heard the needs which UNCITRAL has been taking up in order to find solutions. Working Group V is now considering corporate groups and I think that the idea is that it would be preferable to have proceedings with respect to the group as a whole or more coordination with respect to group members. The mandate for the Working Group is not limited only to the corporate group; the Commission has given a rather open-ended mandate so that if the Working Group decides to consider other matters, including for example, finance, it could perhaps be taken up. Perhaps, the Working Group may also consider issues associated with banking.

Although we have heard that the UNCITRAL Model Law on Cross-Border Insolvency itself does not actually per se exclude banking institutions from the concept of cross-border insolvency, some countries still consider that this is not a part of insolvency law. If it could be included in insolvency law, then UNCITRAL could consider that as well. With respect to judicial cooperation, we have heard that UNCITRAL, with the assistance of INSOL International, is doing some work on protocols to provide information for judges. If that work could be recognized by practitioners and the judiciary alike, it would reduce a lot of risk and save a lot of jobs. Lastly, I think the other issue which is very important is that the product of UNCITRAL should not only just be put on the shelf or somewhere in a library. It must be implemented. As I mentioned, insolvency systems have two sides: one is the law and the other one is the implementation. I think both parts could be covered by the work of UNCITRAL. To ensure the proper outcome, we will have to work in coordination with other institutions, including the World Bank, and the private sector, like INSOL International, because technical assistance is a way of changing the system, of moving from the law to real implementation. I am saying this because I think, at least from my experience with reform in my country, that when we had to reform the law quickly, it was not really part of the law that was key, but rather the implementation of the law. I would like to thank Neil for your good efforts today as panel facilitator. Before I give the floor for evaluation and other comments, may I first thank all the panellists for their efforts today as well.

## 2. *Comments, evaluation and discussion*

*Christopher Redmond*

*American Bar Association, United States of America*

I am a practitioner from the United States. As was addressed in the examples, the various entities ended up in various insolvency proceedings either directly or indirectly. The incidence of cross-border cases in today's economy is increasing. The critical issue generally is that once companies file for insolvency, they have to obtain post-commencement financing to be able to operate, to be able to pay the expenses and the various administration expenses to move forward. In cross-border cases, there are many banks who are willing to finance cross-border cases, but they want liens on all the different companies, not just in one jurisdiction. My question is really twofold. How important is the initial financing in these cross-border cases, and secondarily, is there an appetite or some kind of development of model law provisions to facilitate the process so that banks and financial institutions can take liens on the various properties to provide financing to these entities?

*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

No surgeon would commence a major operation without ensuring that there is a supply of blood. And cash is the lifeblood of a group. Unless there is sufficient cash to see a group through a reorganization, then you will not get to the other end. Very simply, it will wither and die before you have restructured it. Where do you get this cash from? The very nature of the group's insolvency normally dictates that there is no surplus cash in the group. In very rare circumstances, there may be assets that can be realized that will not prejudice the whole, but these are the exception. The questioner is absolutely right. We need mechanisms by which

funds can be borrowed in order to keep a group going. Now it is also appropriate that the group is coordinated in some way. But very often the value of the assets will actually be in the subsidiaries. And therein lies the problem—you will have a borrower in one jurisdiction without substantial assets; and you will have assets in other jurisdictions where the entities in those other jurisdictions are the subject of other insolvency proceedings. We have to find solutions to this problem, and I am not going to pretend that there is one just waiting to be put on the table for us to sign up to. Financial institutions will lend, but quite predictably they will only lend against security. And that is the mechanism that we have to find. I cannot see how you can do it unless you are able to bring all the proceedings under largely coordinated control, which I think in North America is referred to as administrative consolidation. I say “administrative”—I am distinguishing it from “substantive” consolidation.

*Majeed H. al-Anbaki*

*Permanent Mission of Iraq to the United Nations (Geneva)*

Thank you very much for this attractive lecture, attractive talks. It was really very interesting. I have a practical question. Somehow it has academic aspects as well. Let us assume that A and B are both institutions belonging to State C. A is involved in banking; A is a bank. B is a maritime transport company. A (a bank) has branches in other States, let us assume D. A has a branch in D (State). B (maritime transport) also has branches in D (State) and elsewhere—in E (State). Now A became bankrupt in D (State). Can the creditors seize the assets and the property of B (transport company) in D (State) on the ground of the principles we call the alter ego principle? On the ground that both institutions A and B belong to the same State, which is C, despite the fact that A and B are financially independent and separate: is that in harmony with the law of insolvency across borders and, if that is true, with this law of UNCITRAL, do you not think that it will hinder the progress of international commerce?

*Wisit Wisitsora-At, Chair*

I hope this is not a true story, but I give the floor to Sumant and then to Neil.

*Sumant Batra*

*Kesar Dass B and Associates, India*

I can respond very quickly on this. The answer will vary based on the law which operates in the respective jurisdiction in which these various companies or entities may be located. But generally, if all the entities are financially independent companies incorporated under the laws of the different countries, then their insolvency has to be tested on the basis of the law that operates in that particular country. The treatment in insolvency of any company which is doing business in the jurisdiction of another country will depend on the cooperation which may exist between the country of domicile and the country in which business is being done. Otherwise, in the facts that you give, it is very difficult to give a simple answer because the solution would depend on the laws of the various countries and also on the facts.

*Neil Cooper*

*Kroll, United Kingdom of Great Britain and Northern Ireland*

The problem I have is that I think I might be liquidator of part of this group. And what I am aware of is that one particular country has declared some of the subsidiaries, I will

use the term “*compagnie fictive*”; they have said that they are simply shell companies and that they are all really organs of the parent company. Sumant is right. It depends on the law of the country. It is very seldom that we will do anything that will encourage the piercing of the corporate veil. And what you are talking about at the minute is an example of where the corporate veil of two different entities seems to have been both pierced and completely intermingled. The circumstances under which that should happen will be very, very rare and will normally involve what amounts to fraud.

*Wisit Wisitsora-At, Chair*

Let me see if there are some others who wish to make comments.

*Yuejiao Zhang*  
*Shantou University, China*

I think it is a very interesting case study. I think that we should also look at the role of the intermediaries, like the lawyer’s role and the accountants. That is very important, because for harmonized insolvency law, it takes time. It cannot happen overnight. But for the cross-border issue, for instance, where you are dealing with the bank branch, the parent company, according to company law, one way or another, is liable. But the subsidiaries, if their assets are small, cannot cover the payments. Then you can ask for the guarantee of the parent company. Because you then have contractual arrangements; you can also impose your rights across borders. I think the role of the intermediaries is very important for the time being. The lawyers also can play a very important role in preparing the contract and watching the assets and following the bankruptcy proceedings. I think that we can coordinate to reduce the risk as much as possible.

*Majeed H. al-Anbaki*  
*Permanent Mission of Iraq to the United Nations (Geneva)*

The role of auditors is indeed critical. In a crisis, the most important thing is to have information on the whole group and know what the financial condition of each individual subsidiary is. In Switzerland, we have a general rule that requires financial groups operating across the globe to use, to the extent possible, the same audit firm for all the group companies. This significantly facilitates the flow of information, which is so relevant in a situation where we have a crisis.

*Neil Cooper*  
*Kroll, United Kingdom of Great Britain and Northern Ireland*

While totally agreeing with you, can I add another category that we need, and that is the judiciary. We found that in those countries where the judiciary have a high skills set, that drives up the skills set of the professionals and we end up with an improving institutional capacity to deal with problems. Where one is low, the other also tends to be low. There are other issues that we need to deal with in emerging countries. We did a review for one of the development banks where the response from one country was that the tax authority in that country had the ability to obtain lots of information. The judges therefore do not normally demand bribes from the tax authority. You just have to wonder about what is accepted as “normal” and how long it will be tolerated before we are able to

do something about driving up the conditions of the judiciary and the practitioners—the lawyers and the accountants—who deal with this work. It is essential. As Wisit said before, “Good laws on their own will not solve things.”

\* \* \*

*Wisit Wisitsora-At, Chair*

I think perhaps we have used up our time, because we need to finish by five o'clock and there are some other issues to be addressed. I think we will conclude discussion of the panel on this topic. If you have any questions, you may perhaps approach the panellists, because they will be still with us until the end.

## **IV. Sale of goods, transport law and electronic commerce**

### **A. The future of contract law harmonization**

*Chair: Ole Lando  
Copenhagen Business School, Denmark*

Our first speaker is Ms. Diana Wallis, who is Vice-President of the European Parliament. She is a member of the Liberal Democrats and the first British female of any political persuasion to be elected to the post of Vice-President of the European Parliament. Ms. Wallis is a lawyer.

#### *1. The European Contract Law Project*

*Diana Wallis  
European Parliament, Member for the United Kingdom of Great Britain and Northern Ireland*

You have asked me to come to speak about harmonization of contract law and in particular to address the European Contract Law Project. I want to share with you today the thoughts of a directly elected parliamentarian, a politician at the supranational level, and to show how we have to deal with issues of private international law, and of contract law harmonization, in a transparent, open and accountable democratic decision-making process.

I would like to tell you in detail something about the European Contract Law Project.

The European Parliament has been a big fan of this project, going back to 1989. Our basic feeling has been that you will make the internal market—one of Europe's biggest successes—even better if you can break down the differing laws that sometimes form a barrier to trade, cost us in terms of transactional costs and, perhaps, cause a lack in consumer confidence to engage in a market where there are different laws and legal systems. And better still, it would help Europe's economy be that best economy in the world that we have sought to make it.

But it is odd because if you look at the European Contract Law Project, it has its genesis, its beginning, in consumer law, not in the area of civil justice. It comes out of a feeling that in the area of consumer law, historically we have a large number of directives, central directives, dealing with different issues that are topics to do with contract law, but we have ended up with something of a mess, a hotchpotch, a patchwork of different definitions, different ideas, that need to be reviewed and sorted out.

In this context, there is also a large research project funded by the Commission to look at contract law which is producing something known as the Common Frame of

Reference (CFR). It is an academic work, so it has also been a consultation exercise with stakeholders from business, from consumer groups and from lawyers, all sorts, across the whole of Europe.

But what are we actually doing? Well, we are going with this. Parliament wants it to be much more than just something that looks at tidying up consumer laws. There are various possibilities, therefore, that could happen. It could remain with the CFR as just an academic work on the shelf. It could be what has been called a legislative toolbox. It could be an optional instrument. It could be a European code of contract. It could be a mix of any of those.

Let us have a look at each.

As an academic work, it would of course have huge significance in its own right and that will happen anyway: a huge study putting together comparative analysis from all of Europe's legal systems to inform students, practitioners and judges for the future. That maybe would lead to a long-term, gradual convergence, but not harmonization through legislation.

Then there is the idea of a legislative toolbox. There is much preoccupation among legislators at the moment about what is called better legislation. So if we want to get rid of all the anomalies and differences in European legislation that refer to contract law, especially in the consumer field, how can we do this? Can we have a sort of an encyclopaedia of terms and definitions that every time we make law in this field, either at the European or national level, the legislator will refer to this so-called toolbox or toolkit that the European Commission sometimes refers to? So that is another possibility.

Then there is the possibility of the so-called optional instrument, which, I think, to many people in this hall will be obvious: a body of contract law that parties may opt into from different countries to avoid the problems of differences in national law. But, of course, this is absolutely important to the better functioning of Europe's internal market. It gets away from the problem of different national laws. But here we hit the problem. The European Union has no competence to harmonize basic civil law, torts and contract laws. Even in the name of the internal market, there is no legal base for us to do this. Instead, what we have chosen to do, rightly or wrongly, is to proceed to harmonize the laws which deal with the choice of applicable law, the so-called conflict laws. Those we have harmonized. Currently we are looking at Rome I, which deals with contracts. Yesterday, in the Parliament, we voted and we finalized Rome II, which deals with torts arising from non-contractual obligations.

But these regulations at the European level actually underline national law. They show that there is a choice to be made but it is still based on national law. And even if you look at the internal market area where we have a principle called the "country of origin principle" or mutual recognition, it still leads you back to national law. So still we have the problem of bringing two sides or more together.

To give a taste of the debate on the Rome I regulation, moving from the Rome Convention to a European regulation, there has been a huge discussion about the consumer provisions. Business faces 27 different national legal regimes. National governments do not want harmonization of basic law, so it is an impossible situation; and, therefore, the optional

instrument looks like the perfect answer. Some have described, for instance in Internet trade, the possibility of having a blue button with the European Union flag on it so that if the parties want this optional instrument, they press the blue flag, the blue button. That could be the way of the future. That might be what the CFR ends up as: an optional instrument.

But there is something sad in the text for Rome I. The Commission proposed that the parties should be able to actually do this, to opt for the CFR or other supranational texts like the Unidroit Principles. But we are being told “no”. Business lobbies tell us that they do not want it, that it is uncertain. Governments tell us they do not like it because it is not linked to a body of national laws, it is not linked to a national legal system. So the vision of the blue button is beginning to look a bit shaky. Some of us want to keep it, at the very least, as a recital in the Rome I text.

But this brings us back to the problem (I come from a Parliament) that this is a political matter and it is a matter of democracy. Governments and others want to keep law under their control to at least be able to have some democratic accountability about the way it is formed and the way it is developed.

The last option for the CFR, which I think you will have guessed by now, is highly unlikely: that it could be defined now as a European code of contract. I do not think so. In my own country (the United Kingdom is a common law country), if you even say the word “code”, you are likely to be hung from the nearest lamppost. We do not like codes and we do not like constitutions, which is all very sad, but the CFR could, I believe, be an embryonic code for future generations who have less difficulties with these words.

But let us be in no doubt: national governments regard basic contract law as their own preserve and the conflict-of-laws rules that we have and are still developing underline that sort of choice. And we then continue in this direction. If you look at some of the other cross-border legislation in the civil justice area in Europe, you will see that we go towards developing a twenty-eighth regime. One additional regime above that of all the individual member States, rather than interfering or touching the national legal order. And this goes back to the problem that the Treaty does not give us the power to do it. Traditional cooperation, yes; mutual recognition, yes, except in the consumer field—and that is why the Contract Law Project came from the consumer field. We are able to harmonize.

So it may be, with the review of the consumer key, that we get some form of harmonized instrument. But let us be in no doubt what difficult political discussions this phrases. In the last weeks in the Parliament, we have come to the conclusion that the only items that we might be able to get in a harmonized horizontal instrument are the definition of a consumer, and even that is fraught with difficulties, something on precontractual information and something on the rights of withdrawal, but even that would be a huge debate about the actual timespan.

But contract law goes through everything, through all our human relationships, not just consumer issues. Many of us in the Parliament would like to see afar, to go much, much further than just consumer law. But harmonization is such a complex issue and the European Union, I have to say, is the most advanced supranational example we have where we have the sort of political development that has allowed us to get as far as we have got. But there are still huge tensions to be resolved between

this level and the national level. What worries me is the aspect of justice and justice for our citizens and for those who have to use the law that we make and the legal system through which it can be accessed. And I sense a growing fear or anxiety among some of my colleagues about a body of law or bodies of law that become detached from democratic accountability. I am not sure how we will deal with it but I share this last thought with you.

Over the last years, I have been in a privileged position on behalf of the Parliament to attend many times discussions at the Hague Conference. I felt myself to be an oddity there as the only parliamentarian among many experts and government representatives. I think for the future, we have said this in the European Parliament, we would like to see a parliamentarian organization shadowing, as it were, and I hope informing in the right way, the work of something like the Hague Conference. We have to ensure that whatever we do in the name of harmonization works for our citizens, works for the society that we are creating and, above all, works for access to justice and democratic accountability.

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*Ole Lando, Chair*

Thank you very much for that clear and well-structured address. I have a question for you. The European Union appears to be sponsoring and encouraging the preparation of the CFR, some of which will govern the so-called B2C (business-to-consumer) contracts, and that is planned to become binding rules of law that the courts of the European Union member States will have to apply. Some of it will address the B2B (business-to-business) contracts, which—according to what you say—cannot be made into binding law and must remain soft law, which the national courts may apply if it suits them to do so and their national law will allow it. How are the two going to be presented? Can you keep them in the same instrument? If not, how will you separate them?

*Diana Wallis*

*European Parliament, Member for the United Kingdom of Great Britain and Northern Ireland*

Indeed, the conundrum that we face, and I guess some of us have felt it, is that. But it seems to me that it is impossible to separate out consumer law from the rest of contract law. Then if you look at the resolutions of the European Parliament, if you look at what will be voted on the review of the *acquis communautaire* on consumer law to inform the Commission's work, you will see just that we are very concerned that the review of the consumer *acquis's* future work on the CFR in its wider fields having to do with business-to-business contracts somehow keeps together, because what we do not want, in my view, and I believe many of my colleagues agree with me, is a section of contract law under the heading of consumer law that is sort of ghettoized. If we really want to do good work, we have to keep the whole thing together and on track, with one informing the other. But it will be a very difficult job, especially, as I have tried to emphasize, because of the difficulty as to whether or not the European Union has indeed the legal treaty base to legislate in this area.

## 2. Contract law at the national, regional and global levels

*Jean-Paul Béraudo*

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*“Peace through law” and trade*

Just over two centuries ago, the country I come from, France, was something of a curiosity in Europe on account of the number of its customary law systems and the compartmentalization of its jurisdictions one from another. In his *Philosophical Dictionary*, the French writer Voltaire, who advised Frederick II of Prussia, wrote that in France a man who travelled changed laws almost as often as he changed post horses. Indeed, the decision to create a code of civil law common to the entire kingdom, enshrined in the Constitution of September 1791, was justified by the existence of 65 general customary law systems, counting only those that existed in written form, and 300 local customary law systems. Given the proliferation of autonomous jurisdictions, a form of exequatur, known as *pareatis*, was required in order to enforce within the jurisdiction of the parliament of Aix-en-Provence, for example, a judgement issued within the jurisdiction of the parliament of Rennes or that of Dauphiné. The jurisdictions were unified by the establishment of a court of cassation in 1791. The unification of legislation would follow some 15 years later, in 1804, with the promulgation of the French civil code by Napoleon, the celebrated guest of Schönbrunn Palace, a short distance from here.

Many European States have at different times gone through a similar process of evolution towards unified legislation whose enforcement is controlled by a superior jurisdiction that regulates the application of that legislation throughout the State. This was the case particularly in Italy and Germany. The same is probably true of countries elsewhere in the world.

Even in federal States, for certain activities—particularly commerce—legislative unification is considered useful and is effected voluntarily. That was the role played in the United States of America by the Uniform Commercial Code adopted by the 50 states of the Union (Louisiana has not enacted article 2, on the sale of goods), the District of Columbia, Puerto Rico, Guam and the United States Virgin Islands. This legislative and judicial unification current is particularly strong. Counter-currents are something of an aberration—like Spanish Catalonia’s autonomous legislation relating to debts, which establishes a time limit for suing that differs from the one in force throughout the rest of Spain!

A phenomenon observed during the nineteenth century within certain countries has gradually spread and taken on global dimensions.

From the 1860s onwards, more and more bilateral agreements on the mutual recognition and enforcement of judgements were concluded by the powers of the day in the wake of commercial treaties. Following the creation in 1893 of the Hague Conference on Private International Law, conventions on conflicts of law emerged, initially in the area of personal status. Since then, the flow has never ceased.

The creation of the Hague Conference was followed by the creation, in 1926, of the International Institute for the Unification of Private Law (Unidroit), which has its seat in Rome, at the magnificent Villa Aldobrandini, where the setting—with the Roman statues gracing its walls—inspires thoughts that transcend the centuries. Then came the United Nations Commission on International Trade Law (UNCITRAL), also an organization with a wide brief, established by the General Assembly through resolution 2205 (XXI) of 17 December 1966.

This resolution, recalling the background to the envisaged establishment of UNCITRAL and defining the organization's mandate, puts forward the eminently political idea that “international trade cooperation among States is an important factor in the promotion of friendly relations and, consequently, in the maintenance of peace and security”.

I said “eminently political” because that idea runs completely counter to the idea of economic autarky. National striving for economic self-sufficiency has often been at the root of wars waged in order to seize areas of rich agricultural land or mineral resources greatly sought after at the time. I should nevertheless point out that the idea of international trade as a factor for peace is today contested by economic historians who state that the first wave of globalization, starting in the 1860s, did not prevent the First World War from breaking out.

General Assembly resolution 2205 (XXI) also expressed the “conviction” of the General Assembly that “divergences arising from the laws of different States in matters relating to international trade constitute one of the obstacles to the development of world trade”.

Thus, in 1966, the General Assembly revived the League of Nations motto “Peace through Law” inspired by Léon Bourgeois, who was awarded the Nobel Peace Prize in 1920.

### *The traditional conflict-of-laws method*

Let us, however, consider the veracity of the General Assembly's assertion that the “harmonization and unification” of law are a factor in the development of trade. To that end, let us examine a situation where the substantive rules are not unified, as is still the case in many areas of economic activity and in some regions of the world.

In such a situation, the problem of divergent legal systems is resolved by the conflict-of-laws method, the origins of which date back to ancient times. With respect to contracts, that method consists of allowing the parties to choose the legal system that will govern the contract. Under recent instruments, such as the Inter-American Convention on the Law Applicable to International Contracts (the Mexico Convention of 1994) or the future Rome I regulation on the law applicable to contractual obligations, the choice may be based on legal principles established by international organizations. For a long time to come, those principles will probably continue to be the Unidroit Principles of International Commercial Contracts (more than a hundred decisions issued by the ICC International Court of Arbitration cite the Unidroit Principles; only three cite the Principles of European Contract Law (“the European Principles”) alongside the Unidroit Principles).

Today, in 2007, all States recognize the right of the parties to an international transaction to choose the legal system that will govern the contract concluded between

them. This common position extends to the effects of the choice: the objectivist doctrine prevails in the sense that the contract is governed by the chosen legal system and any future changes in it. With the subjectivist doctrine on the other hand, the prevalent doctrine in England until around 1930, the chosen legal system is incorporated into the contract as any other clause and the law is frozen in the form in which it was agreed upon by the time when the choice is made. Consequently, later changes in the chosen legal system have no effect on the contract.

Differences between conflict-of-laws systems become apparent when the parties to a contract did not make a choice of legal system and the applicable legal system now has to be determined. That was the situation in Europe before the Convention on the Law Applicable to Contractual Obligations (Rome, 1980) entered into force—as is often the case, a situation rather like a scaled-down version of that in the world at large with all its diversity.

In some Latin countries (particularly Italy, Spain and Portugal), a contract was governed by the common national law of the contracting parties. In many other countries, that approach simply elicited a condescending smile as it was inappropriate to the business relationships existing there. In West Africa, where many Lebanese are prominent in the business world, should Lebanese law apply in the case of a contract between a trader who is a citizen of Senegal and a trader who is a citizen of Côte d'Ivoire on the grounds that both are Lebanese? Should a contract between a Sikh trader who is a citizen of Zimbabwe and a Sikh trader who is a citizen of South Africa be governed by the law of the Punjab?

In several countries, the place of conclusion of the contract was decisive; in others, the place of execution.

In England, the “proper law of the contract” applied a system under which importance is attached to aspects disregarded elsewhere, such as the language of the contract or the currency of payment.

In that regard, the unification of conflict-of-laws rules achieved through the Rome Convention, following the conventions negotiated within the framework of the Hague Conference on Private International Law, is a huge step forward. The same is true of the Mexico Convention of 1994, which, even after more than 10 years, has unfortunately—and inexplicably—been ratified by only two States.

#### *Shortcomings of the conflict-of-laws method*

However, the conflict-of-laws method has a number of shortcomings. I will confine myself to three of them.

The first, which relates to what I was just talking about, is the difficulty of identifying conflict-of-laws rules that are essentially from a jurisprudential source. The unification achieved through recent conventions is in most cases limited to the most general elements of a juridical category. For want of agreements, discussions about the scope of the applicable law frequently end in a very brief list. Several conventions developed at The Hague reflect this difficulty of finding common ground between common law and civil law systems.

The second shortcoming relates to the very purpose of the method, which is to decide which of the national legal systems relevant to a particular transaction shall be the applicable one. For most, national laws were drafted for domestic use and reflect the conditions of the time.

In saying that, I have in mind French law on the sale of goods as governed by the Civil Code of 1804, which remains applicable to sales contracts. Its provisions were based on the “Treatise on the Contract of Sale” by Robert-Joseph Pothier, the second edition of which revised by the author was published in 1765. I would mention, incidentally, that the jurist Pothier is the only Frenchman to have been honoured with a statue at the Capitol in Washington, D.C.

However, Pothier, like the authors of the Civil Code, was drafting laws for the rural society of his time. He was thinking of transactions among farmers at markets where the parties were physically present, face to face. The hidden defect so characteristic of the French Civil Code is the sickness of the sterile cow that cannot bear a calf. Obviously, this great text is far removed from the realities of international trade today. When it is applied to them, chance plays a big role!

The final shortcoming that I would mention is of a socio-economic nature: the party to the contract whose country’s legal system has been chosen or been declared applicable has a great advantage. That party will be able to continue operating in the usual manner without running the risk of nullity or even a minor violation of the law. The general conditions or standard provisions set out in the commercial documents of that party will normally be the valid ones. In the event of court proceedings, that party will be able to continue using the same lawyer with whom it is generally easier to communicate. That lawyer is familiar with the business and the commercial practices of the client, having at times reviewed those general conditions or standard provisions, or even having drafted them.

On the other hand, the party whose country’s legal system has not been chosen runs the risk of operating improperly without being aware of it. When proposing or accepting modifications to the contract, especially small ones, that party may not realize the potential economic and other consequences. Should a dispute arise, that party will have to call upon the services of a lawyer of the country whose law is applicable. The costs entailed will probably be additional to those of that party’s usual lawyer, without whom it is difficult to manage.

Such are the explanations for the success of uniform law conventions and other instruments unifying substantive law.

#### *The deceptive supremacy of regional law*

Given that the positive economic effects of unified commercial law are universally recognized, let us consider whether it is better to undertake unification at the regional level or worldwide. There are several ways to approach this question.

The first, which I would describe as theoretical, consists of recalling what is incontestably true: at the regional level, especially in Europe, there are a body of rules and procedures and

high-calibre officials of various nationalities. These great assets make possible the fairly rapid formulation of legal texts covering, sometimes in detail, issues especially chosen because of their importance for trade within the region. Moreover, in Europe the procedures for the adoption of directives, regulations and other texts have the huge advantage of enabling the results of the work of experts to quickly become positive law. And if necessary, a jurisdictional body is on hand to bring into line any national administrations that might be recalcitrant. The picture, after 50 years of the European Union, is indisputably one of brilliant success.

Certainly, the international organizations that produce general legal texts, such as the Hague Conference on Private International Law, Unidroit and UNCITRAL, are unable to compete with what can be achieved within a regional framework.

There are many reasons for this. Besides material reasons, such as the budgets for permanent secretariats staffed with jurists, there are ones relating to tradition and legal status of organizations.

Many of the jurists involved in legislative drafting have only tenuous links with national administrations, so that their personal views often obtrude and the success of their efforts is consequently jeopardized at the ratification stage.

UNCITRAL, unlike the Hague Conference on Private International Law and Unidroit, makes little use, other than during diplomatic conferences, of small working groups and drafting committees for, in the first case, examining an issue in great depth and, in the second, submitting a text to the scrutiny of experienced national legal experts who ensure its clarity and the practical functionality of the terms or expressions used in it.

I should say, with reference to European Union texts, that drafting by lawyer-linguists also has shortcomings. However, recourse to drafting committees is in practice impossible when drafting legal instruments in 23 languages.

The tradition of adoption by consensus often produces a result that is admittedly unopposed but does little to bring about progress in the field of law.

Lastly, all the international organizations have produced conventions that, owing to insufficient interest, have never entered into force.

Once a convention has entered into force, its uniform application depends on the good will of national jurisdictions, in the absence of a jurisdictional body tasked with guiding its interpretation by means of a preliminary ruling.

The superiority of regional institutions when it comes to producing legal norms and controlling their application is indisputable.

#### *Back to the realities*

However, the theoretical approach that I have just described overlooks the fact that the world of today—like the world of yesterday—is not without norms in the areas of interest to those who engage in international trade.

Rules promulgated by the non-specialized international organizations already exist in the area of conflict of laws (the 1955 Convention on the Law Applicable to International Sales of Goods and the 1978 Convention on the Law Applicable to Agency) and in the area of uniform substantive law (the United Nations Convention on Contracts for the International Sale of Goods and the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”), two conventions that have been widely ratified, or the Unidroit conventions on international financial leasing and international factoring).

Incidentally, these two types of rule do not correspond to different stages of development in the unification of law; unification in the conflict-of-laws area preceded that in the area of substantive law. They are mutually supportive. The conventions on uniform substantive law require the conflict-of-laws rules in order that the scope of their application may be determined. It was because they were aware of this situation that States met under the aegis of the Hague Conference on Private International Law in order to draw up conflict-of-laws rules that would underpin the United Nations Convention on Contracts for the International Sale of Goods, as provided for in the preamble to the Convention on the Law Applicable to Contracts for the International Sale of Goods of 22 December 1986.

It is also important to recall the norms elaborated by non-governmental organizations such as the International Chamber of Commerce (ICC), the value of which lies in their adoption, most often simply by reference, by contracting parties (see, for example, ICC publication *International Standby Practices: ISP98* or ICC publication *ICC Uniform Customs and Practice for Documentary Credits: UCP 600*, (2006)).

Lastly, the law of obligations as a whole is since 1994 governed by an informal law—namely, the Unidroit Principles, which were completed in 2004. Widely applied by arbitrators, they are also applied, albeit less frequently, by State jurisdictions. This may change, however, once the Mexico Convention of 1994 has been ratified by a larger number of States or once the Rome I regulation enters into force. By the way, it is regrettable that the latter does not provide for application of the Unidroit Principles by judges, even in the absence of designation by the parties. I personally have experienced, both as judge and as arbitrator, the great intellectual comfort that the Principles afford in the decision-making process. They are known and accessible to the parties and are applicable prior to the emergence of a dispute—often prior to the conclusion of the contract. This is why the judge or arbitrator, wishing to respect the equality of the contracting parties, can safely recommend to them that the Principles be applied.

This brief overview of the present state of the law relating to international contracts in the world at large raises the question of what role remains for the national or regional legislator.

#### *The subsidiary yet substantive role of regional law*

When the national legislator is in a State belonging to an organized regional system such as the European Union, the scope for legislating in matters of international trade is extremely limited, to say the least. The rules that may affect the internal European Union market, even indirectly, fall exclusively within the competence of European Union institutions.

On the other hand, the question of what the regional legislator can do given the activities of the international organizations is worthy of more detailed examination as to legality and the legislative assessment of the facts.

With regard to international conventions ratified by the States belonging to a regional group, it is diplomatic law that applies. Unless such a convention is denounced by a State, that State must implement it, and the convention must be implemented in accordance with the geographical, temporal and substantive scope established by it.

This raises the question of the validity, under treaty law, of provisions that treat international relations within the regional group as internal relations.

For example, article 23, paragraph 2, of the draft Rome I regulation states that “this Regulation shall not prejudice the application of international conventions referred to in paragraph 1. However, where, at the time of conclusion of the contract, all material aspects of the situation are located in one or more member States, this Regulation shall take precedence over the following Conventions: ...”. The 1955 Convention on the Law Applicable to International Sales of Goods and the 1978 Convention on the Law Applicable to Agency are then cited. In order to be valid, such a restriction of the geographical scope of the Hague conventions should emanate from all States parties to them and not from an international organization, the European Union, that has no legislative power over those conventions—and, I might add, did not even exist in 1955!

On the same subject, I have highlighted the impossibility of imposing a security obligation, as provided for in European Council Directive 85/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products, in contracts governed by the United Nations Convention on Contracts for the International Sale of Goods of 11 April 1980, in which no such obligation exists, even if the contracts have been concluded by traders established in States members of the European Union (the two texts overlap with respect to material damage, which article 5 of the Directive does not exclude from the scope of the Convention). That caveat was accompanied by the suggestion that “contracting States which have the same or closely related legal rules on matters governed by this Convention” might make the declaration provided for in article 94. The Commission could ask Member States to submit a declaration to the United Nations Treaty Office stating that, in addition to the provisions of the United Nations Convention on Contracts for the International Sale of Goods of 11 April 1980, the European Union rules on product liability would be applied to sales contracts concluded between parties established in a European Union member State.

That would be a good example of the complementary role that can be played by global and regional legislators.

We are all aware that different States and different regions do not all progress at the same pace and in the same direction. It is not unusual for the same objectives to be achieved by different means. The European Union is much concerned with consumer protection and competition, but its concern is not universal. Moreover, it cannot be denied that an administered economy has, in certain areas and at certain times, positive aspects. Many expensive investments yielding low initial profits would not have been made in Europe, certainly not in France, if the State had not played the role of investor.

It is therefore necessary that the major regional groups in the world, depending on the degree of integration achieved by them, be able to assure legislative functions with a view to adapting global legislation to the level of regional development.

Supplementing the United Nations Convention on Contracts for the International Sale of Goods with suitable provisions that relate specifically to contracts concluded between parties established within the European Union or under which goods are to be moved within the European Union is a positive step.

Bringing all elements together to create a new body of law governing only sales concluded by European traders would cause confusion. Traders and judges would then have to apply three sets of rules: national rules for internal contracts, regional rules for international contracts confined to the region and rules established by the international conventions for international contracts not confined to the region. Since it is unusual for traders to operate at only one of the three levels in question, the risks of legal blunders cannot be ruled out. Moreover, one does not have to be a fortune-teller in order to predict that the geographical delimitation of the fields of application could lead to conflicts of texts. In addition, there would be the difficulties of delimitation arising from the fact that the substantive domains covered by the three sets of rules would probably not tally, having been drawn up by more than one legislator and without any coordination.

It would appear that, because they are aware of these dangers with their potential serious economic consequences, the European Union institutions are thinking of harmonizing the contract law of the member States as part of a process of alignment or unification of legislations. If that undertaking is successful, despite resistance on the part of some member States, the member States will share a body of legislation relating to internal contracts that will play the role of subsidiary legislation with respect to the intra- or extra-community international contracts already governed by a certain number of conventions in force and the Unidroit Principles. Replacing the existing conventions with a body of law specific to intra-community international operations would be a demonstration—running counter to European Union tradition—of a form of nationalism that could have disastrous legal, economic, cultural and even political consequences.

During the 13 years that have passed since the Governing Council of Unidroit promulgated the Unidroit Principles, in May 1994, they have been put thoroughly to the test. They have become the universal *lex mercatoria* that was so dreamed of. Only a foolhardy regional legislator would want to substitute something else for this code of 185 articles whose application is no longer even a matter for discussion thanks to its role in ensuring legal security in international relations. After more than a third of a century of judicial and arbitral experience closely linked to international trade contracts, I can say that the period that preceded the Principles was one of stumbling uncertainty in the search for an applicable body of law, whereas now we have an unprecedented degree of legal security.

#### *The need to coordinate global law with regional law*

Given the present situation, the international law-making organizations should be encouraged to adopt a pragmatic attitude. The world today is no longer as it was when they were established. Regional organizations have grown in number, and the legislative

activity of some of them is very intense; for example, it can be said that the European Union is overburdening national legislators in their task of incorporating its texts. The existence and the legislative activity of regional organizations are realities that must be taken into account at the institutional and the functional level.

At the institutional level, the international law-making organizations must adapt their working methods in order to enable States members of regional organizations to define and express their common positions. The necessary time must be provided and meeting agendas must be adapted.

The diplomatic clauses that usually appear at the end of conventions must be fine-tuned in order to facilitate ratification by interested regional organizations.

It is also necessary to provide for certain convention provisions to be supplemented or even replaced by harmonized rules specific to a particular region regarding an area to be determined subsequently, on the basis of—for example—where the traders' businesses are registered, or the place of contract execution, the place of delivery of the goods or the place of rendering of the service. Article 94 of the United Nations Convention on Contracts for the International Sale of Goods is a good start as long as it is understood in the sense that the addition or replacement of rules can have a more limited purpose than conclusion of the sale or execution of the contract.

The international law-making organizations must also adopt a realistic attitude regarding the issues selected for consideration. They need to realize that States belonging to closely integrated regional organizations generally have little room for manoeuvre when negotiating on issues covered by a regional body of law. In the working groups, such States can do no more than invite their interlocutors to follow the existing regional model. Inevitably, they will be accused of imperialistic behaviour. Also, they may lose interest in the activities of the working groups, knowing in advance that the resulting text will not be ratified by them.

It is therefore best for the organizations not to establish working groups on areas of law where there has already been unification at the regional level.

For example, what value would an international convention on commercial agency contracts have for the 27 member States of the European Union, which are since 18 December 1986 already enjoying the benefits of European Council Directive 86/653/EE on the coordination of the laws of the member States relating to self-employed commercial agents—a directive that has led to an entirely satisfactory unification of substantive law despite national laws relating to the concept of “mandate” that used to diverge significantly?

We need to draw lessons from past failures. For example, after some 15 years our work on bills of exchange and promissory notes came to a disastrous close when the Sixth Committee of the General Assembly, in 1988, adopted a text that we all knew would never enter into force.

The choice of issue had been made without due consideration to the fact that the Unidroit conventions of 1930 and 1931 covering the same ground were in force, directly or indirectly, for some 60 countries and would not be swept aside for the sake of an attempt to arrive at a new text.

That having been said, the non-specialized organizations with a worldwide mandate still have much that they can do in performing their primary task, which is to address truly global issues. They can do this in several ways.

One way, illustrated recently by the Hague Conference on Private International Law, is to build bridges between different systems. As we know, since the adoption of the 1968 Brussels Convention and the 1988 Lugano Convention, 30 European States and some of their overseas territories share a unified judicial space. An initially ambitious project was launched to extend the system of unified rules of jurisdiction, automatic recognition of judgements and minimum requirements so as to achieve *exequatur* worldwide. In its original form, the project failed, but the text adopted on 30 June 2005, limited to choice of court agreements, is undoubtedly of relevance to small and medium-sized commercial operations that do not warrant submission to an arbitration body. Contracting parties will greatly benefit from the possibility to choose a neutral, impartial and technically competent jurisdiction.

Also the organizations could focus on truly global issues regarding which there has been no unification—transport law, for example, with which an UNCITRAL working group is currently dealing.

On the other hand, there are issues on which regulation at the regional level is precluded by the success already achieved globally. This is notably so for arbitration. Article 220 of the 25 March 1957 Treaty establishing the European Economic Community stated that the formalities governing the recognition of judicial decisions and of arbitral awards should be simplified. The Jenard report indicates that the experts did not wish to legislate on arbitration in view of the existence of the New York Convention, which had already proven a great success and been applied effectively.

There are other issues regarding which the regional organizations realize that they are better addressed globally since they call for broad ratification—particularly ratification by non-member States that are very prominent in international trade.

It is the conventions on these issues that have enjoyed greatest success within the organizations that prepared them. One needs only to look at their ratification status.

Today, the establishment of all working groups should be coordinated not only with other international law-making organizations but also with regional organizations.

### *Ontogeny recapitulates phylogeny*

I began by speaking about the judicial and juridical unification that took place in France and some other countries two centuries ago—a national phenomenon that foreshadowed a process that we have now been observing worldwide for half a century.

Judicial unification is being achieved through the New York Convention. Each of the 142 States that have ratified it to date is demonstrating its willingness to embrace a global system of civil and commercial law by fulfilling the obligations it has undertaken. Judicial unification is also being achieved through regional legal structures such as those of the

European Union, the Organization for the Harmonization of Business Law in Africa (OHADA) and the Common Market of the Southern Cone (MERCOSUR), which coordinate the automatic recognition of and simplified procedures for the execution of judgements made by national courts.

Judicial unification is the next step, just as the French Civil Code of 1804 followed the reform of the judicial system in 1791. The United Nations Convention on Contracts for the International Sale of Goods was, in effect, the embryo of a global code of obligations that has carried over into the Unidroit Principles, which even the sceptics recognize as being an effective body of law.

I have thus contextualized—without causing theological controversy, I hope—Charles Darwin’s celebrated dictum that the development of the individual recapitulates the development of the species: “Ontogeny recapitulates phylogeny”.

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*Ole Lando, Chair*

This was very interesting but I must say I think you are too optimistic as regards the importance of *les conflits de lois*. My studies on how the conflict of laws is handled in the *cabinets* and the courtrooms in various countries, and among them your own, have brought me to the conclusion that lawyers do not like it. It is too academic, too complicated, and much of its theory is above courtroom reasoning. I think it was Max Rheinstein, a well-known American jurist, who said that even today the average lawyer shies away from conflict of laws as from terra incognita. So you often see professors teach a conflict-of-law doctrine, which the judges in their own countries often do not apply.

The next speaker is Professor Lebedev. The first time we met was in The Hague at the Conference on Private International Law. I knew you then as a prominent Professor of Law, but since I was ignorant of your many qualities, I asked you: “Do you know anything about the Maritime Court of Arbitration of the International Chamber of Commerce in Moscow?” and you replied: “I am the Chairman of that Court.”

### 3. Global and regional harmonization: the Russian perspective

*Sergei N. Lebedev*

*Chairman, Maritime Arbitration Commission, Russian Chamber of Commerce and Industry; and Professor, Moscow State Institute of International Relations, Russian Federation*

It has been my pleasure to participate in the work of UNCITRAL since 1970, and I am convinced that the resounding success of UNCITRAL has been made possible by the creative efforts of experts from all parts of the world who were involved at the outset and are now involved in the preparation of excellent legal documents on the most diverse and complex issues relating to international trade, and also by the invaluable assistance provided by the UNCITRAL secretariat staff at all levels.

As mentioned earlier, UNCITRAL was established in the light of the clear need to promote international economic relations despite the difficulties existing at that time, including, among others, the East-West confrontation. Today, internationalization has led to what we now call “globalization”, which is affecting all socio-economic aspects of life practically all over the world. The globalization process is considered to be irreversible, although it is unavoidably meeting considerable difficulties as it moves forward in the face of contradictions and opposition.

As we know, awareness often lags behind real life. One Russian writer said recently that globalists were people who ate at McDonald’s and anti-globalists were people who ate at McDonald’s and then demonstrated against the globalists. It is generally assumed that the globalist approach has reached maturity in a number of countries and regions whereas it still encounters difficulties in other regions. However, experts in the field of international relations believe that the decisive factor today is the rationalization and standardization of forms of economic interaction and cooperation. As it is sometimes said, the world is shrinking. Accordingly, the idea that there is a clear need to harmonize and standardize the legislative regulation of the relations developing between players in different countries, between the participants in international trade, is fully justified. That idea is now axiomatic, but it is still useful to keep reiterating it.

As my time is very limited, I will confine myself to a very general outline of what, of course, deserves much more time—namely, what is happening in the context of the current discussions within the Commonwealth of Independent States (CIS), which was established in December 1991, when the Soviet Union ceased to exist and 12 former Soviet republics, having become independent States, decided to create that new umbrella organization.

The CIS Charter provides that one of the key objectives of the CIS shall be legislative cooperation—the adoption of international and other instruments, in particular, relating to legal assistance among the CIS member States and other aspects of legal relations. In 1992, the CIS Interparliamentary Assembly was established, comprising representatives of the parliaments of the CIS member States and with the task of harmonizing the national legislations of those States and drafting—inter alia—model laws.

Also in 1992, an important agreement was adopted relating to the principal aspects of harmonizing the economic and trade legislations of the CIS member States. In 1994, a further body of importance in the context of today’s discussions was established—namely, the Scientific Consultative Centre for Private Law, whose Council comprises State representatives. The Centre is a public body tasked with preparation of model laws and recommendations for the improvement of legislation. The objective of unifying and harmonizing legislation on various issues is established in several other agreements between the CIS member States.

Already, the level of unification achieved is very high. Here, I would briefly mention the Convention on Legal Assistance and Legal Relations in Civil, Family and Criminal Matters (Minsk, 1993), an agreement concerning the procedure for the settlement of disputes relating to the conduct of economic activities (Kiev, 1992) and a number of bilateral treaties. In addition, agreements are in place relating to matters such as investment, property, migration and currency regulation. However, I would particularly mention something which is, I believe, unprecedented—namely, the preparation of a model civil

code that has been approved by the Interparliamentary Assembly and adopted, with various amendments, by most of the CIS member States. It was this that gave rise to an expression now being used in our legal jargon and literature—namely, the “*sblizhenye* [bringing closer together] of legislations”. This does not mean unification through intergovernmental agreements, but rather bringing national legislation closer together on the basis of the model civil code and of model laws relating to various matters. In the preparation of these models, account has been taken of the provisions contained in universal conventions, particularly the Vienna Convention on the Law of Treaties (which entered into force in 1980) and the legislations of other countries, which is particularly important at a time of fundamental economic reform.

As I am running out of time, I would like to mention that the model civil code contains a section on private international law. A decision was taken—whether altogether appropriate I do not know—to include the rules of private international law in the civil code rather than in a separate legal instrument. Some countries, including Azerbaijan, Georgia and Ukraine, have adopted separate legal instruments in the field of private international law tailored to their own particular needs, while in other countries, including the Russian Federation, the rules of private international law are set out in the national civil code. It should be noted that, in the drafting of the section of the model civil code on private international law, account was taken of international conventions such as the Convention on the Law Applicable to Contractual Obligations (Rome, 1980) and of the legislations of other countries, such as Poland and Hungary, in the matter of cross references to specific types of contract when determining the applicable law.

Lastly, Mr. Chairman, we come to the question of harmonization. Here we have in mind primarily UNCITRAL model laws such as that on international commercial arbitration. How should the provisions of national laws based on such model laws be interpreted? At present, there are differences of opinion about this in the Russian legal literature. It has been suggested that such provisions, regardless of their origin, regardless of the fact that they are contained in model laws developed by international organizations or by the CIS Interparliamentary Assembly, should be interpreted in the same way as any other provisions of domestic law (in contrast to provisions incorporated from international conventions). Should they? Perhaps, when interpreting those provisions one ought to take into account their particular origin and character. As has already been said here, if in future the process of harmonization through new laws becomes more widespread, there will be a need for a more fundamental analysis of the difficult question of how to interpret provisions that are contained in national legislation but are based on models developed by international organizations. In that regard, the decision of UNCITRAL to include a “harmonization clause” in its Model Law on International Commercial Arbitration would seem to be timely.

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*Ole Lando, Chair*

The next speaker is Ms. Yuejiao Zhang, who is presently the Director-General of the Asian Development Bank, a professor and the Vice-President of the China International Economic Society. She has so many qualifications that she has given me three cards filling in all these qualifications.

#### 4. *Global and regional harmonization: the Chinese perspective*

*Yuejiao Zhang*  
*Shantou University, China*

##### (a) *Introduction*

Uniform law and harmonization of regulations present themselves in numerous manifestations, both under Unidroit and UNCITRAL on contract law and between multilateral financial organizations such as the World Bank, Asian Development Bank and African Development Bank on international procurement procedures etc. There are the well-known international conventions, prepared by international organizations, adopted at a diplomatic conference and afterwards hopefully ratified by a significant number of States, such as the United Nations Convention on Contracts for the International Sale of Goods (CISG). There are model laws, drafted with a view to being adopted by national legislators, such as the UNCITRAL Model Law on International Commercial Arbitration. Furthermore, there are legal guides, designed for use by private or public operators in the field of international trade, such as the General Principles of Commercial Contract of Unidroit. The next category are standard terms (general conditions), drafted either by an organization of interested businesspeople or by an international non-governmental organization, such as the International Chamber of Commerce (ICC) on Incoterms, which only become binding provisions between the parties after having been adopted by parties to an individual contract. All these types of international instruments make their contribution to the harmonization of international commercial rules and regulations to facilitate cross-border transactions of goods and services.

I was very fortunate to attend the discussion and preparation of the CISG and joined the preparation work for China's ratification of this convention. As elected Governor of Unidroit from 1992 to 1999, I attended several preparation works for the General Principles of Commercial Contract of Unidroit and the International Financial Leasing Convention and Factoring Convention etc. When I served as the Director-General of the Department of Law and Treaties, I participated in the preparation of the foreign economic contract law and the contract law of China. I would like to share my personal observations on the impacts of the harmonized international contract law on China's contract law. When I served as Director-General of the Asian Development Bank in Europe, I was a member of the OECD Development Assistance Committee that worked on the harmonization of procurement guidelines and financial reporting guidelines used by the multilateral development banks. I will give a brief survey of their work on harmonization of law and contracts. I will conclude with some comparative remarks on the work of global harmonization of contract law and some suggestions for future work.

##### (b) *United Nations Commission on International Trade Law*

China has participated in UNCITRAL since 1980 and has been a member of UNCITRAL since May 1983. China is very active in sending its legal experts to take part in the unification and harmonization of international trade law in order to promote international trade. China was one of the negotiators of the CISG and signed it on 11 December 1986 together with Italy and the United States. The CISG entered into force on 1 January 1988.

For the qualified parties of member countries, if they do not exclude the application of the CISG for their contract, the CISG will automatically apply for their signed contract.

The CISG has been widely used for private parties' negotiations on their sales of goods contracts. The number of States parties to the CISG is increasing rapidly. As of 2 December 2006, the United Nations reported that 70 States had ratified the CISG. The United States and most European States are parties to the CISG, but the United Kingdom has not yet joined the CISG. With the anticipated acceleration of globalization and liberalization movements in the near future, there will be a greater demand for global harmonization of contract law. The CISG will surely be acceded to by more States.

(c) *Unidroit*

Unidroit was founded in 1926 under the aegis of the League of Nations to promote the unification of private law. The Institute has its seat in Rome and counts 61 member States, including many European States, such as France, Germany and the United Kingdom, as well as the People's Republic of China, the Russian Federation and the United States of America. The activities of the Institute are directed by a Governing Council consisting of 25 eminent lawyers and professors of law from different member States (mostly academics, some State officials) who are elected by the Unidroit General Assembly every five years.

Until recently, the Institute directed its activities exclusively towards international conventions, its most renowned success being the 1964 Hague uniform laws on the international sale of goods, which subsequently served as a key source of inspiration for the 1980 United Nations Convention on Contracts for the International Sale of Goods, already ratified by more than 30 States. As early as 1971, the Governing Council decided to embark upon the project of the "Progressive Codification of International Commercial Law"; however, it soon became apparent that the project's title could give rise to misunderstandings. Also, several drafted international conventions were adopted by the diplomatic conferences but they were never signed or ratified by the required number of States; therefore, the preparation of international conventions failed to be adapted as much as it should be. As a result, the project was categorized as a legal guide named the Principles of International Commercial Contracts to show its flexibility for adaptation. In fact, it has been widely used in international commercial circles.

Preparatory work was carried out by three well-known comparatists representing three major legal systems, and at the end of the 1970s a working group was formed. The group eventually consisted of all member States of Unidroit originating both from civil law and common law countries in accordance with the universal vocation of the Institute, including Australia, Canada, China, France, Germany, Ghana, Italy, Japan, Portugal, the Russian Federation, Spain, the United Kingdom and the United States of America. Preliminary drafts for the separate chapters or sections were produced by members of the group and were then discussed by the group as a whole; each chapter or section underwent at least two readings (one reading normally taking a session of a week's length). Decisions normally were made by consensus, but sometimes, in exceptionally arduous cases, after long discussions, this consensus was brought about by abiding by the outcome of an indicative vote.

The Principles are articles accompanied by comments, which include illustrations wherever deemed useful to explain their content and scope, and references to other pertinent

international instruments of unified law. The comments do not refer to national legal systems, unless a specific rule or institution is borrowed from a national source and it is felt useful to indicate such origin; or, conversely, unless a rule intends—without expressly saying so—to exclude the application of a national rule.

Beginning in 1980 the working group met once or twice a year for one-week sessions. In 1994, the group finished the first part of its work and in the same year the Governing Council of Unidroit—which in the preceding years had already discussed a number of controversial questions—approved the work of the working group and consented to the publication of the Principles.

The Unidroit Governing Council at its 1996 meeting decided to reconvene the working group in order to continue its work on other topics. This second phase of the group's activity was finished in 2003. The enlarged version of the Principles was published in 2004.

The Principles may serve as a model law that could inspire legislators who strive for law reform. The Principles (and their accompanying comments) may serve to enlighten parties negotiating a contract in order to identify the problems to be resolved in their contract and, if possible, to find suitable rules to settle them.

Parties to an international contract could choose the Principles as the law applicable to their contracts.

*(d) Comparison between the United Nations Sales Convention, the Unidroit Principles and China's Contract Law*

*(i) General provisions and principles of China's legislation*

China's legislation on contract law has four principles: *(a)* it shall be in accordance with the Constitution; *(b)* it shall be based on actual circumstances and China's existing legal system; *(c)* it shall promote economic development and be consistent with reform and opening to the outside world; and *(d)* it shall use international conventions and international practices as a reference.

This is reflected in the Legislative Law of China published on 1 January 2000. In the Legislative Law, article 3 says that "Law-making shall follow the basic principles of the Constitution, centre around economic development, ... and be consistent with reform and opening up to the outside world." And article 6 indicates "Law-making shall be based on actual circumstances, and shall, in a scientific and reasonable way, prescribe the rights and obligations of citizens, legal persons and other organizations, and the powers and duties of state organs."

Along with the economic reform and the implementation of the opening to the outside policy of China since 1978, China has harmonized its contract law gradually. China's Economic Contract Law published in 1982 is mainly applicable to domestic contracts reflecting the central planned economy in China. For example, a contract could become void if the State plan changes. To meet the needs of foreign economic and trade development, on 21 March 1985 China promulgated the Law on Foreign Economic Contracts. The Foreign

Economic Contract Law was much more open than the Domestic Contract Law. For instance it deleted the impact of State planning on the validity of contracts and, under it parties can select the applicable law, including foreign laws; the formation of a contract should be in writing; and the limitation period is four years.

There were many problems for the application of the parallel systems under the two contract laws. The formation of contracts was different. The Domestic Contract Law allowed oral contracts, but the Foreign Economic Contract Law required all contracts to be in writing. The Foreign Economic Contract Law allowed parties to select the applicable law including foreign laws, but the Domestic Contract Law did not. The limitation period for domestic contracts was two years but for foreign economic contracts it was four years. The definition of parties was sometimes very difficult; and therefore defining the application of foreign economic contract law or domestic law was difficult. Unification of contract law was very much needed. In this particular regard, China is undergoing economic reform and deepening its market economy. China has achieved great success in its opening to the outside policy. China is becoming the biggest developing country with the most foreign investment. China's foreign trade volumes increased rapidly during the last decade. China is becoming the third largest trading country in the world. China needs to bring its commercial law in line with the world trading system. After almost 10 years of extensive studies on contract law legislation under the two legal systems and careful domestic market and law research work, as well as detailed contract law preparation work, the Contract Law of China was finally adopted on 15 March 1999 and entered into force on 1 January 2000. Meanwhile, the Domestic Contract Law of 1982 and the Foreign Economic Contract Law of 1985 were both abolished. The new Contract Law is a unified, comprehensive and modern contract law. During the preparation of the Contract Law, Chinese legislators listened widely to the opinions of Chinese and foreign legal scholars and practitioners. The Contract Law's drafting committee conducted many consultation meetings with representatives of all levels of society, including top experts, as well as experts of UNCITRAL and Unidroit, to gain from their experience in the preparation of the CISG and the Principles.

(ii) *Comparison between China's Contract Law, the United Nations Sales Convention and the Unidroit Principles*

The Unidroit Principles consist of a preamble and 10 chapters, as follows: general provisions, formation and authority of agents, validity, interpretation, content and third-party rights, performance, non-performance, set-off, assignment of rights and limitation period.

The CISG has 6 chapters and 101 articles, as follows: general provisions, formation of the contract, sale of goods, obligations of the seller, delivery of the goods and handing over of documents, conformity of the goods and third-party claims, remedies for breach of contract by the seller, obligations of the buyer, payment of the price, taking delivery, remedies for breach of contract by the buyer, passing of risk, provisions common to the obligations of the seller and of the buyer, anticipatory breach and instalment contracts, damages, interest, exemptions, effects of avoidance, preservation and final provisions.

China's Contract Law has two parts (general provisions and specific provisions), 24 chapters and 428 articles. The general provisions include basic principles, conclusion

of a contract, validity, performance, modification and transfer, termination of rights and duties, liability for breach of contracts and other provisions. The specific provisions include sales contracts, contracts for the supply and use of electricity, water, gas and heat, contracts for gifts, contracts for loans, contracts for leases, contracts for financial leasing, contracts for work, contracts for construction projects, contracts for carriage, contracts for technology, contracts for deposit, contracts for warehouses, contracts for mandates, contracts for commissions, contracts for brokerage and supplementary provisions.

The coverage of China's Contract Law is much larger than that of the CISG and the Principles. The CISG covers only international sales of goods. The Principles cover commercial contracts. The Principles open with the statement (preamble) that they set forth general rules for international commercial contracts. These concepts are not defined. However, the comments indicate that "commercial" is not to be understood in the sense of those legal systems whose codified law distinguishes between civil and commercial law, but is meant—following the example of the CISG—to exclude the so-called consumer contracts for which many States have special legislated rules of a protective and mandatory character. China's Contract Law covers not only sales contracts but also contracts of leasing, transportation, transfer of technology, gifts and contracts, deposit and warehouse contracts etc. The CISG governs only the formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a contract. The CISG is not concerned with (a) the validity of the contract or of any of its provisions or of any usage, and (b) the effect which the contract may have on the property in the goods sold. Article 5 indicates that the CISG does not apply to the liability of the seller for death or personal injury caused by the goods to any person. The CISG is applicable only to a sales contract between two parties in two different member States that ratified the CISG. China's Contract Law, as a country's domestic law, can supplement the issues not covered in the CISG, such as contracts concluded between a Chinese company and a foreign company in a country not party to the CISG, as well as the validity of a contract and compensation for damages and injuries of goods to a third party etc.

(iii) *Common principles and similar provisions*

a. *Principles of autonomy*

Articles 2, 3 and 4 of China's Contract Law reduce the interference of the State (articles 10 and 12). Article 3 of China's Contract Law says: "The contractual parties are of equal status. Neither party may impose its will on the other party." Article 4 indicates: "The contractual parties are free to enter into a contract according to law. No organization or individual may illegally interfere with this right." And article 12 says: "The contents of the contract shall be agreed upon between the parties."

Chapter 1 of the Principles formulates some general principles, including the principle of freedom of contract.

b. *Binding character of the contract*

The preamble of the CISG indicates that parties are bound to usages. Article 14 of the CISG says: "A proposal for concluding a contract addressed to one or more specific

persons constitutes an offer if it is sufficiently definite and indicates the intention of the offer or to be bound in case of acceptance.”

Article 8 of China’s Contract Law indicates: “A contract legally formed is binding upon the parties. Each party shall perform its duties according to the terms of the contract. Neither party may unilaterally modify or discharge the contract.”

*c. Good faith*

Article 7 of the CISG indicates its international character and the need to promote uniformity in its application and the observance of good faith in international trade.

China’s Contract Law says, in its article 5: “The contractual parties shall ascertain their rights and duties in accordance with the principle of fairness.” Article 6 says: “The contractual parties shall exercise their rights and perform their duties in accordance with the principle of good faith.”

*d. Formation of contract*

In the first section (formation), some 10 articles on offer and acceptance closely follow the pattern offered by the CISG.

China’s Contract Law requires, in its article 9: “The parties concluding a contract shall have correspondent civil right capacity and civil conduct capacity.” Each party may authorize an agent to conclude a contract.

A contract may be concluded in written, oral or other forms.

Where a contract is required to adopt written form by law or administrative regulations, the written form shall apply. Where the parties have agreed that the contract shall be in written form that form shall apply (art. 10).

The written form refers to written contracts, letters, data messages (including by way of telegram, telex, telecopy, electronic data interchange and electronic mail) etc., whose contents can be manifested in visible form (art. 11).

The CISG, in its article 11, indicates: “A contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirement as to form. It may be proved by any means, including witnesses”. The definition of “writing” in the CISG is similar to that in China’s Contract Law (art. 13): “For the purposes of this Convention, ‘writing’ includes telegram and telex.”

*e. Authority of agents*

The second section (on authority of agents) of the Principles governs the “external aspect” of agency: the authority of a person, the agent, to affect the legal relations of

another person, the principal, by a contract with a third party. Where the third party knew or ought to have known that the agent was acting as an agent (and the agent acts within the scope of its authority), there will be a contract between the principal and the third party. Where an agent acts without authority, the third party is protected if the principal caused the third party reasonably to believe that the agent has authority.

The problem of “undisclosed agency” is solved in the following way. Where the third party neither knew nor ought to have known that the agent was acting as an agent (and the agent acts within the scope of its authority), the agent binds itself; but where the agent, when contracting with the third party on behalf of a business, represents itself to be the owner of that business, the third party, upon discovery of the real owner of the business, may exercise also against the latter the rights it has against the agent.

China’s Contract Law stipulates, in its article 414: “A commission contract is a contract under which the factor engages in trade activity in its own name for the principal, while the principal pays remuneration.”

Article 396 says: “A mandate contract is a contract under which the mandator and the mandatory agree that the mandatory handles the affairs of the mandator.”

Article 402 deals with undisclosed “principals”: “Where the mandatory, in the name of himself, concludes a contract with a third party within the scope authorized by the mandator, the contract is directly binding over the mandator and the third party if the third party has the knowledge of the relationship of agency between the mandator and the mandatory, unless definite evidence is given to prove that the contract is binding over only the mandatory and the third party.”

Article 400 stipulates: “If the mandate by the mandatory to a third party is upon the mandator’s consent, the mandator may give direct instruction to the third party as to the trusted affairs, and the mandatory is only liable for the choice of the third party and its direction to the third party. If the mandate by the mandatory to a third party is not upon the mandator’s consent, the mandatory shall be liable for the act of the third party, except for the case under which the mandate by the mandatory to a third party is needed for the protection of the mandator’s interest under urgent circumstance.”

#### *f. Validity*

The chapter on validity deals with a subject matter which is nearly entirely excluded from the scope of the CISG. Article 4 of that convention states that it is not concerned with the validity of the contract or of any of its provisions.

Article 3.2 of China’s Contract Law lays down the important rule that a contract is concluded, modified or terminated by the mere agreement of the parties, without any further requirement. The main purpose of this article is to do away with the civil law doctrine of cause and with the common law doctrine of consideration.

The rest of that chapter is devoted to the so-called defects of consent. Mistake, fraud and threat are dealt with, as well as “gross disparity”, namely the situation where either

the contract or an individual term unjustifiably gives a party an excessive advantage over the other party.

In the cases mentioned above, the contract may be avoided by the disadvantaged party by a notice to the other party which must be given within a reasonable time after the avoiding party either knew or could not have been unaware of the relevant facts and became capable of acting freely. Avoidance may be partial and it has retroactive effect. The party who is entitled to avoid the contract may also claim damages (so as to put it into the same position it would have been in, if it had not concluded the contract) if the other party knew or ought to have known the ground for avoidance. In the cases of mistake and of gross disparity, it is possible for the other party to prevent the avoidance of the contract by a reasonable offer to modify the contract.

Chapter 3 of China's Contract Law deals with contract validity. Article 44 stipulates: "A contract shall take effect at the moment it is formed according to law." Where laws or regulations require a procedure of approval, registration etc., those provisions shall be followed.

The validity of a contract may be subject to conditions by agreement between the parties (art. 45). The validity of a contract may be subject to a time limit agreed upon between the parties. A contract subject to a time limit for validity becomes effective when the time limit is mature (art. 46). A contract concluded by a person with limited civil conduct capacity shall take effect after it is ratified by his/her legal representative (art. 47). A gratuitous contract or a contract concluded in conformity with a person's age, intelligence or mental health condition, however, does not need to be ratified by the legal representative (art. 48). Where a contract is concluded in the name of the principal by a doer without agent rights or exceeding agent authority or after the termination of the agency, the contract shall be invalid to the principal in the absence of his ratification and the doer shall be liable.

Where a contract is concluded in the name of the principal by a doer without agent rights or exceeding agent authority or after the termination of the agency, this agency is effective so long as it is reasonable for the counterpart to believe that the doer has the agent right (art. 49).

Article 52 stipulates: "A contract is void: if it is concluded through fraudulence or duress of one party to harm the interests of the State; involves maliciously conspiring to injure the interests of the State, of a collective or of a third party; uses a lawful form to conceal an illegal purpose; impairs the social public interests and violates the compulsory provisions of laws or administrative regulations."

Article 53 says: "The following exemption clauses in a contract are void:

"(1) One in connection with physical injury caused to the other party;

"(2) One in connection with property losses caused to the other party due to a deliberation or gross negligence."

An avoided contract or a rescinded contract has no legal restraint from the time when it is concluded. Where the invalidity of a part of a contract does not affect the validity of the other parts, the other parts remain valid (art. 56).

The avoidance, revocation and termination of a contract shall not affect the validity of the independent clauses in the contract in connection with dispute settlement (art. 57).

Article 58 further stipulates: “After a contract is avoided or is rescinded, the property acquired under the contract shall be returned. Property that cannot be returned or is not necessary to be returned shall be reimbursed in money. The party who was at fault must compensate the other party for the loss caused thereby; where both parties were at fault, each must bear an appropriate amount of liability.”

#### *g. Performance*

The first section of the CISG is devoted to many problems that are well known to lawyers familiar with a codification of private law: time of performance, order of performance, place of performance, payment by cheque or other instrument (a subject which as yet has found its way only into some national codes), currency of payment, imputation of payments and the like. A new topic is concerned with national public permission requirements affecting the validity of the contract or making its performance impossible. The rules state which party shall take the measures necessary to obtain permission, and the position of the parties where permission is either refused or neither granted nor refused.

The section on hardship begins by stating that if the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations. However, article 6.2.2 allows for an exception in the case of hardship, described as the situation where the occurrence of events (specified in paras. a to d) fundamentally alters the equilibrium of the contract either because the cost of a party’s performance has increased or because the value of the received performance has diminished. In the case of hardship, the disadvantaged party is entitled to request renegotiations and, upon failure to reach agreement, the court may, if reasonable, either terminate the contract at a date and on terms to be fixed or adapt the contract with a view to restoring its equilibrium.

Chapter 4 of China’s Contract Law deals with performance. Article 60 stipulates:

“The parties shall fully perform the obligation according to the contract.

“The parties shall perform such duties as notification, assistance, confidentiality etc., observing the principle of good faith and in accordance with nature and purpose of the contract and trade usage.”

#### *h. Non-performance*

Chapter 7 of the Principles is divided into four sections, as follows: general provisions, right to performance, termination, and damages and exemption clauses.

Following the CISG approach, the Principles have adopted a unitary concept of “non-performance” (art. 7.1.1): the term denotes any failure of a party to effect due performance, including late performance and defective performance. The term has been

preferred to the term “breach” used in the CISG, since breach in the common law is restricted to non-performance which gives the other party the right to claim damages, whereas non-performance may also lead to the use of other remedies, such as termination of the contract and withholding performance, for which there is no requirement that the non-performing party must be liable in damages. This can be illustrated by the operation of the rule which relates to force majeure, where a party proves that the non-performance was due to an impediment beyond its control and that it could not reasonably have been expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences (art. 7.1.7). Although the remedy of damages is not available, the other party is not precluded from exercising the remedies mentioned above.

Section 2 relates to the right to claim specific performance. Not only the obliged of a monetary obligation disposes of that right, but also the obliged of a non-monetary obligation, unless one of the specific exceptions spelled out in article 7.2.2, paragraphs a to e, occurs. To this innovation (a compromise between the civil law and the common law systems) another is added in article 7.2.4, whereby a court ordering a defaulting party to perform is authorized to award a penalty in the event of non-compliance with the order; and that this penalty be paid to the aggrieved party unless mandatory provisions of the law of the forum provide otherwise.

Section 3 deals with the right to terminate the contract in the case of a fundamental non-performance; this concept is described in article 7.3.1, paragraph 2, in a more elaborate manner than in article 25 of the CISG. Similar to “avoidance” in chapter 3, the right to terminate is exercised by a notice to the other party within a reasonable time. This section also addresses issues of anticipatory non-performance, the effects of termination (which does not preclude a claim for non-performance) and, very briefly, restitution.

Finally, the right to damages is set out in section 4: the principle of full compensation (including compensation for non-pecuniary harm), certainty of harm, foreseeability of harm, mitigation of harm and the right to interest in case of failure to pay a sum of money.

The chapter contains two modern rules restricting the freedom of the stronger party to impose unfair contract clauses on the other party. According to article 7.1.6, exemption clauses may not be invoked if it would be grossly unfair to do so, having regard to the purpose of the contract. According to article 7.4.14, a contractually specified sum to be paid in the case of non-performance may be reduced to a reasonable amount where it is grossly excessive in relation to the non-performance and the other circumstances.

Article 112 says: “If the party fails to perform contractual duties or the performance of the duties fails to conform to the agreement, it shall after performing the duties or adopting remedial measures compensate for the losses to the other party in case the other party still suffers from other losses.”

Article 8 insists on the parties’ obligation to perform their contractual obligations: “A contract legally formed is binding upon the parties. Each party shall perform its duties according to the terms of the contract. Neither party may unilaterally modify or discharge the contract.”

Article 113 stipulates:

“Where one party fails to perform contractual duties or the performance fails to conform to the agreement and thereby causes losses to the other party, the amount for losses compensated shall be equal to the losses caused by the breach of contract, including possible profit realized if the contract is duly performed, but shall not exceed the possible loss caused by breach of contract which can be foreseen by the breaching party at the time of contract formation.

“Where the business operator has engaged in fraudulent conduct in supplying goods and services for consumers, it shall take liability for compensation according to the provisions in the Law of the People’s Republic of China on Protection of the Rights and Interests of Consumers.”

Article 114 states:

“The parties may agree that one party pays liquidated damages to the other in case of breach of contract according to the circumstance of the breach. They may also agree on the calculating manner of damages caused by the breach.

“If the agreed liquidated damage is excessively higher than the actual loss, the party may apply to the People’s court or an arbitration body for suitable mitigation. If the agreed liquidated damage is excessively lower than the actual loss, the party may apply to the People’s court or an arbitration body for a suitable extension.”

*i. Assignment of rights, transfer of obligations, assignment of contracts*

Chapter 9 of the Principles contains 30 articles, of which 15 (section 1) are on assignment of rights. A right can be assigned by mere agreement between assignor and assignee, without notice to the obligor. Articles 9.1.5 and 9.1.6 allow for the assignment of future rights and of rights without individual specification. Non-assignment clauses are to a large extent deprived of their effect (see art. 9.1.9). Until receiving a notice of assignment, the obligor is discharged by paying according to the order in which the notices were received.

Chapter 5 of China’s Contract Law deals with modification and transfer. The parties may modify the contract upon agreement. If the procedure of approval or registration is required for the modification of contract by the laws or administrative regulations, provisions of the laws or administrative regulations shall apply (art. 77).

The creditor may transfer whole or partial contractual rights to a third party, except where transfer is not permitted by the nature of contract; transfer is not permitted according to the parties’ agreement and not permitted by legal provisions (art. 79).

The creditor shall notify the debtor in case of transfer of rights; otherwise, the transfer will not bind the debtor. The creditor’s consent is required if the debtor transfers the contractual duty in whole or in part to a third party (art. 84).

If the procedure of approval or registration is required for the transfer of the obligatory right by the creditor or the transfer of the debt by the debtor according to laws or administrative regulations, provisions of laws and administrative regulations shall apply (art. 87).

Upon the other party's consent, one party may transfer both contractual right and duty in general to a third party.

If the party combines after the formation of a contract, the legal person or other organization after combination shall exercise contractual right and fulfil contractual duty. If the party separates after the formation of contract, except where otherwise agreed by the creditor and the debtor, the legal person or other organization after separation shall enjoy joint and several creditors' rights and bear joint and several debts (art. 90).

*j. Limitation periods*

The general limitation period is three years after the day the obliged knows or ought to have known the facts as a result of which the obligor's rights can be exercised. The maximum limitation period is 10 years beginning on the day after the day the right can be exercised. The running of the limitation period is suspended in case of judicial or arbitral proceedings, in case of alternative dispute resolution and in case of force majeure. The parties may modify the limitation periods within the limits indicated in article 10.3 of the Principles.

Article 129 of China's Contract Law stipulates:

“The time limit of bringing suit or applying for arbitration in a dispute over an international contract of sales of goods and contract of technology export and import shall be four years, counting from the day when the party is aware or ought to be aware of its rights' being infringed upon.

“As to the time limit of bringing suit or applying for arbitration in other contract disputes, relevant legal provisions shall apply accordingly.”

*(e) Concluding remarks*

The Unidroit Principles have produced remarkable results, especially in the field of international commercial arbitration. Now that the study group also has finished the second part of its work, an interesting option would be to resume and continue the work in UNCITRAL with a view to preparing an international convention on the general part of the law of contracts. The success of the CISG, also in a sense a combined effort of both organizations, should provide inspiration and courage to undertake such a momentous, albeit arduous, enterprise.

Within the globalization and rapid development of international trade and economic cooperation, harmonization of contract law can provide a sound legal instrument to achieve efficiency and economy for cross-border movement of people, goods and services. The advantages of harmonization of contract law are obvious and evidenced all over the world:

(a) Reduction of transaction costs: the advantage of a harmonized set of legal rules is that the information costs about the relevant legal situation for the users of the legal rules (firms and consumers) might be considerably lower than in a number of different domestic legal systems;

(b) Avoidance of conflict of law: a uniform, internationally applicable law for commercial transactions can avoid conflict of law with different domestic legal systems;

(c) Support for economic and law reforms by providing harmonized contract law: many countries are undertaking domestic economic and law reform to build up a market economy ruled by law. They need to draft or revise the contract law making it suitable to their economic reform towards a market economy. Harmonized contract law can be a good reference or a model.

Under the globalized trading system and new forms of international transaction, harmonized international business rules can make transactions faster and more efficient. It will further promote international trade and improve the standard of living of people.

Harmonized business rules will support the world rule-based trading system by educating stakeholders in business transactions to perform their obligation, enhance the performance of contracts and reduce disputes and waste of time and energy.

Just like WTO, regional free trade agreements are still grey areas of the uniform, rule-based world trading system. We should encourage global harmonization of contract law in order to reduce as much as possible regional approaches to harmonization of contract law. The current more than 300 regional free trade agreements make the trading system and rules segmented and different from region to region. It will produce barriers and obstacles for entrepreneurs outside the region. They have to invest in getting knowledge about the regional contract law and spend more in legal fees to settle disputes arising from contracts between two parties in the region and non-regional enterprises. It runs counter to the objective of harmonization and unification of international trade contained in the mandate given by the General Assembly to UNCITRAL four decades ago.

UNCITRAL and Unidroit should play an important role in the harmonization of contract law.

To conclude, I would like to emphasize that the globalization of trade strongly needs harmonization of contract law. Harmonization implies voluntary participation by all interested States. It is not an order imposed from outside of the State, therefore it does not affect the sovereignty of a State. Unification is not "one size fits all". Mutual respect of each other's legal system is the key to success in the harmonization of law. As indicated in the preamble of the CISG: "The adoption of uniform rules which govern contracts for the international sale of goods and take into account the different social, economic and legal systems would contribute to the removal of legal barriers in international trade and promote the development of international trade." For reaching our common goal, all countries and legal experts should take an active part in the harmonization of contract law and seek common grounds to adopt the modern provisions of contract law, so that the harmonized contract law can better serve society and help lawyers, practitioners, judges, teachers and arbitrators, businessmen and ordinary people.

5. *Comments, evaluation and discussion*

*Jorge Sánchez Cordero*

*Director, Mexican Center of Uniform Law, Mexico*

My first question is addressed to our friend and judge, Mr. Béraudo. We are certain that Community law prevails not only over national law but also over the international law applicable to the European countries. Now, what would be the consequences of European Union legislation as concerns the composition and the method of work of UNCITRAL?

My second question is addressed to the Vice-President of the European Parliament. We know the work they have been doing most successfully and we also are aware of the work done by Gandolfi and von Bar in the European Union. Within the political and cultural framework of the preparation of a European text, what would be the impact of a code of contract and what would be the impact from the political and cultural standpoints?

*Jean-Paul Béraudo*

*Honorary Counsel, Court of Cassation, France; Vice-President, the International Court of Arbitration, International Chamber of Commerce; and Associate Professor, University of Paris I (Panthéon-Sorbonne), France*

As I already stated, it was a surprise for me that the draft Rome I regulation envisaged its precedence over two international conventions, the 1955 and 1978 Hague conventions on the law applicable to sale and to agency. Such a provision is contrary to the basic principles of international public law. When the directive on products liability came into force, I compared it with the CISG. There is overlap of the two texts about material damage. I thought that, contrary to article 94 of the CISG, the European Union would make a statement whereby the States bound by specific agreement would make a declaration thereon and thus for the sales governed by the CISG where the parties have their place of business in different countries bound by a specific text, this is the criterion of the internationality of the CISG. Unfortunately that declaration was not suggested to the member States. I hope that in the future on both sides, both for the international and the European or regional organizations, it will be possible to do so. The international organizations should refine their diplomatic clauses and enable on specific points the regional organizations to supplement the text which had been approved internationally, which are necessarily vaguer because without that they would not get the necessary consensus to have been adopted.

*Diana Wallis*

*European Parliament, Member for the United Kingdom of Great Britain and Northern Ireland*

If I may add something also to this last comment. It is rather difficult perhaps for the European Union sometimes to want to do things for systems and enterprises within the European Union and at the same time make sure that we have a regime or a legal construct that still interfaces properly with the rest of the world. Some of you will know, I am sure, that the European Union has recently adhered to the Hague Conference on Private and International Law as the European Union rather than as a separate member State. That gives the Commission a particular role in the international field that it did not have before.

However, I think that you have to accept that after 50 years, the European Union is a political construct that has gone very much further than any other regional entity that we have known before. And because of that, because we have been on the brink of having a European Constitution, there will be times when the European legislator will want to go further than has previously been possible just through international treaties. We will want to go further, to make a reality of the internal market, to make a reality of European citizenship, and, therefore, these things are intention; there will be difficulties, but we have to be open and try to solve them.

You asked about a European code again. Let us be absolutely clear and perhaps I did not make myself clear enough when I originally spoke. At the moment, there is no possibility of a European code of contract, in a legislative sense. There is no legal treaty base to do such a thing. That is why there is so much anxiety about this Common Frame of Reference. If it is just going to be an academic work, as I described, or a consultative work for the legislator, or an optional instrument, because that is what we would call soft law, the European legislator has now a proper part in the process that helps that evolve. But as you can imagine, both for the member States of the European Union and the Parliament that is unthinkable because it is quite clear where this is going ultimately. It will involve the contract law in all our countries. So this, again, is a conundrum that we have to solve within the architecture of what is the European Union at the moment. If it was going to be a European code for contract law or a European code of any sort, it would have to be subject to the full legislative process, the co-legislative process that we know in the European Union now, but there is no possibility of that within the treaties as presently constructed. So maybe it will just be an informative way, as I say, just a tool, but if it is that, legislators both at the national and European levels want to be involved, quite rightly, and that is the point I tried to make, I was amused—and I am sure it was not done on purpose—but the last slide that we saw showed everybody involved in the process of harmonization of contract law, except politicians.

*Didier Operti Badán*

*Secretary-General, Latin American Integration Association*

The comments we heard from my colleague Mr. Sánchez Cordero of Mexico and some of the responses we have heard cause me profound concern which I would like to share with you.

The formulation of uniform or harmonized law presupposes that all participants in the process are in the same situation more or less, so at least there is equilibrium, a balance of rights and interests. However, we seem to be witnessing the emergence of a real “Eurocentrism”. This is something that was referred to this morning, and that causes concern in terms of international law—not inside Europe but outside of Europe—when compared to the conventional regular sources that we use as a basis for regional law. But the preponderance of the primacy of domestic internal law in Europe over the international conventions, international law, seems to us almost revolutionary. Assuming that it is a revolution, we ask ourselves if it is an abrupt change or if it is more than an evolution. If it is not a revolution, then we need to deal with it and work out a strategy with the in-depth approach that it deserves. If it is more than an evolution, a phenomenon of concentration and redistribution of economic power, and interests, we need to admit that we are in the presence of a new international phenomenon which we do not know at this moment

whether or not it is compatible with global legal harmonization, at UNCITRAL or elsewhere. We need to start looking for a new language, a way to define these new phenomena in terms of the interests of other countries of the world who proceed on the basis of international law.

*Diana Wallis*

*European Parliament, Member for the United Kingdom of Great Britain and Northern Ireland*

My guess is, from listening to you, you asked me for an immediate reaction. We are in an evolutionary process and not a revolutionary process and the problem is this. I have tried to hint at it that the European Union—I think somebody once described it like this—is an unidentified constitutional object. It is like nothing we have had to deal with on a regional basis before and it is in a constant state of evolution and therefore it will constantly throw new challenges at us and we have got to learn to deal with that, both internally and in our external relationships. I cannot offer you the solution. I can only offer you my observation as to what is happening. It is difficult. It is challenging but Europe has gone further than most other regional organizations and that is the difficulty it faces for us.

*Eckart J. Brödermann*

*Brödermann & Jahn, Germany*

We heard from China how they moved through a huge learning curve over the past 25 years and that is something we can learn from, because Europe, although very modern and sophisticated in its national systems, is in a learning curve right now; we are at the beginning of a long learning process about how to put this law and the commercial side together. And that is why mistakes happen. What Judge Béraudo said is absolutely right. In my own doctoral thesis 25 years ago, I wrote on the interaction between public international law and European law; and there have since been better books than my own, but I am sure that nobody in the Commission has ever read them. There is a difference, for example, between a German-French case, both members of one convention and of the European Community, as compared to a case between a French party and a party from China. So there are ways to cope with this. I think the situation will evolve, and if it evolves wrongly in the beginning, we will make improvements and go to the courts, and in the end it will be sorted out. But what is important from the European point of view is that you should try not to succumb to economic lobbying alone. Here in this room there is an international legal lobby, and each of us really goes beyond national borders: there is an international community, and if you take that home to Europe that would be great.

*Patrice Lyons*

*Law Offices of Patrice Lyons, United States of America*

Ms. Wallis, I was very interested in your Internet “blue button”. Over the years, I have struggled with issues relating to the formation of contracts in the Internet environment. For example, “Accept” buttons have become customary for many people doing business in this context. Often, a user just clicks on an “Accept” button and gets a download of software. In other words, there is performance of the contract. So I do believe you have a valid contract, at least insofar as the acceptance of the contract is concerned. You have a certain harmonization in practice. How would this relate to your “blue button” suggestion? While

formal harmonization of contract law is indeed challenging at the moment, it is also apparent that the young Internet users have gone ahead and started down the path to developing more flexible systems. I would appreciate your thoughts on that.

*Diana Wallis*

*European Parliament, Member for the United Kingdom of Great Britain and Northern Ireland*

Some of us have been enthused by the idea that we would have to get beyond a continual discussion about traders having to respect so many different laws and consumers being frightened of dealing with traders in different legal jurisdictions with different laws. So the easiest way seems that perhaps you could have several optional sets of terms and conditions of business that parties could choose to use, but that they would know that the terms and conditions were approved at the European level so both sides could use them with reasonable safety and certainty. But, of course, even conditions have to have reference to a system of law to be interpreted, so the feeling was that, yes, you could have these conditions arising out of the Common Frame of Reference maybe, and the blue button would indicate that you accepted those conditions and each side could trade with some confidence. That is the very simple idea that we aim at but, as with all simple ideas, people tell you it is far too complicated and impossible. But we shall keep trying because I think that has to be the direction in which we have to travel. Sometimes I feel at the moment, and this is such a very general comment, that we have become frightened of vision in Europe and that "vision" has become a dirty word. I wish we could have a clear vision of what we want in terms of our civil and commercial law and our justice system across the European Union that matches with the aspirations of the internal market. But it seems to be that everybody is too frightened of saying anything that infringes on national competence. That is a dreadful shame, because I think that most businesses and, indeed, most of our participants who travel about so much would appreciate a justice system and a law that lived up to their expectations.

*Dmitry Davydenko*

*Director, Institute of Private International and Comparative Law, Russian Federation*

My question is for all members of the panel. In view of the great success of the CISG, what is your assessment of the prospects for universal international conventions being adopted with regard to other common types of international commercial contracts? Maybe other conventions could be based on the principles of the CISG and take regional integration into account. Is that likely?

*Sergei N. Lebedev*

*Chairman, Maritime Arbitration Commission, Russian Chamber of Commerce and Industry; and Professor, Moscow State Institute of International Relations, Russian Federation*

Well, it seems to me that there are good possibilities to develop new conventions to go to other types of contracts. With regard to regional unification which we have mentioned, it might be interesting that not all countries members of the CIS are parties to the CISG, but what is interesting is that there is certain implementation of that convention in countries which are not parties to the convention. The Model Civil Code for the CIS actually used not only the principles but the rules of the CISG. And the same relates to the chapter of

the Code devoted to leasing contracts, because the instruments prepared by Unidroit have been taken into account. The same relates, for instance, to the regime of letters of credit. Again, the international rules have been reflected in those codes and those codes have been adopted in almost all countries of the CIS. At the same time, however, if you look into the status of conventions and model laws published by UNCITRAL, you will see that some of them, particularly the last conventions, have not been adopted by many countries. Perhaps this is natural; it is the process. But I believe that there is a point in that those conventions have not been adopted by diplomatic conferences but rather by resolution of the General Assembly. And if not all countries had the possibility to participate in conferences for adoption of such uniform rules, this might have a negative impact on their implementation.

As regards possible new areas of work, I believe that UNCITRAL might in the future consider again the problem of agreed and liquidated damages. Much effort has been devoted to that project. Unfortunately, no final decision has been made, although it happened 25 years ago. Maybe it will come back again at this new level. It might be a good topic for a new convention.

## **B. Uniform contract law in practice**

*Chair: Manuel Olivencia Ruiz*  
*University of Seville, Spain*

I have been granted the honour of chairing this session by the Congress organizers without any merit on my part other than that of being a long-standing, modest contributor to UNCITRAL who has followed 37 of its 40 sessions, with greater or lesser participation but always with enthusiasm, has supported in his own country (Spain) the adoption of its instruments (the United Nations Sales Convention and model laws on insolvency and arbitration) and is still working with UNCITRAL, in teaching (as Emeritus Professor at the University of Seville) and in practice (as an arbitration attorney and business adviser).

I am both grateful and pleased to see here, at the Vienna headquarters, which I hold very dear, so many old and good colleagues and friends, and I remember with emotion many others, academics and associates, who are no longer with us.

My congratulations to the organizers for having chosen “Modern law for global commerce” as the Congress theme. The trend in commerce towards “internationality” and cross-border trade is today an unstoppable movement and a sign of our time and space, these two concepts having changed with the communications and telecommunications revolution. The world has become smaller (the “global village”), distances have shrunk, transport has become faster and the transmission of sound and images, words and data is immediate. The pace of our era has speeded up and more happens in less time.

The political, social, economic and legal changes occasioned by this phenomenon are spectacular. Economic and legal changes concern us in particular. Globalized trade is a fact. “Modern law” is an aspiration, modern not in the sense of up to date but of its time, geared to the new realities and forward-looking.

The law does not evolve at the pace of what it regulates. Markets have expanded and their activities have increased but the law regulating them has not attained “global” status.

It is well known that legal gaps exist in a key area of international trade law, the law of obligations and contracts, despite worthy efforts by UNCITRAL, Unidroit and other formulating agencies.

Unification entails not just the formulation of legal rules; it involves primarily the implementation of uniform law, its adoption, interpretation and application. Our session is thus concerned with uniform contract law in practice.

Two key components of uniformity will be considered in particular, the United Nations Sales Convention and the Unidroit Principles of International Commercial Contracts (latest version, 2004), one a legal instrument and the other a soft-law instrument, in order to examine usage in practice.

That calls for a review of the work of States (national courts and legislators) and also of market operators, parties and their counsel, the scope of party autonomy in adoption, choice, exclusion, inclusion or incorporation in contracts, as well as interpretation and application by judges and arbitrators.

Our presenters and speakers are authorities in the formulation and practical implementation of rules of uniform law.

The first speaker will be Professor Henry D. Gabriel. Professor Gabriel graduated from York University, Canada, obtained a law doctorate from Gonzaga University, where he was also Professor, and a master’s degree from the University of Pennsylvania, was Professor at Columbia University and has taught at Loyola University, New Orleans, since 1984. He has been a visiting professor and lecturer in every continent—Australia, Europe (specifically Italy), America and Asia (Japan)—and enjoys worldwide renown as a lawyer with extensive experience in the United States Supreme Court and courts of appeal, which is of importance from a practical standpoint. He is a member of the American Law Institute and the American Bar Association, where he has been Chair of the Business Law Section Committee on Sales Law. He has been United States delegate to UNCITRAL, specifically for the Working Group on Electronic Commerce. In legislative matters in the United States, he was the reporter for revisions of the Uniform Commercial Code and has served on the drafting committee of the Uniform Electronic Transactions Act. His scientific body of work is extensive and prestigious.

### *1. Choice of law, contract terms and uniform law in practice*

*Henry D. Gabriel*

*De Van Daggett Professor of Law, Loyola University Law School, United States of America*

There are three subjects embedded in my topic of “Choice of law, contract terms and uniform law in practice”. These are: does choice of law really matter to commercial parties; are these concerns reflected in the contract terms of the commercial agreements; and, to the extent that they are, are the legal choices reflected in the choosing of uniform

laws? In the brief time I have today, I would like to summarize what we know about these three questions in the actual practice of commercial transactions.

Before looking at these specific questions, it is important to remember that various uniform laws, both internationally and domestically, have been some of the most important achievements in private law in recent times. For example, internationally, the United Nations Sales Convention has effectively become the universal standard in international sales contracts.

From my own jurisdiction, one of the most effective unifications of domestic law is the American Uniform Commercial Code, which is now the law in all 50 states in the United States of America and has effectively unified on the national level the commercial law. There seems to be little doubt that the unification of laws throughout the world has increased certainty, transparency, efficiency and fairness in the law.<sup>125</sup>

My comments, although they are generally applicable to choice-of-law provisions that concern domestic uniform laws, are primarily directed to uniform laws created for primary use in international transactions. For our purposes today, the question is not whether uniform international laws create part of the commercial background of international transactions as default provisions, which they clearly do, but whether parties choose to use these uniform laws.

Thus, for example, I am not addressing such instruments as the Cape Town Convention, which, although they greatly increase and facilitate international commerce and finance, are not essentially part of the subject of choice of law. These international commercial laws will generally govern the transactions despite party choice.

Moreover, there is no way to determine how often parties intend for the application of uniform laws, but leave no record of that choice because the law is the law anyway by default. For example, parties might be quite willing to choose the CISG to govern their contract, but do not do so expressly because the CISG already applies to the transaction anyway.

As for the first question—whether choice of law matters to parties—we have to work our way through several layers of other considerations. First, we need to distinguish the concerns of the businesspeople from those of the lawyers. It is always important (and sobering to the lawyers) to remember that the businesspeople, the folks that actually put together international transactions, have little if any concern for questions of choice of law.

To the extent that legal questions are likely to concern commercial parties, the concerns will be ameliorated by those terms that virtually all legal systems allow through freedom of contract to be resolved by the parties themselves.

Thus, for example, in a sales contract, these include such terms as price, delivery, risk of loss, payment time and method, and the quality of performance.<sup>126</sup> If the seller does not

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<sup>125</sup>For an examination of the economic efficiencies brought about by unification of commercial laws, see Larry E. Ribstein and Bruce H. Kobayashi, “An economic analysis of uniform State laws”, *Journal of Legal Studies*, vol. 25, No. 1 (1996), p. 131.

<sup>126</sup>In areas of the law that are still undeveloped, parties may feel a particular need to contract around otherwise applicable law. This has been the case in the area of software licences when the parties have been uncomfortable with existing legal rules. See, for example, Raymond T. Nimmer, “An essay on article 2’s irrelevance to licensing agreements”, *Loyola of Los Angeles Law Review*, vol. 40, No. 1 (2006), p. 235.

deliver the goods, the bank does not pay on the letter of credit or the carrier causes loss to the cargo, the harmed party will either be compensated, the parties will settle the dispute without resort to questions of law or the aggrieved party will sue the party that caused the harm.

Choice of law will have little bearing on the outcome of any of these resolutions. To the extent that there are issues in dispute, the issues are usually factual issues that do not raise legal questions that will be answered by a choice-of-law provision.

There are two legal questions that the commercial parties are often quite concerned about.

First, there is the question of choice of forum. If there is a legal dispute, where will the dispute be resolved? In the case of court litigation, most parties, for obvious reasons, choose the forum in their own jurisdiction.

The second question is whether to choose arbitration over the otherwise available judicial process. For many reasons, in international disputes parties will often choose arbitration.

Questions of both choice of forum as well as the choice of arbitration both impact on the question of enforcement—an issue of great importance. But neither of these two concerns specifically addresses the question of choice of law as it applies to the substantive aspect of the transaction.

Moving to the concerns that lawyers have in the structuring of an international transaction, unlike the actual commercial parties that the lawyers represent, the concerns that more likely reflect the interests of those in this room today, we can look at choice-of-law provisions.

Thus, as to this first question—does choice of law matter to parties?—it seems we can give a qualified “yes”. There are some areas where parties have traditionally found the differences in the law matter.

This, for example, has been the case of warranties and other obligations imposed on sellers of goods. It is also the case in some areas of banking and finance law. But choice of law rarely tends to be the primary point of concern of the parties.

This brings us to the second question: do parties add choice-of-law provisions to their agreements? It is generally thought that the concept of freedom of contract or party autonomy provides open-ended choice for parties to choose the underlying law that will govern their transactions.<sup>127</sup> To a large extent, that is so, but it is subject to many important limitations.<sup>128</sup> Although the question of the legal restrictions on choice-of-law provisions is beyond the scope of my remarks today, it is important to note that they do exist; and to the extent that these restrictions do exist, they inhibit the ability of parties to choose uniform laws, or any specific laws for that matter. Thus, we must note that the option to

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<sup>127</sup>The presumption in favour of the validity and enforcement of choice-of-law clauses is particularly strong in international cases. See, for example, *Roby v. Corporation of Lloyd's* 996 F.2d 1353 (United States, Federal Court of Appeals for the Ninth Circuit, 1993).

<sup>128</sup>For a detailed examination of the problem that courts have in the enforcement of choice-of-law provisions under conflict-of-laws rules, see Kermit Roosevelt III., “The myth of choice of law: rethinking conflicts”, *Michigan Law Review*, vol. 97, No. 8 (1999), p. 2,448.

choose uniform laws may be limited, and this limitation will have an impact on whether parties provide for choice of law in their agreement.

In addition, it is clear from many cases, particularly the CISG cases, that parties do not bother to put in any choice-of-law provisions and only discover the applicability of a specific set of rules when litigation arises. Unfortunately, we have no clear data on how prevalent choice-of-law provisions are or how often they are absent from an agreement.

However, there is strong evidence to suggest that choice-of-law clauses are often put in agreements with no particular thought of the effect or outcome of the provisions. Thus, for example, it is not uncommon for the parties to provide for the law of a specific domestic jurisdiction only to discover later in litigation that their agreement is bound by the CISG because, unknown to the parties, that was the applicable domestic law by treaty.<sup>129</sup>

Thus, to the second question—do parties make use of choice-of-law provisions?—we answer, “sometimes, and not always thoughtfully”.

This brings us to our third question: do parties, when providing a choice-of-law provision, choose uniform international laws in an international transaction?

If we mean international uniform laws in international contracts, the answer is “not usually”. The evidence suggests that in international contracts, when the parties consciously choose the law, they choose domestic laws.<sup>130</sup> In other words, in international transactions, parties more often opt out as opposed to opt in to international uniform laws.<sup>131</sup> Moreover, the evidence suggests that often when parties expressly specify international norms, they refer to “international legal principles and practices” or “general international commercial practices” and this is done not to supplant but to supplement domestic law.<sup>132</sup>

What I have just said may be subject to some qualification because the evidence we have on the substance of choice-of-law provisions is based on studies by major international arbitral centres. It may be unfair to generalize about the whole world of international commercial law from the cases that end up in major arbitral institutions.

It is important to remember that uniform law is really more of an aspiration than a reality in the world today. First, many of the transactions that concern international commerce are

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<sup>129</sup> See, for example, *Vlero Mkt. & Supply Co. v. Greeni Oy & Greeni Trading Oy*, 373 F.Supp.2d 475 (United States, District of New Jersey 2005). Conversely, sloppy drafting can also result in a court not fully appreciating the import of a choice-of-law provision. Thus, for example, in an American case, the United States District Court for the District of Rhode Island concluded that the law of the state of Rhode Island governed an agreement when the contract had a choice-of-law clause which read that the agreement “shall be construed and enforced in accordance with the laws of the State of Rhode Island. *American Biophysics Corp. v. Dubois Marine Specialties*, 411 F.Supp.2d 61, 63 (United States, District of Rhode Island 2006). In this case, the parties were both from countries that are parties to the CISG: the United States and Canada. The court apparently did not consider the fact that the CISG is the law of Rhode Island in this type case.

<sup>130</sup> One study indicated that parties chose domestic law in 79 per cent of the cases. ICC, “2005 statistical report”, *International Court of Arbitration Bulletin*, vol. 17, No. 1 (Spring 2006), p. 11. There are two obvious reasons for this. First, there is the perception that a party’s own domestic law might be more favourable. Second, and more intuitive, is that parties (or the lawyers representing the parties) will choose the law most familiar. This is usually the domestic law of the respective party.

<sup>131</sup> See Peter M. Haver, “Adopting European sales conditions for sales into the United States”, *Business Law International*, vol. 38, 2007, p. 38; Franco Ferrari, “Remarks on the UNCITRAL digest’s comments on article 6 CISG”, *Journal of Law and Commerce*, vol. 25, 2005, p. 13.

<sup>132</sup> Christopher R. Drahaazal, “Contracting out of natural law: an empirical look at the new law merchant”, *Notre Dame Law Review*, vol. 80, No. 2 (2005), p. 523.

not subject to uniform laws. This is changing quite a bit, and there is substantial development of recent and future projects. Thus, the Convention on International Interests in Mobile Equipment (2001) as well as the United Nations Convention on the Assignment of Receivables in International Trade (2001) are welcome additions to uniform laws that govern financing of sales and other transactions. But there are still substantial areas of private international law that are not governed by uniform laws or customs.

It is also important to remember that beyond all of the academic theory of the benefits of uniform law to parties, particularly in international transactions, the parties themselves, and the lawyers representing those parties, do not really care much for uniform law in the abstract. What the parties are interested in is law that favours their particular interests. If it is uniform, so much the better (or just as likely, so much more the indifference).

Because uniform law reduces transaction costs by providing known default rules, this is often reason enough to choose a uniform legal regime. (Certainly, this has long been the justification for the massive, time-consuming and expensive uniform law projects both at domestic as well as international levels.) Moreover, uniform laws are often chosen because the parties are familiar with them and therefore have the comfort that they will not be surprised with unfamiliar rules.<sup>133</sup>

As it turns out, however, particularly in domestic formulations of uniform law, often (but not universally) the uniform laws favour the parties with the strongest bargaining positions as it is the representatives of these parties who have been most active in the processes of formulating uniform law. It is these parties who have the most to gain by uniform laws and tend to have the bargaining position to ensure that these laws will be the chosen sources of laws in their respective transactions.

In addition, those parties that opt to choose a uniform law instrument by a choice-of-law provision are often sophisticated enough to provide specific terms that contract around many of the default provisions otherwise provided by the uniform law instrument.<sup>134</sup> In this respect, the ultimate law that governs the underlying transaction may be somewhat irrelevant because those terms that might be different among the various possible sets of legal rules that are of importance to the parties (or at least to the party with the strongest bargaining position) will be replaced with specific terms that reflect party choice.<sup>135</sup> Such is the effect of party autonomy.

It is also worth considering in the discussion of uniform laws the differences in hard laws and soft laws. Parties often are provided the possibility of choosing soft uniform law instruments, such as the Unidroit Principles of International Commercial Contracts to

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<sup>133</sup>I am assuming that the parties have consciously made a choice to use one or another uniform law. The more paradigmatic situation is when the underlying transaction is governed by uniform laws and the parties have made no conscious decision as to which law may govern the transaction. This is the case, for example, in the majority of cases where the CISG applies.

<sup>134</sup>Thus, for example, it has been suggested that a party might choose to have a transaction governed by the Unidroit Principles of International Commercial Contracts instead of the domestic American Uniform Commercial Code because the Unidroit Principles have neither a writing requirement nor a parol evidence rule. Sarah Howard Jenkins, "Contracting out of article 2: minimizing the obligation of performance and liability for breach", *Loyola of Los Angeles Law Review*, vol. 40, No. 1 (2006), p. 401. However, it would seem odd that a party that was astute enough to choose the Principles over the domestic law would somehow still be worried about form requirements that could be easily met.

<sup>135</sup>This includes those areas that may vary depending upon the underlying law, such as standards of performance, the basis for acceptance or rejection of performance, damages and the method of dispute resolution.

govern the underlying contract, the International Chamber of Commerce Incoterms to govern the shipping agreement or the International Chamber of Commerce Uniform Customs and Practice for Documentary Credits (UCP) for the payment by letters of credit.

In some circumstances, such as the UCP for letters of credit and the Incoterms for shipment contracts, these rules may govern without express party choice by well-known custom and usage. To that extent, these instruments are no different than hard-law instruments, and they become part of the agreement either by express party choice or implied by custom and trade usage.

For our purposes here, the question is how often parties specifically choose these soft-law instruments. Unfortunately, we have no basis to determine this, as in the case of most transactions there is no public record of usage.

In conclusion, despite the widespread application of international uniform laws in international transactions, it appears that when it comes to express party choice, several factors inhibit more widespread use. First, often parties simply do not make any express choice of law to govern their transactions, and therefore the transactions are governed by the applicable law under conflict-of-law rules. Second, to the extent that parties do make an express choice-of-law decision, there is a strong tendency toward the adoption of the familiar, and this is often domestic law.

To increase the use of international uniform law, a desire that should be self-evident to this body, there appears to be two avenues to pursue. First, there should be conscious effort on the part of bodies such as this to educate parties to the existence of these instruments. Second, it is incumbent upon bodies such as UNCITRAL to ensure that these instruments reflect a fair balance between the competing domestic legal traditions such that the use of these instruments encourages international trade and facilitates predictable and fair resolution of disputes that will inevitably arise. Events such as this Congress should help achieve both of these goals.

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*Manuel Olivencia Ruiz, Chair*

Professor Bonell, who will next take the floor, has asked me to be brief when introducing him, specifically to save time, and I will do so since, among other things, Professor Bonell is well known and needs little introduction.

He is Professor of Comparative Law at the University of Rome I “La Sapienza”, and holds doctor honoris causa degrees from several universities, but I particularly wish to mention here that he has been Chairman of the Working Group for the Preparation of the Unidroit Principles of International Commercial Contracts, a member of the Commission on European Contract Law, an adviser to the Study Group for a European Civil Code, delegate of Italy to UNCITRAL, where he is well known, and a member of the Italian delegation to the 1980 Diplomatic Conference for the Adoption of the Draft Convention on Contracts for the International Sale of Goods, a member of the International Academy of Comparative Law, editor-in-chief of the UNILEX database and author of a considerable body of scientific work.

## 2. Towards a legislative codification of the Unidroit Principles?

*Michael Joachim Bonell*

*Professor of Law, University of Rome I “La Sapienza”, Italy; and Chairman of the Working Group for the Preparation of the Unidroit Principles of International Commercial Contracts\**

### (a) *The Unidroit Principles—a soft-law instrument*

The Unidroit Principles of International Commercial Contracts are a non-legislative codification of the general part of the law of international commercial contracts.<sup>136</sup> They have been prepared by a group of independent experts from all the major legal systems and geopolitical areas of the world, set up by the International Institute for the Unification of Private Law (Unidroit).<sup>137</sup> As such, they do not have the force of law and, apart from their wider scope, the only difference with respect to other internationally widely used soft-law instruments, such as the Incoterms or the Uniform Customs and Practice for Documentary Credits (UCP) issued by the International Chamber of Commerce, is that they have been produced under the supervision of and finally adopted by an intergovernmental organization.<sup>138</sup>

It was both the merits and the shortcomings of the United Nations Convention on Contracts for the International Sale of Goods (CISG) which prompted Unidroit in the early 1980s to embark upon the preparation of the Unidroit Principles. Indeed, the worldwide adoption of an international uniform sales law like the CISG paved the way for the even more ambitious project of formulating rules for international commercial contracts in general. At the same time, since the negotiations leading up to the CISG clearly demonstrated that this convention was the maximum that could be achieved at the legislative level, Unidroit decided to abandon the idea of a binding instrument and instead merely to “restate” (or where appropriate to “pre-state”) international contract law and practice.

To the extent that the Unidroit Principles address the same issues as the CISG, their provisions are in general taken either literally or at least in substance from the corresponding provisions of the CISG.<sup>139</sup> However, since the Unidroit Principles were not intended to become a binding instrument, they could and actually did in addition deal with a number of topics not covered by the CISG.<sup>140</sup> More importantly, while as a rule preference was given to solutions generally accepted at the international level (“common core” approach), exceptionally solutions best suited to the special needs of international

\*The opinions expressed in this paper are those of the author only and do not necessarily reflect those of the other members of the Working Group.

<sup>136</sup>The Unidroit Principles were first published in 1994 and a second, enlarged edition appeared in 2004. At present, work is under way on a third edition which will include additional topics.

<sup>137</sup>The International Institute for the Unification of Private Law (Unidroit) was founded in 1926 as an auxiliary organ of the League of Nations and became in 1940 an intergovernmental organization whose membership presently comprises 61 States from all five continents.

<sup>138</sup>The final version of the Unidroit Principles was adopted by Unidroit’s highest scientific organ, the Governing Council, composed of 26 members elected by the Unidroit General Assembly of all member States.

<sup>139</sup>For further details, see Michael J. Bonell, *An International Restatement of Contract Law: The Unidroit Principles of International Commercial Contracts*, 3rd ed. (Ardsley, New York, Transnational Publishers, 2005), pp. 305 ff. (where also references to the few but significant departures are to be found).

<sup>140</sup>Mention may be made of contracting on the basis of standard terms, mistake, fraud and threat, gross disparity, exemption clauses, public permission requirements, authority of agents, third-party rights and set-off.

trade were preferred even though they represented a minority view at the domestic law level (“better rule” approach).<sup>141</sup>

(b) *The Unidroit Principles and their favourable reception in practice*

As stated in the introduction to the first edition of the Unidroit Principles, “[i]n offering the Unidroit Principles to the international legal and business communities, the Governing Council [of Unidroit] is fully conscious of the fact that the Unidroit Principles ... are not a binding instrument and that in consequence their acceptance will depend upon their persuasive authority”.<sup>142</sup>

In practice the reception of the Unidroit Principles has been extremely favourable.<sup>143</sup>

Hailed as “a significant step towards the globalisation of legal thinking”,<sup>144</sup> the Unidroit Principles have been taken by a number of national legislatures as a source of inspiration for the reform of their domestic contract laws.

Moreover, also in view of the fact that they are available in virtually all the principal languages of the world, the Unidroit Principles are more and more frequently used by parties in negotiating and drafting cross-border contracts.

Finally, and most importantly, not only arbitrators but also domestic courts increasingly refer in their decisions to the Unidroit Principles.<sup>145</sup> In a number of decisions—all arbitral awards—the Unidroit Principles have been applied as the rules of law governing the substance of the dispute. This either because expressly so requested by the parties or because the contract referred to “general principles of law”, “lex mercatoria” or the like, and the arbitrators applied the Unidroit Principles on the assumption that they represented a particularly authoritative expression of similar supranational or transnational principles and rules of law.<sup>146</sup> In other decisions—by both domestic courts and arbitral tribunals—the Unidroit Principles have been used to interpret international uniform law instruments. In still other decisions—which by the way represent almost half of the reported cases and again comprise court decisions as well as arbitral awards—the Unidroit Principles have been invoked in support of a particular solution adopted under the applicable domestic law or in order to fill gaps in the latter.

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<sup>141</sup> Suffice it to mention the provisions on precontractual liability, merger clauses, battle of forms, duty to achieve a specific result and duty of best efforts, hardship, cure by non-performing party, right to performance and agreed payment for non-performance.

<sup>142</sup> See Unidroit Principles of International Commercial Contracts (1994), p. ix.

<sup>143</sup> For more detailed information, see Bonell, *An International Restatement*, pp. 248 ff.

<sup>144</sup> Joseph M. Perillo, “Unidroit Principles of International Commercial Contracts: the black letter text and a review”, in *Fordham Law Review*, vol. 43 (1994), pp. 281 ff and p. 315.

<sup>145</sup> As of June 2007, the total number of arbitral awards and court decisions referring in one way or another to the Unidroit Principles reported in the Unilex database ([www.unilex.info](http://www.unilex.info)) was 146; however, in fact at least the number of arbitral awards referring to the Unidroit Principles is likely to be much greater since most awards on account of their confidential nature remain unknown.

<sup>146</sup> Recently arbitral tribunals have gone even further and applied the Unidroit Principles in the absence of any choice-of-law clause in the contract. In so doing, the arbitrators relied on the relevant statutory provisions or arbitration rules according to which they may—to quote the language used, for instance, in article 17 of the ICC Rules of Arbitration—“apply the rules of law which [they] determine to be appropriate”.

(c) *Towards a legislative codification of the Unidroit Principles?*

(i) *Pros and cons of the non-binding nature of the Unidroit Principles*

The fact that the Unidroit Principles are the product of a group of independent experts acting under the aegis of an intergovernmental organization without direct involvement of governments has undoubtedly its advantages. Not only did it permit wider discretion in their preparation but it also renders them more flexible and capable of rapid adaptation to the changing conditions in international trade practice. As pointed out by one of the participants in the project:

“At the thought of drafting principles for the entire world ... we do not tremble for at least four reasons. One, ... whatever rules we write are only likely to be applied if they find favour with someone concerned with a particular transaction or dispute ... Two, most of our principles are unlikely to miscarry because they are framed with evident generality (e.g. ‘good faith and fair dealing’) or they have built-in safety valves (e.g. ‘unless the circumstances indicate otherwise’), giving them enough flexibility to permit a judge or arbitrator to use common sense in applying them so as to avoid an arbitrary or unfair result. Three, in some instances we have declined to deal with tough questions, as in the area ... of invalidity on a variety of grounds under the applicable domestic law. And four, ... Unidroit is free to amend the Principles ... from time to time to take care of problems that later surface.”<sup>147</sup>

Or, in the words of two American arbitrators:

“The Unidroit Principles are work in progress and unlike an international treaty are readily amenable to amendment to reflect contemporaneous commercial concerns ... Principles that may fail the test of the marketplace will be cast off, and those that are needed but nowhere found will be ... devised.”<sup>148</sup>

Nor is there necessarily a contradiction between the purposes of the Unidroit Principles as indicated in the preamble—above all, that of serving as a model for legislatures and that of being applied as the rules governing the contract—and their non-binding nature. As pointed out by one of the most eminent experts of transnational commercial law;

“The impact of the [P]rinciples may prove to be even greater than that of an international convention, for a convention has no force at the time it is concluded and represents at most a provisional indication of support by participating States which may or may not crystallise, whereas the Principles represent the unconditional commitment and consensus of scholars of international repute from all over the world.”<sup>149</sup>

It may therefore not come as a surprise that there are those who openly state that the non-binding nature of the Unidroit Principles, far from being problematic, makes them even more attractive. As pointed out by another expert of transnational commercial law;

<sup>147</sup>E. Allan Farnsworth, “Closing remarks”, *American Journal of Comparative Law*, vol. 40, No. 3 (1992), pp. 699-700.

<sup>148</sup>See Charles N. Brower and Jeremy K. Sharpe, “The creeping codification of transnational commercial law: an arbitrator’s perspective”, *Virginia Journal of International Law*, vol. 45, 2004, pp. 220-221.

<sup>149</sup>Roy Goode, *Commercial Law in the Next Millennium*, Hamlyn Lectures (London, Sweet & Maxwell, 1998), p. 234.

“The informal approach taken by the Unidroit Working Group has had a decisive influence on the success of the Principles. ... Informal, not formalized codification of transnational commercial law is the order of the day.”<sup>150</sup>

Or, to quote again Roy Goode:

“The Principles demonstrate ... that the formulation of international rules of general law, whether relating to international trade or otherwise, is best left to scholars [who possess both the technical expertise and freedom from political constraints], leaving governments ... to focus on more specific areas—for example competition law and consumer protection—where the rules are essentially mandatory rules or rules of public policy rather than dispositive provisions.”<sup>151</sup>

However, the present status of the Unidroit Principles has clearly also its shortcomings. Like any other soft-law instrument in the field of contract law, the Unidroit Principles are binding only within the limits of party autonomy, whereas in the absence of voluntary acceptance by the parties, courts and arbitral tribunals will apply them, if at all, only if persuaded by their intrinsic merits. Accordingly, the preamble to the Unidroit Principles states that they *shall* be applied (emphasis added) only when the parties have agreed that their contract be governed by them, whereas in all other cases—namely where the parties have agreed that their contract be governed by the “general principles of law”, the “*lex mercatoria*” or the like, or where the parties have not chosen any law to govern their contract, or for the purpose of interpreting or supplementing international uniform law instruments or domestic law—the Unidroit Principles simply *may* become relevant (emphasis added), i.e. their application is left to the discretion of the adjudicating body.

In fact, already shortly after their publication voices were raised in support of the transformation of the Unidroit Principles into a binding instrument. Thus, to quote a Dutch judge and member of the Governing Council of Unidroit:

“The Unidroit Study Group has all but finished its work ... [A]fter some period for study and reflection has passed, it would be worthwhile to consider resuming and continuing the work in UNCITRAL with a view to preparing an international convention on the general part of the law of contracts.”<sup>152</sup>

Or, as suggested by a French judge:

“Once the Principles have become accessible to all, ... they could, if their success justifies it, be incorporated in a treaty and thereby acquire the greatest force of law.”<sup>153</sup>

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<sup>150</sup> Klaus P. Berger, *The Creeping Codification of the Lex Mercatoria* (The Hague, Kluwer Law International, 1999), p. 154.

<sup>151</sup> Roy Goode, “Rule, practice and pragmatism in transnational commercial law”, *International and Comparative Law Quarterly*, vol. 54, No. 3 (2005), p. 553 and p. 556.

<sup>152</sup> Arthur S. Hartkamp, “Principles of contract law”, in *Towards a European Civil Code*, Arthur S. Hartkamp and others, eds. (Nijmegen, Netherlands: Ars Aequi Libri, 1994), p. 50. Yet for a more cautious approach recently taken by the same author, see *infra* text and note 40.

<sup>153</sup> Jean-Paul Béraudo, “Les principes d’Unidroit relatifs au droit du commerce international”, *La Semaine Juridique*, 1995, I, p. 194.

Likewise, as an American lawyer pointed out:

“Adoption of the Principles would expand the narrow focus of the CISG into a far more comprehensive legal structure to govern [international commercial contracts] ... ”<sup>154</sup>

Recently the idea of promoting the Unidroit Principles from their present status as a soft-law instrument to a binding legislative text has been relaunched in the context of the proposal to prepare a “global commercial code”. As pointed out by the most eminent supporter of such a proposal:

“The need for a Global Commercial Code ... will grow with the globalization of communications and commerce ... . When the world becomes one market, that market will require one law, and that law must include general principles of contract law ... . [The Unidroit Principles] will have to be raised from their present status to that of rules of law binding on the courts ... . [T]hey should be incorporated in the Code, thus making their many mandatory and non-mandatory provisions part of that Code ... .”<sup>155</sup>

(ii) *Different ways of promoting the Unidroit Principles from their present status as a non-binding instrument*

The transformation of the Unidroit Principles into binding legislation is certainly the most radical, but by no means the only nor necessarily the best, way of promoting them from their present status as a mere soft-law instrument. And since it is rather unlikely that governments will at least in the near future be willing to embark upon a far-reaching project such as the adoption of the Unidroit Principles by an international convention, it may be worthwhile further to explore less radical and maybe even more appropriate options.

a. *Formal endorsement of the Unidroit Principles by the Commission*

A first step in that direction would be the formal endorsement of the Unidroit Principles by UNCITRAL—and this is expected to take place on the occasion of the next UNCITRAL session, in June 2007. UNCITRAL has already endorsed other soft-law instruments that have proved particularly successful in practice, such as Incoterms or the Uniform Customs and Practice for Documentary Credits prepared by the International Chamber of Commerce; and it goes without saying that if UNCITRAL were to recommend also the use of the Unidroit Principles by parties in international trade transactions, this would definitely enhance the prestige and popularity of the Principles worldwide.

<sup>154</sup>Barton S. Selden, “Lex mercatoria in European and U.S. trade practice: time to take a closer look”, *Annual Survey of International and Comparative Law*, vol. 2, 1995, p. 128.

<sup>155</sup>Ole Lando, “Principles of European contract law and Unidroit Principles: moving from harmonisation to unification?”, *Uniform Law Review/Revue de droit uniforme*, vol. VIII, Nos. 1-2 (2003), p. 132; Ole Lando, “CISG and its followers: a proposal to adopt some international principles of contract law”, *American Journal of Comparative Law*, vol. 53, No. 2 (2005), p. 384.

b. *Recommendation by the Commission to use the Unidroit Principles as a means to interpret and supplement the United Nations Sales Convention*

Article 7 of the CISG states that:

“In the interpretation of this Convention regard is to be had to its international character and to the need to promote uniformity in its application... .”

and that:

“Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.”

The purpose of the provision is to make it clear that the Convention should be interpreted and supplemented autonomously, i.e. according to international uniform principles and rules, whereas recourse to domestic law is admitted only as a last resort.<sup>156</sup> In the past such autonomous principles and rules had to be found by judges and arbitrators themselves on an ad hoc basis. Now that the Unidroit Principles exist, the question arises whether they may be used for this purpose.

Among scholars, opinions are divided. While according to the prevailing view the answer is in the affirmative,<sup>157</sup> others deny the possibility of using the Unidroit Principles to interpret or supplement the CISG on the basis of the rather formalistic argument that the former were adopted after the latter.<sup>158</sup>

In practice, not only arbitral tribunals but also domestic courts seem to have few if any scruples in referring to the Unidroit Principles to interpret and supplement the CISG. Only in a few cases has this been justified on the ground that the individual provisions invoked can be considered an expression of a general principle underlying both the Unidroit Principles and the CISG. Other decisions simply equate, with no further explanation, the Unidroit Principles in their entirety to the general principles underlying the CISG and so justify the application of individual provisions of the Unidroit Principles to interpret or supplement the CISG. Still other awards go even further and apply the Unidroit Principles as “trade usages ... in international trade widely known” according to article 9 (2) of the CISG, or because they represent “a worldwide consensus in most of the basic matters of contract law” or “a restatement of the commercial contract law of the world [which] refines and expands the principles contained in the United Nations Convention”.<sup>159</sup>

<sup>156</sup> See Michael J. Bonell in *Commentary on the International Sales Law: The 1980 Vienna Sales Convention*, Cesare M. Bianca and Michael J. Bonell, eds. (Milan, Giuffr , 1987), pp. 72 ff.; John O. Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention*, 3rd ed. (The Hague, Kluwer Law International, 1999), pp. 88 ff.

<sup>157</sup> To be sure, there are those who are in favour of virtually unlimited recourse to the Unidroit Principles on the ground that they represent “general principles of international commercial contracts” and as such meet the requirements of article 31, paragraph 3, of the Vienna Convention on the Law of Treaties or more specifically of article 7, paragraphs 1 and 2, while others admit recourse only to those individual provisions of the Unidroit Principles that can be considered an expression of a general principle underlying both the Unidroit Principles and the CISG: see, also for further references, Bonell, *An International Restatement*, pp. 233 ff., and pp. 317 ff. (see footnote 139 above).

<sup>158</sup> In this sense, see recently James J. Fawcett, Jonathan M. Harris and Michael Bridge, *International Sale of Goods in the Conflict of Laws*, Oxford Private International Law Series (Oxford, Oxford University Press, 2005), p. 934.

<sup>159</sup> For a more detailed and critical analysis, see M. J. Bonell, *An International Restatement*, pp. 325 ff. (see footnote 139 above).

Under the circumstances it would be desirable to have UNCITRAL adopt a formal recommendation<sup>160</sup> to use the Unidroit Principles to interpret and supplement the CISG, provided that the issues at stake fall within the scope of the CISG and that the individual provisions of the Unidroit Principles referred to can be considered an expression of a general principle underlying both the Unidroit Principles and the CISG. Such a recommendation would have the merit of promoting uniformity in the application of the CISG worldwide while at the same time ensuring that in practice recourse to the Unidroit Principles is made only within the limits and on the conditions provided by article 7 of the CISG.

*c. Formal recognition of the parties' right to choose the Unidroit Principles as the law governing their contract*

One may think of a variety of situations in which parties to an international commercial contract—be they powerful “global players” or small or medium businesses—may wish to, and actually do, avoid the application of any domestic law and instead prefer to subject it to a genuinely neutral legal regime such as the Unidroit Principles.<sup>161</sup>

Likewise, an increasing number of model contracts prepared by international agencies such as ICC or the UNCTAD/WTO International Trade Centre contain a reference to the Unidroit Principles either as the exclusive *lex contractus* or in conjunction with other sources of law (e.g. a particular domestic law; general principles of law prevailing in a given trade sector; usages).<sup>162</sup>

However, according to the relevant conflict-of-laws rules the effects of the parties' agreement on the application of the Unidroit Principles vary considerably depending on whether such agreement is invoked before a domestic court or an arbitral tribunal. Only in the context of international commercial arbitration are parties nowadays permitted to choose a soft-law instrument such as the Unidroit Principles as the law governing their contract in lieu of a particular domestic law. By contrast, as far as court proceedings are concerned the traditional and still prevailing view is that the parties' freedom of choice is limited to a particular domestic law, with the result that a reference to the Unidroit Principles will be considered as a mere agreement to incorporate them into the contract and as such can bind the parties only to the extent that they do not affect the mandatory provisions of the *lex contractus*.<sup>163</sup>

To be sure, recently there have been some significant developments suggesting that things may change in the near future.

Thus, the 1994 Inter-American Convention on the Law Applicable to International Contracts refers on two occasions to legal sources of an “anational” or supranational

<sup>160</sup>For a precedent, see the recommendation regarding the interpretation of article II, paragraph 2, and article VII, paragraph 1, of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done in New York, 10 June 1958, adopted by the United Nations Commission on International Trade Law on 7 July 2006 at its thirty-ninth session (*Official Records of the General Assembly, Sixty-first Session, Supplement No. 17 (A/61/17)*, annex II), and article VII, paragraph 1, of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

<sup>161</sup>For the most frequent situations, see Bonell, *An International Restatement*, pp. 174 ff. (see footnote 139 above); Eckart Brödermann, “The growing importance of the Unidroit Principles in Europe—a review in light of market needs, the role of law and the 2005 Rome I proposal”, *Uniform Law Review/Revue de droit uniforme*, vol. 11, 2006, pp. 751 ff.

<sup>162</sup>Further details in Bonell, *An International Restatement*, pp. 275-277 (see footnote 139 above).

<sup>163</sup>See, also for further references, Bonell, *An International Restatement*, pp. 192 ff. and pp. 180 ff., respectively (see footnote 139 above).

character for the purpose of the determination of the *lex contractus*,<sup>164</sup> thereby justifying the conclusion that under this Convention the Unidroit Principles may well be applied as the law governing the contract at least if expressly chosen by the parties.<sup>165</sup>

Furthermore, a reference to the possibility for parties to agree on the applicability of the Unidroit Principles can now be found even in the United States Uniform Commercial Code. More precisely, comment 2 to section 1-302, as revised in 2001, states that “parties may vary the effect of [the Uniform Commercial Code’s] provisions by stating that their relationship will be governed by recognized bodies of rules or principles applicable to commercial transactions ... [such as ] the Unidroit Principles of International Commercial Contracts ...”.<sup>166</sup>

Finally, and most important, in a draft regulation of December 2005 intended to replace the Rome Convention on the Law Applicable to Contractual Obligations, the Commission of the European Communities proposes to insert in article 3 of the Rome Convention a new paragraph 2 to read “[t]he parties may also choose as the applicable law the principles and rules of the substantive law of contract recognised internationally ...”;<sup>167</sup> as pointed out in the explanatory notes, “[t]he ... words used would authorise the choice of the Unidroit Principles ... while excluding the *lex mercatoria*, which is not precise enough, or private codifications not adequately recognised by the international community ...”.

While discussion on this proposal is still going on within the European Union,<sup>168</sup> it is suggested formally to recognize at a universal level the right of parties to an international commercial contract to choose as the governing law a soft-law instrument such as the Unidroit Principles. Such explicit recognition would have the merit of rendering the principle of party autonomy consonant with the needs of businesses engaged in international trade, while at the same time eliminating the totally unjustified differentiation in the parties’ freedom to choose the applicable law depending on whether they decide to have their disputes settled by arbitration or in court.

The Hague Conference on Private International Law would obviously be the most appropriate body to launch such an initiative which could eventually lead to the adoption of a binding treaty or—alternatively—of a model law or simply a recommendation.<sup>169</sup> As to how best to formulate the proposed recognition of the right of the parties to choose the

<sup>164</sup>Precisely in article 9 (2) and in article 10.

<sup>165</sup>For further references, see Bonell, *An International Restatement*, pp. 183-186 (see footnote 139 above).

<sup>166</sup>It is true that such reference is made in the context of section 1-302 laying down the principle of freedom of contract and not in the context of section 1-301 dealing with the parties’ right to choose the applicable law. Yet, the probability that, if parties actually choose the Unidroit Principles as the rules of law governing their contract, individual provisions of the Principles will be struck out because of their incompatibility with the Code is rather remote, all the more so since most of the mandatory provisions of the Code are restricted to consumer transactions.

<sup>167</sup>Proposal for a regulation of the European Parliament and the Council on the law applicable to contractual obligations (Rome I), Brussels, 15 December 2005 (COM (2005) 650 final).

<sup>168</sup>So far, the proposal seems to be meeting considerable reservations on the part of member States apparently concerned about the risk of excessive legal uncertainty deriving from the choice of “anational” principles and rules as the law governing the contract as compared to the alleged certainty and predictability of the choice of a particular domestic law. Yet—as pointed out by an eminent Swiss scholar (Frank Vischer, “The relevance of the Unidroit Principles for judges and arbitrators in disputes arising out of international contracts”, *European Journal of Law Reform*, vol. 1, No. 3 (1998-1999), p. 211)—the Unidroit Principles, far from being just a loose set of a few poorly drafted principles, in fact represent “a codification of high quality and homogeneity in contents which in many respects even surpasses the quality of traditional national legal order.”

<sup>169</sup>By coincidence, the Hague Conference is currently exploring the possibility of preparing a parallel instrument to the 2005 Convention on Choice of Court Agreements and concerning choice of law in international contracts: what is proposed here could perfectly fit in that project.

Unidroit Principles as the law governing their contract, one possibility would be to use the formula of article 28 (1) of the UNCITRAL Model Law on International Commercial Arbitration and generically state that parties to an international commercial contract may choose the “*rules of law*” (emphasis added) applicable to their contract.<sup>170</sup> If such language was considered to be too vague, one could restrict the parties’ freedom of choice to “principles of commercial contracts recognized by international organizations”<sup>171</sup> or even specifically refer to the Unidroit Principles alone.<sup>172</sup>

*d. Adoption of the Unidroit Principles as a model law*

If the conversion of the Unidroit Principles into a binding instrument in the form of an international convention is not a realistic and perhaps not even a desirable objective,<sup>173</sup> it may still be worth considering adopting them as a model law. The direct involvement of governments would certainly enhance the authority of the Unidroit Principles; at the same time, the risk of their losing much of their innovative character and being reduced to the lowest common denominator among existing domestic laws is certainly less acute given the non-binding nature of the chosen instrument.

What still remains to be seen is whether the Unidroit Principles should be the subject of a model law on its own or be part of an even farther reaching project, such as a global commercial code. Such a code—to be adopted in the form of a model law<sup>174</sup> prepared by UNCITRAL in cooperation with other interested international organizations—should be a sort of consolidation of existing international uniform law instruments (e.g. the CISG, the various transport law conventions, the Unidroit conventions on leasing and factoring etc., as well as soft-law instruments such as Incoterms, the Uniform Customs and Practice for Documentary Credits etc.).<sup>175</sup> The Unidroit Principles—it is suggested—could play the role of the code’s “general contract law”: more precisely, the code could contain a provision declaring that the Unidroit Principles apply with respect to the specific contracts covered by the code to matters not expressly settled unless the parties have excluded the Unidroit Principles by choosing another law or otherwise.<sup>176</sup>

<sup>170</sup> Such broad language would cover practically all choice-of-law clauses in favour of non-State principles and rules most frequently used in international trade, including a reference to the *lex mercatoria* or to no further specified “general principles of law” and “usages and customs of international trade”.

<sup>171</sup> To make it clear that parties may choose as the law governing their contract, instead of the law of a particular country, not any set of privately drafted contract rules but only “codifications” or “restatements” prepared under the aegis of an international organization.

<sup>172</sup> The reference to the Unidroit Principles could be further qualified by the statement that questions not expressly covered by them should be settled as far as possible in accordance with their underlying principles or in the absence of such principles in accordance with the otherwise applicable domestic law.

<sup>173</sup> See on this point the pertinent remarks of Klaus P. Berger, “European private law, *lex mercatoria* and globalisation”, in *Towards a European Civil Code*, 3rd ed., Arthur S. Hartkamp and others, eds., (The Hague, Kluwer Law International, 2004), pp. 53-54.

<sup>174</sup> For the different view that the proposed code should be adopted in the form of a binding convention, see text and note 155 above.

<sup>175</sup> The idea of a global commercial code was first launched by Gerold Herrmann, “Law, international commerce and the formulating agencies—the future of harmonisation and formulating agencies: the role of UNCITRAL”, paper presented at the Schmitthoff Symposium 2000 “Law and Trade in the 21st Century”, Centre of Commercial Law Studies, London, 1-3 June 2000.

<sup>176</sup> In this sense, see Michael J. Bonell, “Do we need a global commercial code?”, *Dickinson Law Review*, vol. 106, 2001, pp. 87 ff.; Arthur S. Hartkamp, “Modernisation and harmonisation of contract law: objectives, methods and scope”, *Uniform Law Review/Revue de droit uniforme*, vol. 8, Nos. 1-2 (2003), p. 89; Huang Danhan, “The Unidroit Principles and their influence in the modernisation of contract law in the People’s Republic of China”, *Uniform Law Review/Revue de droit uniforme*, vol. 8, Nos. 1-2 (2003), p. 117.

(d) *Conclusions*

The Unidroit Principles, prepared as a soft-law instrument, have been very favourably received in practice. To transform them into binding legislation in the form of an international convention is neither feasible nor recommendable.

There are less radical but maybe even more appropriate ways to promote the Unidroit Principles from their present status as a non-binding instrument.

Apart from endorsing them, UNCITRAL may formally recommend the use of the Unidroit Principles to interpret and supplement the CISG within the limits and on the conditions laid down in article 7 of the CISG.

On its part the Hague Conference on Private International Law may take the initiative of formally recognizing the right of parties to an international commercial contract to choose the Unidroit Principles as the law governing their contract.

Last but not least, UNCITRAL may prepare, in cooperation with other interested international organizations, a “global commercial code” to be adopted in the form of a model law which refers to the Unidroit Principles as its “general contract law” applicable to the specific contracts covered by the code unless otherwise agreed by the parties.

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*Manuel Olivencia Ruiz, Chair*

I give the floor to Professor Sono. His name is well known in these forums. Professor Sono follows a paternal tradition as an academic, he is a university professor, as well as in his inclination to, specialization in and dedication to law harmonization and unification. At present he is an Adviser in the Ministry of Justice of Japan and expert in UNCITRAL topics.

3. *Contract law harmonization and third countries: the case of the United Nations Sales Convention*

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(a) *Introduction*

The United Nations Convention on Contracts for the International Sale of Goods (the CISG) is one of the most successful instruments of contract law harmonization. After 27 years since its adoption, and 19 years since its coming into force, the number of contracting States has reached 70. Those States share a common contract law of sales which is often

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\*The views expressed herein are solely those of the author and do not represent the views of the Japanese Government. The author wishes to thank Professor Albert Kritzer for valuable input in the preparation of this paper. All Internet resources cited herein were last accessed on 15 June 2007 unless otherwise indicated.

characterized as a lingua franca of international trade. The CISG removes legal barriers to cross-border trading through the reduction of legal costs, and the contracting States are enjoying the benefit of harmonization. This poses the question of what the rest of the world is doing. Africa and Asia are rather slow in becoming members of the club. Perhaps, each country and region has its own reason. I will avoid making any hasty generalization and will take Japan as an example in order to answer two related questions.

The first is a question that any Japanese attending a colloquium dealing with contract law harmonization or the CISG cannot avoid. Namely, why has Japan not become a member of the CISG, and will Japan remain a non-contracting State? After making some excuses for the past, I will make some optimistic remarks about the future.

The second question is whether the CISG is irrelevant in non-contracting States. I ask this question in order to describe the creeping influence of the CISG witnessed even among non-contracting States.

(b) *Japan as a non-contracting State*

Japan is currently a non-contracting State. Given the extent to which it is involved in export/import trade, one may wonder why.

It is not that any decision to reject the CISG has been made. There was a time in the early 1990s when it seemed that Japan was almost going to join the CISG community. In 1989, soon after the CISG came into force, the Ministry of Justice organized an informal study group to examine the CISG. It was expected that upon the recommendation of this study group, the Ministry would commence the official process of acceding to the CISG. This did not happen. The study group continued with its mandate until 1993, when their work was suspended before reaching any conclusion.

The most direct reason for the suspension was this:<sup>177</sup> in the early 1990s, the Japanese economy was struggling with the aftermath of the burst of the bubble economy. The legislative agenda became full of urgent legislation directed toward economic recovery. This included laws on secured transactions, insolvency laws, corporation laws and so on, which required the full attention of the Ministry. The Ministry could no longer afford to continue with its work on the CISG.

But that answers only half the question. There still is the question of why the Ministry gave priority to that legislation over the CISG. True, of course, economic recovery was a more urgent matter with more direct impact on the economy than the CISG. However, just giving a go to the CISG would not have taken up much manpower since the study group had been already examining the CISG. I suspect that there was also some hesitation, though not a concern, about the CISG.

First of all, it was still in the early 1990s, when the number of contracting States was around 30. It was not clear whether the use of the CISG would become prevalent. There was also some uncertainty as to how the CISG would be applied in other contracting States.

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<sup>177</sup>For another account of the story, see Yoshihisa Nomi, "The CISG from the Asian perspective", in *Celebrating Success: 25 Years United Nations Convention on Contracts for the International Sale of Goods* (Singapore, Singapore International Arbitration Centre, 2005). Available from <http://cisgw3.law.pace.edu/cisg/biblio/nomi.html>.

Secondly, the major Japanese trading companies (the “sogoshosha”) did not really feel the need at that time for the CISG and were not particularly enthusiastic about it. Rather they were reluctant to take on the costs of learning the CISG,<sup>178</sup> and had repeated that they would opt out of the CISG anyway. Standard terms opting out of the CISG became so common that you will find them even in contracts which do not involve any element of sale of goods.

This lack of support discouraged the Ministry from continuing its work on the accession to the CISG under the economic conditions of the time.

(c) *Toward a contracting State*

Will Japan remain a non-contracting State? I am happy to report to you that, most likely, Japan will join the club soon. In October last year [2006], the Ministry resumed its work toward accession to the CISG. The plan is to get approval from the Diet, which is a constitutional requirement, as early as in 2008.

What made this change happen? The most direct reason is that the congested legislative agenda has cleared somewhat, and the Ministry is now able to devote their manpower to this task again. A more indirect reason, but an equally important one, is the phenomenal success of the CISG.

All of the dismal predictions which were sources of reluctance in acceding to the CISG in the early 1990s turned out to be wrong. The number of contracting States has more than doubled. With the emergence of the vast array of court and arbitral decisions, and the enormous amount of scholarly writings, doubts about the predictability of the CISG have diminished as well.

Also, small and medium-sized enterprises which are not particularly prepared to face the legal technicalities are engaging in international trade more than ever. Arguably, they may become the largest beneficiary of the CISG when Japan becomes a contracting State. This factor adds to the reason to accede to the CISG.

The major trading companies are also beginning to change their attitude toward the CISG, now that they have discovered that the CISG is being used in a large part of the world. They are finding out that the CISG can curtail costs of dealing with diverse domestic laws, as well as transactions costs associated with negotiating choice-of-law clauses.

This sudden awareness is in large part due to the growth of the Asian market.<sup>179</sup> Most symbolic is the rapid increase of Japan’s trade with China. In the year 1990, China’s share in Japan’s export/import trade was less than 4 per cent. Today it is close

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<sup>178</sup>Luke Nottage, “Who’s afraid of the Vienna Sales Convention (CISG)? A New Zealander’s view from Australia and Japan”, *Victoria University of Wellington Law Review*, vol. 36, No. 4 (2005), pp. 815 and pp. 829-840. Available from [www.austlii.edu.au/nz/journals/VUWLR/2005/39.html](http://www.austlii.edu.au/nz/journals/VUWLR/2005/39.html) and <http://cisgw3.law.pace.edu/cisg/biblio/nottage.html>.

<sup>179</sup>The following analysis is based on trade statistics available from the Japan External Trade Organization website ([www.jetro.go.jp/en/reports/](http://www.jetro.go.jp/en/reports/)).

to 20 per cent. This is equal to Japan's trade with the United States, which used to be Japan's largest trading partner for years. The United States and China combined account for nearly 40 per cent of Japan's international trade. More importantly, it seems that Chinese traders are not shy to use the CISG. More on this later.

The same applies to other East Asian countries. Japan's trade with this region, even excluding China, amounts to more than 20 per cent of Japan's export/import. This surpasses Japan's trade with the United States or China. Given the diversity of legal systems among these countries, and given that many of these countries are either transition economies or economies in the process of developing their legal infrastructure, the advantage of having one common contract law is becoming more attractive than ever. Of course, at present, China, Singapore and Korea are the only East Asian States parties to the CISG. However, joining the CISG would be a big step for Japan toward dealing with the Asian diversity.

(d) *The creeping influence of the United Nations Sales Convention in a non-contracting State*

At present, Japan, as a non-contracting State, is involved in very limited CISG practice, but nonetheless the success of the CISG does have some ripple effect.

(i) *The United Nations Sales Convention in Japanese courts*

First of all, it is always possible that the CISG may be applied in a non-contracting State as foreign law. There was one close call in 1998. In a case of an import of a classic Porsche from the United States to Japan, the Tokyo District Court considered applying the CISG.<sup>180</sup> In that case, the Japanese rules of private international law led to the application of United States law (or California law) and the court considered that United States law would mean the CISG. There are obvious flaws in this reasoning,<sup>181</sup> but that did not affect the outcome of the case: the court, after its discussion of the CISG, denied its own jurisdiction over this case. Effectively, every reference in this case to the CISG is in the *obiter dictum*.

However, the point here is that the court did consider the CISG at length. It is unusual that a court would do so and overturn it later by denying its own jurisdiction. What caught my attention is the judge. The decision was rendered by Judge Toshifumi Minami, who was involved in several UNCITRAL deliberations of the CISG in the late 1970s and also at the 1980 diplomatic conference as a Japanese delegate. This decision may have been a part of his crusade to raise awareness about the CISG in Japan.

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<sup>180</sup> Japan 19 March 1998 Tokyo District Court (*Nippon Systemware Kabushikigaisha v. O.*), 997 Hanrei Taimuzu 281. For a brief account, see <http://cisgw3.law.pace.edu/cases/980319j1.html>. On appeal, the Tokyo High Court (Japan 24 March 1999 Tokyo High Court, 1700 Hanrei Jiho 41, translation unavailable) reversed the district court's decision on jurisdiction and rendered judgement applying Japanese law.

<sup>181</sup> First, the court apparently overlooked that article 1 (1) (b) should be fulfilled pursuant to the Californian rules of private international law in order to apply the CISG to this case. No such analysis is given. Second, the court further overlooked that the United States has declared an article 95 reservation.

(ii) *United Nations Sales Convention cases involving Japanese parties*

Other than the above, a quick search of the Pace CISG database revealed nine cases where the CISG was applied to international sales involving a Japanese seller or buyer.<sup>182</sup> One of them is an Australian court decision, and the other eight are cases from China: three court decisions and five arbitration cases. The arbitration cases are all from the China International Economic and Trade Arbitration Commission (CIETAC). The cases identified are probably only the tip of the iceberg, and this is indicative of where the gravity of the CISG practice in Japan will lie. (Three of the cases do not make it clear on what basis the CISG was applied,<sup>183</sup> and the following examination will concentrate on the other six which makes the reason clear.)

a. *Article 1 (1) (a)*

One would not expect the CISG to be applied to cases involving Japanese parties on the basis of article 1 (1) (a). However, three of the CIETAC cases applied the CISG, surprisingly, on the basis of article 1 (1) (a). The cases involved parties whose places of business were in China and Japan, and the tribunal applied the CISG pointing out that China and Japan are both parties to the CISG.<sup>184</sup> This is clearly wrong. However, it does sound so natural that Japan is a contracting State and it reinforces the view that it is about time that Japan live up to the expectations of other CISG States.

Besides, we also have to take into account the operation of Japanese companies through their overseas subsidiaries. Although the subsidiaries are not Japanese parties in the technical sense, it is no secret that they are controlled by their Japanese headquarters. Many subsidiaries will have their place of business in a contracting State, and as such, they will be subject to the CISG through article 1 (1) (a). For example, a sale of goods between a subsidiary of a Japanese company in Germany and a buyer in France will be governed by the CISG.<sup>185</sup>

b. *Article 1 (1) (b), including opting in*

Next, there is an application of the CISG on the basis of article 1 (1) (b). In 2003, the Supreme Court of Victoria, Australia, applied the CISG to a dispute involving a Japanese

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<sup>182</sup>An Internet search using the combination of terms “CISG case presentation” and “country: Japan” will result in a list of cases in the Pace database involving a Japanese seller or buyer.

<sup>183</sup>China 19 February 2001 Jiangsu Higher People’s Court [Appellate Court] (*Tai Hei v. Shun Tian*), translation available from <http://cisgw3.law.pace.edu/cases/010219c1.html>; China 27 November 2002 Higher People’s Court of Ningxia Hui (*Xinsheng Trade Company v. Shougang Nihong Metallurgic Products*), translation available from <http://cisgw3.law.pace.edu/cases/021127c1.html>; China 20 July 1993 CIETAC Arbitration proceeding (*Shaping machine case*), translation available from <http://cisgw3.law.pace.edu/cases/930720c1.html>.

<sup>184</sup>China 7 November 1996 CIETAC Arbitration proceeding (*Stone products case*), translation available from <http://cisgw3.law.pace.edu/cases/961107c1.html>; China 2 April 1997 CIETAC Arbitration proceeding (*Wakame case*), translation available from <http://cisgw3.law.pace.edu/cases/970402c1.html>; China 21 October 2005 CIETAC Arbitration proceeding (*Sheet metal producing system case*), translation available from <http://cisgw3.law.pace.edu/cases/051021c1.html> (last accessed on 17 July 2007). See also Dong Wu, “CIETAC’s practice on the CISG”, *Nordic Journal of Commercial Law*, vol. 2, 2005, pp. 9-10, available from [www.njcl.fi/2\\_2005/article2.pdf](http://www.njcl.fi/2_2005/article2.pdf); and Fan Yang, “The application of the CISG in the current PRC law and CIETAC arbitration practice”, *Nordic Journal of Commercial Law*, vol. 2, 2006, p. 25, available from [www.njcl.utu.fi/2\\_2006/article4.pdf](http://www.njcl.utu.fi/2_2006/article4.pdf).

<sup>185</sup>One early example is France 22 April 1992 Appellate Court Paris (*Fauba France FDIS GC Électronique v. Fujitsu Microelectronik GmbH*), translation available from <http://cisgw3.law.pace.edu/cases/920422f1.html>. The German seller was a subsidiary of Fujitsu Ltd., a Japanese company.

seller and an Australian buyer.<sup>186</sup> In that case, the private international law of the forum led to the application of Victorian law, and the CISG was applied on the basis of article 1 (1) (b). This is a straightforward CISG case.

What is more interesting for our purposes, however, are the cases where the parties “opted in” to the CISG.<sup>187</sup> There is a Chinese case in which the parties chose the law of the People’s Republic of China as the governing law.<sup>188</sup> The court interpreted correctly that the law of the People’s Republic of China includes the CISG. If the parties have chosen the law of a contracting State, without expressly excluding the CISG, the prevailing view is that the CISG would apply on the basis of article 1 (1) (b).<sup>189</sup>

There are also some cases that applied the CISG because the parties based their arguments before the tribunal on the CISG. For example, one CIETAC tribunal ruled that “[b]oth the [Buyer] and the [Seller] analysed the rights and responsibilities based on the law of the People’s Republic of China and the CISG. Accordingly, the Arbitration Tribunal holds that the law of the People’s Republic of China as well as the CISG shall be the applicable law to this case.”<sup>190</sup>

As can be seen from these examples, it seems that Japanese business is starting to appreciate the merits of the CISG, especially in the context of trading with China, and likely in the context of trading with the diverse legal systems of Asia.

### (iii) Assimilation of the United Nations Sales Convention into Japanese law

Other than the practice described above, the CISG is gradually becoming assimilated into Japanese law. First of all, the CISG is starting to influence the interpretation of the Japanese Civil Code. For example, the CISG limitation of avoidance of contracts to cases of “fundamental breach” was first considered to be an alien concept in Japan. It was traditionally understood under Japanese law that, as a general rule, the injured party may avoid the contract after giving the breaching party a *Nachfrist* period, no matter how trivial the breach may be (although it was also understood that fault on the part of the

<sup>186</sup> Australia 24 April 2003 Supreme Court of Victoria (*Playcorp Pty Ltd v Taiyo Kogyo Limited*) (*Toys case*), available from [www.austlii.edu.au/au/cases/vic/VSC/2003/108.html](http://www.austlii.edu.au/au/cases/vic/VSC/2003/108.html) and <http://cisgw3.law.pace.edu/cisg/text/030424a2english.html>. A brief account is also available from <http://cisgw3.law.pace.edu/cases/030424a2.html>.

<sup>187</sup> Another interesting phenomenon is the application of the CISG as *lex mercatoria* independent of the requirements of article 1. Although the author could not find any case involving a Japanese party applying the CISG as *lex mercatoria*, there was one that came close. It is a case from New Zealand (New Zealand 27 November 2000 Court of Appeal Wellington (*Hideo Yoshimoto v. Canterbury Golf International Ltd*), Case Law on UNCITRAL Texts (CLOUT) no. 702, also available from <http://cisgw3.law.pace.edu/cases/001127n6.html>), which involved a contract between a Japanese seller and a New Zealand buyer for the sale of “shares” of a company. This case is clearly outside the scope of the CISG because article 2 (d) explicitly excludes the sale of shares from the application of the CISG. Nonetheless, the court considered the application of article 8 of the CISG (together with article 4.3 of the Unidroit Principles of International Commercial Contracts 1994). In the end, the court decided not to do so, because such a decision would only be overturned by the Privy Council in England. However, the court gave the impression that otherwise it would have applied the CISG.

<sup>188</sup> China December 1994 Fujian Higher People’s Court (*San Ming v. Zhazhou Metallic Minerals*), translation available from <http://cisgw3.law.pace.edu/cases/941200c1.html>. For a brief account of the lower court decision (China August 1994 Xiamen Intermediate People’s Court (*San Ming v. Zhazhou Metallic Minerals*)), see <http://cisgw3.law.pace.edu/cases/940800c1.html>.

<sup>189</sup> On the other hand, in Italy 19 April 1994 Florence Arbitration proceeding (*Leather/textile wear case*), CLOUT No. 92, translation available from <http://cisgw3.law.pace.edu/cases/940419i3.html>, a case involving a dispute between an Italian seller and a Japanese buyer, the parties chose “Italian law” as governing law. The majority of the tribunal decided to apply not the CISG but domestic Italian law, although one of the three arbitrators dissented.

<sup>190</sup> China 23 July 1997 CIETAC arbitration proceeding (*Polypropylene case*), translation available from <http://cisgw3.law.pace.edu/cases/970723c1.html>. For other similar CIETAC cases, see Wu, “CIETAC’s practice on the CISG”, pp. 5-6.

breaching party was necessary). There were, however, exceptions scattered around the Code which allowed avoidance of contracts only when the purpose of the contract could no longer be achieved. A reconfiguration of the interpretation of the Japanese Civil Code now attempts to turn these exceptions into the norm, which will put the Civil Code in line with the CISG. According to this view, the limitation of avoidance to cases of fundamental breach is nothing new and it has always been a part of the Japanese Civil Code.

And then further, the Ministry has now started working on the revision of the Obligations Law of the Civil Code.<sup>191</sup> That decision was made in order to adapt the Code to the social and economic change that took place since its enactment more than a century ago. However, this decision was also stimulated either directly or indirectly in part by the success of the CISG. It is only natural that the CISG will have an impact on this upcoming revision.

(e) *Conclusion*

I have stressed that the most direct allure of the CISG for a non-contracting State contemplating joining it lies in its success and the benefit that it brings.<sup>192</sup>

However, we must also not forget what made it successful. It was the wisdom of its founders in creating a fair, reasonable and practical contract law, as well as those whose efforts went into the continuous development of the CISG through its interpretation and application.

It is my hope that Japan, as well as other non-contracting States, will soon take part in this endless project toward harmonization.

4. *The practice of excluding the United Nations Sales Convention: time for change?*

*Eckart J. Brödermann*

*Brödermann & Jahn, Germany*

There is an old peasant saying in Friesland, Germany: “Wat de Boor nicht kennt, dat freet er nicht.” In English, that translates to: “What the farmer is not familiar with, he does not partake of.” This proverb both (a) summarizes the essence of the problem of only limited use of the 1980 United Nations Sales Convention (CISG) and/or its explicit exclusion according to article 6 of the CISG and (b) explains why this attitude is going to change or, in fact, why it is increasingly changing in view of the inherent value of the CISG in that it corresponds to a market need.

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<sup>191</sup> See the website of the “Japanese Civil Code (Law of Obligations) Reform Commission” from [www.shojihomu.or.jp/saikenhou/](http://www.shojihomu.or.jp/saikenhou/). Nomi, “The CISG from the Asian perspective” (see footnote 177 above), suspects that one reason that held Japan back from acceding to the CISG in the early 1990s was the misconception that a revision of the Civil Code would be required to accommodate the CISG. As Nomi points out correctly, this is a fallacy. However, the Government’s willingness today to consider revising the Civil Code certainly helps to remove this (false) barrier.

<sup>192</sup> For a similar “realist” argument regarding a slightly different context, see Souichirou Kozuka, “Contract law in East Asia at the turn of the century: lawyers and globalisation”, in *Globalization and Economic Law Reforms: Perspectives from India, Mexico, Thailand and East Asia*, Shinya Imaizumi and others, eds., Joint Research Program Series, No. 136 (Chiba, Japan, Institute of Developing Economies, 2005); and Souichirou Kozuka, “Economic implications of uniformity of law”, in *An Economic Analysis of Private International Law*, Jürgen Basedow and Toshiyuki Kono, eds., *Materialien zum ausländischen und internationalen Privatrecht*, No. 46 (Tübingen, Germany, Mohr Siebeck, 2006).

(a) *The United Nations Sales Convention corresponds to a need in the market*

The CISG is the result of worldwide efforts for uniformity in one of the most central areas of international trade law. It corresponds to a need in the business community to have neutral legal instruments available in several languages<sup>193</sup> and ready to use without incurring substantial costs for research on a neutral law. In my international practice based in Hamburg, Germany, I have sensed this need over and over again. Companies often need a neutral law in view of their lack of market power to impose their own law (this observation applies not only to small and medium-size enterprises but also to large corporations when they negotiate with other large corporations from other jurisdictions or with a strong, truly independent small or medium-size enterprise that simply does not accept the imposition of any law). Similarly, companies selling to many different markets or, in particular, to Europe need a tool to cope with the entire European market in a proper form, thereby avoiding as much as possible the exposure to approximately 30 different legal orders within and adjacent to the European Community.<sup>194</sup> Incidentally, it is this same need for uniformity which also inspires use of the Unidroit Principles (2004)<sup>195</sup> when an international contract covers more than just issues of sale,<sup>196</sup> or which justifies the efforts of the European Commission and the European Parliament to work on a neutral optional instrument within the project of a Common Frame of Reference for Europe.<sup>197</sup>

Whenever I talk to clients active in international trade and tell them about the CISG, or as the case may be, the CISG supplemented by the Unidroit Principles to the extent that a subject is not covered in the CISG,<sup>198</sup> they are usually convinced by this concept regardless of their nationality or their place of business. Sometimes clients ask for a comparison between the CISG and the sales-related provisions of the German Civil Code, but this is rare. As a result, I use both the CISG and the Unidroit Principles quite often when negotiating or drafting a contract. Of course, from an academic and sometimes also a practical viewpoint, there may be deficiencies: some things need to be regulated differently in a given set of circumstances. Some rules in the CISG are the result of a compromise.<sup>199</sup> In addition, some States—like Denmark—have made reservations to parts of the CISG, such as, for example,

<sup>193</sup>The official version of the CISG is equally valid and available in the six United Nations languages: Arabic, Chinese, English, French, Russian and Spanish ([www.uncitral.org](http://www.uncitral.org)). This website also contains the CLOUT database, which is a steadily growing collection of case law falling under the scope of the Convention. Besides this official website, the CISG is available in several other languages on different websites on international trade. These translated versions—even though not binding—give the chance to contracting parties from all over the world to read the text of the Convention in their mother tongue and thus feel comfortable when applying it to their contract.

<sup>194</sup>Details, important as they are, such as the impossibility to avoid the application of local national mandatory law (e.g. as a result of the application of article 7 II of the 1980 Rome Convention on the Law Applicable to Contractual Obligations or correlating provisions in article 8 of the future Rome I regulation on the law applicable to contractual obligations) need to be left aside for the purposes of this comment. These questions arise irrespective of the choice of law.

<sup>195</sup>See [www.unidroit.info](http://www.unidroit.info).

<sup>196</sup>See Brödermann, “The growing importance of the Unidroit Principles”, pp. 749-770 (see footnote 202 below).

<sup>197</sup>See Eckart Brödermann, “Betrachtungen zur Arbeit am Common Frame of Reference aus der Sicht eines Stakeholders: der weite Weg zu einem europäischen Vertragsrecht”, *Zeitschrift für Europäisches Privatrecht*, vol. 1, 2007, pp. 304-323. In the Conference on European Contract Law held in Brussels on 28 April 2004, organized by the Federal Ministry of Justice of Germany, the Ministry of Justice of Baden-Württemberg and the European Commission, it became apparent that the European Commission continues to concentrate on the creation of such an optional instrument in addition to the preparation of the scientific and (then) the political Common Frame of Reference.

<sup>198</sup>Again, details raised by some academics on the incompatibility between the CISG and the Unidroit Principles need to be left aside (see, for example, Rolf Herber, “‘Lex mercatoria’ und ‘Principles’—gefährliche Irrlichter im internationalen Kaufrecht”, *Internationales Handelsrecht*, vol. 1, 2003, pp. 1-10 [7f.]). They can be dealt with in the contract drafting process, if that is sensed to be necessary in special circumstances.

<sup>199</sup>See, for example, Michael J. Bonell, “European contract law and the development of contract law worldwide”, Speech given at the fourth European Jurists’ Forum, March 2007, as a member of the 1980 Conference on the Convention on the International Sale of Goods.

part II (on contract formation). However, this is again a detail. The mere knowledge that uniformity exists is such an asset that it overrides by far such disadvantages as, for example, declarations by some States parties to the Convention regarding matters of form.

Furthermore, in some situations, a conscious choice to use the CISG is simply more advantageous for a client than choosing autonomous national law. For example, under the CISG regime it is possible to alter some rules as a matter of contract negotiation or adaptation, while under German national law that rule is mandatory. Such examples in which the CISG provides the “better law” for a party are rare, but they exist. Thus, in the case of a guarantee given by the seller with respect to the quality or performance of the good, the CISG, in its article 36, paragraph 2, permits negotiating nonetheless an overall limitation of liability (e.g. to a maximum amount),<sup>200</sup> whereas section 444 of the German Civil Code contains a mandatory prohibition of any such limitation of liability under such circumstances.<sup>201</sup> As a result, both the non-consideration of the CISG and the standardized exclusion of the CISG may sometimes even amount to malpractice.

Still, a clause that can be found in international contracts, quite often, may read, for example: “This contract is governed by German national law excluding the Vienna Convention on the International Sale of Goods.”

So the question remains: why, under these circumstances, do many corporations still explicitly exclude the application of the CISG according to article 6 of the CISG?

*(b) What the farmer is not familiar with, he does not partake of*

The answer is sometimes ignorance, sometimes fear, sometimes a reluctance to change existing patterns—perhaps for lack of time and resources to concentrate on something new.

*(i) Ignorance*

Some lawyers or businessmen are simply not aware of the CISG or the Unidroit Principles. For example, in my arbitration practice I recently had a Dutch-Russian case that had no explicit choice of law. When the arbitration tribunal advised on the applicability of the CISG (both the Netherlands and the Russian Federation are contracting States), it surprised both parties. This kind of case is typical.

Similarly, in all situations in which the CISG has to be applied as part of a national law of a party to a contract according to article 1, paragraph 1 *(b)*, of the CISG, this usually surprises lawyers involved in the case. In a (classical) German-English case—the

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<sup>200</sup> See, for example, Ingeborg Schwenzer in *Kommentar zum Einheitlichen UN-Kaufrecht-CISG*, 4th ed., Peter Schlechtriem and Ingeborg Schwenzer (Munich, C. H. Beck, 2004), article 36, note 11.

<sup>201</sup> German practice tries to circumvent the prohibition through creative wording of the content of the guarantee; see, for example, D. Schmidt in Hanns Prütting, Gerhard Wegen and Gerd Weinreich, *BGB Kommentar*, 2nd ed. (Neuwied, Luchterhand, 2007), section 444, note 5. The choice of the CISG would enhance the chances of successfully limiting liability of the seller in a reasonable way.

German party being the seller<sup>202</sup>—my reference to the CISG in a mediation session last month prompted the opposing lawyer to indicate opposition also on this point in case we should not settle (which we did). The lawyer representing the English party at the time of the contract negotiation had definitely not seen the issue.

There is an explanation for such ignorance. While the CISG was concluded in 1980, it came into force in many countries around 1990 or later, after ratification in the 1980s.<sup>203</sup> The first court decisions and first books and commentaries followed. The lawyers (including in-house counsel) of the generation that had already finished school at that time, who were 25 years old or so, are now in their mid-40s and often are in charge of giving advice. The CISG was never a natural part of their education. Without continued legal education in this area of law, they cannot know about the CISG and certainly not about the more hidden way of applicability by virtue of its article 1, subparagraph 1 (b), which brings it into action as a result of the application of private international law.

(ii) *Fear*

Many lawyers know only vaguely about the CISG. They do not want to run the risk of giving advice on a set of laws, as they cannot evaluate the consequences. Even if the CISG is part of the international sales law of their own country, they prefer to choose the national law which they have studied and which they know inside and out. They never took the time to concentrate on the CISG. As a consequence, they stay away from it in order to avoid doing something wrong and becoming liable for it. Even in cases where the CISG would be better for their party, they may still avoid using it, not realizing that they are not acting in their client's best interests.

(iii) *Reluctance to change existing patterns*

Many companies have made a choice early on to opt out of the CISG as a matter of standard course. Often this decision was taken many, many years ago. At the time when the decision was taken, it may even have been a logical step. There was no case law on the new convention. In some countries, like Germany, the old national law then in force was even better for the seller than the CISG (for example, the available remedies were more restricted; there were formal rules for the buyer to secure its rights). Thus a seller-company was well advised to exclude the CISG. This has changed. Today, ample case law on the CISG is available on the Internet.<sup>204</sup> There are excellent commentaries in various

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<sup>202</sup>In such circumstances, the presumption in article 4, paragraph 1, of the 1980 Rome Convention on the international sale of goods, respectively in article 28, paragraph 1, of the German Introductory Code to the German Civil Code (which has transformed article 4, paragraph 1, of the 1980 Rome Convention into national German law) leads to German law, which, according to article 1, paragraph 1 (b), of the CISG, includes the CISG to the exclusion of autonomous German national law in the German Civil Code.

<sup>203</sup>A detailed list of time of ratification and entry into force in the different countries can be found under [www.uncitral.org/uncitral/en/uncitral\\_texts/sale\\_goods/1980CISG\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html).

<sup>204</sup>See, for example, on [www.unilex.info](http://www.unilex.info), [www.cisg-online.ch](http://www.cisg-online.ch) or [www.cisg.law.pace.edu](http://www.cisg.law.pace.edu).

languages.<sup>205</sup> Moreover, in Germany, for example, the Civil Code was changed with effect as of 2002. To a large extent, the new German sales law is akin to the CISG<sup>206</sup> or even based on it.<sup>207</sup> In some respects, the new national German law is tougher on the seller than the CISG. Since then, a company may have adapted its standard terms and conditions to comply with the obvious changes in the law; however, a re-evaluation of the exclusion of the CISG was not part of the agenda after 2002.

(c) *As farmers become familiar with the United Nations Sales Convention, they will partake in it*

Over the past 20 years, the world has changed dramatically. Each of us and each company is part of a global world, whether we like it or not. Our general mindset has become more international: international action is no longer just a field for a small group of specialists. As a result, international means, like the CISG, which are ready to cope with the effects of globalization, are constantly becoming more and more attractive. Lawyers who learn about the CISG—a legal device with a track record of 15-20 years—listen more attentively. The next generation of lawyers is learning about the Convention at school. The CISG is increasingly becoming part of international legal education around the globe, with the Willem C. Vis Moot Court as one of the best examples. An entire generation of lawyers is emerging that will be knowledgeable about the CISG and open to choosing the CISG. This generation knows about the inherent advantages of the CISG, such as the possibility to use it as a neutral law or to cope with 26 European legal orders at the same time. This generation will have the fortitude to do away with unnecessarily fearful exclusion clauses according to article 6 of the CISG as shown before.

In other words, the farmer—the legal profession—increasingly is getting to know about the CISG and is thus more and more ready to partake in it. Let us all do our share in teaching about the CISG so that it becomes known better in the future. And as we do so, let us include the Unidroit Principles on this way.

##### 5. *Changing the opt-out tradition in the United States*

*Harry Flechtner*

*University of Pittsburgh School of Law, United States of America*

The United States was one of the original contracting States whose ratification of the CISG permitted the Convention to enter into force; in those States, the CISG has been in

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<sup>205</sup> See, for example, Bianca and Bonell, *Commentary on the International Sales Law* (see footnote 156 above); Honnold, *Uniform Law for International Sales* (see footnote 156 above); Peter Schlechtriem and Ingeborg Schwenzer, eds., *Commentary on the UN Convention on the International Sale of Goods (CISG)*, 2nd. ed. (Oxford, Oxford University Press, 2005).

<sup>206</sup> One example for this is section 434 of the German Civil Code; see, for example, Schmidt in Prütting, Wegen and Weinreich, *BGB Kommentar*, 2nd. ed. (see footnote 201 above), § 434 BGB, Rn. 89.

<sup>207</sup> Peter Schlechtriem, “10 Jahre CISG—der Einfluß des UN-Kaufrechts auf die Entwicklung des deutschen und des internationalen Schuldrechts”, *Internationales Handelsrecht*, vol. 1, 2001, pp. 12-18.

effect since 1 January 1988.<sup>208</sup> Despite more than 19 years during which international sales involving parties located in the United States have potentially been subject to the Convention, there have been relatively few reported decisions on the Convention by United States courts or involving United States parties.<sup>209</sup> The most likely explanation—one that my own conversations with lawyers in the United States tends to confirm—is that United States legal counsel routinely have advised their clients to opt out of the CISG and choose United States domestic sales law (almost always article 2 of our Uniform Commercial Code) as the law governing their international sales transactions.<sup>210</sup> My experience suggests, however, that the wisdom of proffering this advice mechanically is now being questioned by United States lawyers.

There were understandable reasons for the opt-out advice, at least during the early years of the Convention.<sup>211</sup> As a new law—indeed, a new kind of law for American attorneys: a uniform international sales law to be interpreted and applied by tribunals from widely different legal traditions—the Convention involved greater uncertainty than our long-established and well-known (at least to United States counsel) domestic sales regime. Plus there were start-up costs in becoming familiar with the CISG and learning how to draft appropriately under it<sup>212</sup>—costs that would either have to be borne by clients paying for extra billable hours expended by lawyers getting up to speed, or absorbed by the lawyers themselves (in the form of unbilled hours of work). Such considerations and costs will have been explored with what I am sure is greater perception and rigour than I

<sup>208</sup> Under article 99, paragraph 1, the Convention enters into force after the tenth State ratifies it. The requisite number was reached when China, Italy and the United States ratified simultaneously on 11 December 1986, joining eight other States that had already ratified—Argentina, Egypt, France, Hungary, Lesotho, Syrian Arab Republic, the former Yugoslavia and Zambia. As a result, the CISG entered into force in these 11 States on 1 January 1988. See the entry for the United States, as well as the entries for Argentina, China, Egypt, France, Hungary, Italy, Lesotho, the Syrian Arab Republic and Zambia, in “UNCITRAL, Status: 1980—United Nations Convention on Contracts for the International Sale of Goods”, [www.uncitral.org/uncitral/en/uncitral\\_texts/sale\\_goods/1980CISG\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html) (accessed 7 June 2007); see also the entry for the former Yugoslavia in the “Table of participating countries” in Pace University Institute of International Commercial Law, CISG Database, [www.cisg.law.pace.edu/cisg/countries/cntries-Yugoslav.html](http://www.cisg.law.pace.edu/cisg/countries/cntries-Yugoslav.html) (accessed 7 June 2007) (explaining that the former Yugoslavia had ratified the CISG on 27 March 1985, and that the Convention had entered into force in the former Yugoslavia on 1 January 1988).

<sup>209</sup> For discussion of the statistics on reported United States CISG cases, see Mathias Reiman, “The CISG in the United States: why it has been neglected and why Europeans should care”, *Rebels Zeitschrift für ausländisches und internationales Privatrecht*, vol. 71, No. 1 (2007), p. 115, and pp. 117-120.

<sup>210</sup> See Reiman, “The CISG in the United States”, p. 122 (“The most important reason for the low number of reported CISG decisions in the United States appears to be [that] the CISG does not apply to the majority of international sales transactions involving the United States simply because parties exclude its operation under article 6”). Anecdotal evidence on the incidence of opting-out of the Convention, such as that offered by Professor Reiman (*ibid.*, p. 123) and myself, is in general the best available: it has been lamented that “there is scant empirical information on the frequency of ... CISG opting outs.” Filip De Ly, “Opting out: some observations on the occasion of the CISG’s 25th Anniversary”, in *Quo Vadis CISG? Celebrating the 25th Anniversary of the United Nations Convention on Contracts for the International Sale of Goods*, Franco Ferrari ed. (Brussels, Bruylant; Sellier, Munich, 2005), pp. 25 and 34. However, a recent interesting empirical study on the practice of opting out of the CISG in Germany and in the United States has appeared: Martin F. Köhler, “Survey regarding the relevance of the United Nations Convention for the International Sale of Goods (CISG) in legal practice and the exclusion of its application”, October 2006, available from [www.cisg.law.pace.edu/cisg/biblio/koehler.html](http://www.cisg.law.pace.edu/cisg/biblio/koehler.html) (accessed 9 June 2007). Working with admittedly modest data (a survey that generated 81 responses), Mr. Köhler reports that more German practitioner-respondents (72.7 per cent) than their United States colleagues (70.8 per cent) reported excluding the Convention “principally or preponderantly” in their practice. On the other hand, 69.7 per cent of German practitioners who responded to the survey “had contact with the CISG in their day to day work” whereas only 29.2 per cent of the United States respondents reported the same.

<sup>211</sup> Reiman, “The CISG in the United States”, pp. 124-127 (arguing that American lawyers advise the clients to opt out of the CISG in favour of United States domestic sales not because the Convention is viewed as substantively inferior, but because it is perceived to involve greater uncertainty, because its application would entail additional costs in becoming familiar with its terms and because of sheer inertia following early decisions to opt out).

<sup>212</sup> More and more resources are available to address the need for guidance in such areas. See, for example, *Drafting Contracts Under the CISG* (Harry Flechtner, Ronald Brand and Mark Walter, eds., forthcoming in Oxford University Press as part of the *CILE Studies* series).

can hope to achieve in the panel on the first day of this Congress chaired by former UNCITRAL Secretary Kazuaki Sono and featuring Professors Gerhard Wagner, Jan Smits and Helmut Wagner.

During the early days of CISG effectiveness, the costs of permitting the Convention to govern a transaction undoubtedly appeared—and to a degree probably actually were—greater from the perspective of United States attorneys than in the view of many of our civil law counterparts. For one thing, many civilian lawyers, German attorneys in particular, came to their initial encounters with the CISG with prior experience of uniform international sales law—the Unidroit-sponsored Uniform Law on Formation and Uniform Law on International Sales. United States attorneys and their common law colleagues, furthermore, are accustomed to looking for guidance from judicial decisions interpreting a law—a process that requires considerable lead time after the appearance of a new law.<sup>213</sup> The civil law tradition of relying more heavily on scholarly commentary, in contrast, meant that even when the Convention first went into force, guidance customarily treated as authoritative was available.

The reasons behind the opt-out advice in the United States often made sense in the short term. For any particular transaction, the uncertainty and start-up costs associated with the Convention might well make it worthwhile to pay the price—for a price is inevitably exacted for getting the other party to agree to something you want—to opt out of the CISG. Over the longer term, however, the extra costs associated with a new law like the Convention tend to decrease: uncertainty concerning its interpretation and operation lessens as the number of decisions applying it and the volume of commentary on it grow, and as tribunals become familiar with it; start-up costs, once incurred, can be amortized over many subsequent transactions. Just as important, the costs of opting out become more evident—not just the price paid to get the other side to agree to apply United States domestic sales law (less advantageous financial arrangements and/or concessions on other terms) but also the price in the form of deals lost when the other side refuses to allow United States domestic sales law to govern. From the perspective of the business side of law practice, law firms that lack expertise in the Convention will find themselves at a competitive disadvantage: why would a business employ legal counsel unable to support a bargaining outcome (applying the Convention) that in at least some cases offers economic advantages—indeed, that may salvage a lucrative deal stalled on the issue of applicable law—when competitor firms have the necessary capacity? That competitive issue becomes even more pressing in an era when the legal marketplace is increasingly global, and there are non-United States firms with extensive experience negotiating and drafting under the Convention.

With respect to the foregoing considerations, the CISG is little different from any new commercial law (although, as noted earlier, the Convention's international scope does create some special challenges). The process by which the community of United States commercial lawyers eventually accepts and learns to work with new laws—a process that had to be gone through in the 1950s and 1960s with respect to what is now our domestic sales law, article 2 of the Uniform Commercial Code—eventually runs its course. I suspect that process has now reached a fairly advanced stage with respect to the Convention.

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<sup>213</sup> See Reiman, “The CISG in the United States”, p. 126 (“the paucity of American case law is unnerving to common lawyers who tend not to trust a statutory rule before they have seen what courts actually do with it”).

Judging from communications I receive from practitioners and other anecdotal evidence, the United States legal community is (somewhat grudgingly) coming to accept the Convention's relevance, to reject the view that its applicability must be avoided at all costs, and even to see the CISG as a perhaps-useful implement in the commercial lawyer's toolbox. Earlier, almost all of the Convention-related inquiries and information that came to me related to litigation, and almost certainly arose out of transactions subject to the Convention not as a matter of conscious choice but by inadvertence. That is, the CISG governed the transaction in dispute because the parties had not consulted lawyers at the contract-formation stage, and hence had not addressed (or perhaps even considered) the choice-of-law question or had employed an inadequately drafted opt-out clause. Of course, this situation is one of the levers that, slowly but surely, is prying open the doors that United States commercial attorneys have closed on the Convention: firms that gain expertise in the CISG because they have litigated disputes where the transaction was accidentally governed by the Convention have now incurred the "start-up" costs I mentioned earlier, and can use their new knowledge and skills in serving clients at the transaction-planning stage. As a result, I increasingly—particularly over the past year—am encountering transactions in which the Convention is consciously and advisedly (if not always completely willingly) chosen as the applicable law.

Thus, market forces, as well as progress in the inevitably cumbersome process by which large legal communities absorb change, are altering the traditional practice of United States lawyers to advise their clients to opt out of the Convention in favour of the application of United States domestic sales law. The good United States attorneys are out front, already to the point of viewing the Convention not as an annoying complication to be swept aside but as a useful tool that can help them serve their clients' needs. Even mediocre United States attorneys will eventually be forced to that position—or suffer the consequences in the marketplace. A propos the theme of the commentary portion of this panel, it is not merely time to change the practice in the United States of excluding the CISG in knee-jerk fashion; the change has already begun. Given the forces impelling it, I believe completion of the change is a *fait accompli*.

## 6. *Comments, evaluation and discussion*

*Aboubacar Fall*

*Executive Secretary, African Law Institute*

Within the framework of the discussion on the subject matter that we have before us this morning, I would like to inform this assembly of the existence of an African body called the Organization for the Harmonization of Business Law in Africa (OHADA).

The principal aims of OHADA, as identified in its founding treaty, are to unify business law throughout the member States and to promote arbitration as a means of settling contractual disputes. This unified legislation is carried out in the form of uniform acts on particular areas of law (arbitration, land, transportation, insolvency, company law etc.). When approved by the Councils of Finance and Justice Ministers, these uniform acts are directly applicable in all member States and supersede the previous legislation on the same area of law in each country. States can however enact legislation that does not conflict with these uniform acts (uniform laws) that are applicable in these States. In such

areas as arbitration and sales, the uniform acts are largely inspired by the UNCITRAL Model Law on International Commercial Arbitration (1985) and the United Nations Convention on Contracts for the International Sale of Goods (1980).

As of today, 16 African countries belong to this organization. We expect others, especially common law countries, to join. It is worth noting that in 16 African countries the United Nations Sales Convention (1980) and the UNCITRAL Model Arbitration Law (1985) are, to a large extent, integrated in their national legislation, through these uniform legal instruments. Within the framework of OHADA's work in progress, a draft uniform act on contract law is in preparation. This project is being carried out with the assistance of Unidroit. It will bring together principles of contract law from the common and civil law legal traditions, thereby widening the geographical scope of the OHADA membership.

I thought that this information would be of interest to the participants at this important meeting on harmonization of contract laws. I invite all of you to visit the OHADA website at [www.ohada.com](http://www.ohada.com).

*Henry D. Gabriel*

*De Van Daggett Professor of Law, Loyola University Law School, United States of America*

I wanted to follow up on that excellent comment about OHADA. It seems to me that if we look at this particular project—which is a new contract principles regime, basically based on the Unidroit Principles—that is a model that will be and should be used more widely. I think that this is one of the things, and we have discussed this over the last couple of days, that UNCITRAL, Unidroit and the Hague Conference might do, and might achieve. One of the goals is not only to produce model laws and treaties for adoption throughout the world, but also work on a regional basis. I think that Unidroit's participation in these regional organizations is a good first step to what I hope we will see happening more broadly, because I think that that is a very important future goal for all of these organizations.

*Jernej Sekolec*

*Secretary of UNCITRAL*

I would like to thank all the speakers, but I would like to limit my comment to what Professor Bonell has said, and I can speak only on behalf of the UNCITRAL secretariat in this instance. It was a very interesting proposal for a global code that UNCITRAL might put on its agenda in cooperation with other organizations. We are all aware of the many thorny political issues that are connected with such a project. But let me give you just a very pragmatic observation concerning the fact that UNCITRAL has been approached on several occasions by a number of countries that have codes dating from the nineteenth century and they are being rewritten and they have very little to go by. They have come to us and said: "Can you please help us?" There is very little that we can offer them; at least we can offer them the Unidroit Principles and the United Nations Sales Convention and all the comments about it, but that is not what they would need for their political process at home.

One additional comment: last week, UNCITRAL commended the use of the Unidroit Principles for their intended purposes and clarified the relationship between the United Nations Sales Convention and the Principles. It was observed that the Convention contained

comprehensive specialized rules governing contracts for the international sale of goods and applied in accordance with its scope-of-application provisions to the exclusion of the Principles. Equally, questions concerning matters governed by the United Nations Sales Convention that are not expressly settled in it are to be settled, as provided in article 7 of the Convention, in conformity with the general principles on which the Convention is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law. Thus, the optional use of the Principles is subordinate to the rules governing the applicability of the United Nations Sales Convention.

*Michael Joachim Bonell*

*University of Rome I “La Sapienza”, Italy*

First of all, I would like to point out that the idea of a global commercial code is not mine but was first launched a number of years ago by the former Secretary of UNCITRAL, Gerold Herrmann, whom I am pleased to see here today. I took up his idea and, like others—in particular Ole Lando—tried to develop it further. As to Jernej Sekolec’s intervention, I of course entirely agree with him that the preparation of such a global commercial code would be an extremely fascinating project worth being taken up by a body like UNCITRAL. A global commercial code in the form of a model law containing a consolidated collection of the most important international uniform law instruments could indeed serve quite a number of different purposes, not least of which as a model for those States—and we know how many there are around the world—wishing to modernize their commercial laws not only with respect to foreign trade relationships but also for domestic transactions. Finally, concerning the role of the Unidroit Principles as a means of interpreting and supplementing the CISG, I can see only advantages in a formal recommendation to this effect by UNCITRAL. Indeed such a recommendation would of course make it clear that the Unidroit Principles should be used only within the four corners of article 7 of the CISG, thereby preventing the too liberal recourse to the Unidroit Principles we see in some recent arbitral awards.

*Harold S. Burman*

*Department of State, United States of America*

There has been a substantial increase in the value of cross-border commerce and trade of both the CISG and the Unidroit Principles in a manner less visible—and it is natural of course—to a room, as most of us are, of lawyers. We think of the pathology of cases. There have been a number of comments on dispute resolution. But unseen by the usual world of lawyers, but seen every day by the world of international commercial finance, the age of globalization has produced a very rapid increase of the method by which commercial finance interests assess risk *ex ante*—highly important—before a contract actually gets under way, if you will. And it is that *ex ante* assessment that drives both the availability of credit and the cost of that credit and the terms or the restrictions on that credit. This is a highly important development in today’s globalized commerce. Because of that, what we see, those of us who work with the capital market, is a rapid increase in the checklist of credit risk assessment. It includes now quite typically if the CISG, for example, is applicable by its terms, it certainly includes contractual undertakings where the principles of Unidroit are referred to, and so forth. This automatically translates, *ex ante*, into reduction of risk, reduction of uncertainty, and it has an immediate effect on the credit availability and cost in transactions. I mention this because it is an everyday experience in the capital markets less seen by those of us in the legal profession who think in terms of not *ex ante*, but *ex post facto* disputes and how you

resolve forum issues, choice of law etc. These instruments have had an effect and will continue, I think, to have an increasing effect—beneficial effect—on the flow of commerce as we move forward in a globalizing age.

*Jean-Michel Jacquet*

*Institut de hautes études internationales, Switzerland*

I would like to make a comment and to put a question to Professor Bonell. The comment is to say that I imagine that some of the people in this room were a little surprised, as I was, by the two statements that were made regarding the CISG. Clearly, it is desirable to make the provisions of the CISG widely known throughout the world of business and enterprise. However, the mechanism for implementation of the Convention, which was very intelligently developed by the drafters of that text, is based on neither familiarity with the Convention nor choice. On the contrary, the Convention is automatically applicable, and familiarity with its provisions, in current practice, is useful mainly for excluding the Convention, not for promoting its implementation. It is interesting to note that some model contracts in some business sectors provide explicitly for the exclusion of the CISG. It is interesting to ask the opposite question, that is, what the situation would be if contracts explicitly stated that they would be governed by the CISG, something that was not envisaged by the drafters of the Convention. Now my question to Professor Bonell. The question is almost one of concept, or of vocabulary. You recalled the question of the possible binding nature of the Unidroit Principles, and you rightly expressed a reservation as to whether the Unidroit Principles could be recognized as binding. However, we have heard about the draft uniform law currently being prepared by OHADA, so my question is: is there a way to make the Unidroit Principles binding? For example, they could become part of positive law in some part of the world, following the example of the OHADA draft. Or might you go as far as to consider that the binding character of the Unidroit Principles could consist of imposing their application in specific situations, which is not the same thing?

*Michael Joachim Bonell*

*University of Rome I “La Sapienza”, Italy*

Indeed, as I have pointed out in my presentation, I think that—at least for the time being—it is rather utopian to envisage the transformation of the Unidroit Principles into an internationally binding instrument, that is to say their adoption in the form of a binding treaty such as the CISG. Quite another thing is of course the possibility to use the Unidroit Principles as a model for domestic or regional law reform projects. But this would of course be up to individual States or groups of States to decide. The same would apply *mutatis mutandis* if the Unidroit Principles were to be adopted—as I have suggested—as the general contract law of the envisaged global commercial code. Indeed, the idea is to adopt the whole code in the form of a model law which by its very nature would leave the individual States free to adopt it either in its entirety or only in part, including the section referring to the Unidroit Principles.

*Eric Loquin*

*Director, Centre for Research on Procurement Law and International Investments (CREDIMI), University of Bourgogne, France*

I would also like to address a comment to Professor Bonell. We support him in his campaign to make the Unidroit Principles directly applicable without the mediation of a law.

It is regrettable that the European Union recently missed an opportunity in that regard. However, I believe that the situation is not hopeless. It would be perfectly possible to combine the Unidroit Principles with national legislation. I had my students working on this issue for several years. In the end, we failed to find a single provision in the Unidroit Principles that would conflict with a rule of public policy of a State. It is therefore possible for the parties to easily combine the application of national law with that of the Unidroit Principles without the risk of the public policy of the State in question voiding any of the provisions contained in the Unidroit Principles. Moreover, certainly in the area of arbitration, the Unidroit Principles are directly applicable. It suffices that the parties refer to them. International arbitration law provides that arbitrators should apply the rules of law, not the law chosen by the parties. Those rules of law could be the Unidroit Principles, and in some arbitration courts, such as the International Chamber of Commerce, in the absence of choice, arbitrators apply the rules they deem appropriate. It seems to me to be reasonable to view the Unidroit Principles as rules that are perfectly suited to the needs of international trade.

*Eckart J. Brödermann  
Brödermann & Jahn, Germany*

Professor, would you be able to have your research findings translated into several languages and to arrange for them to be published, as they would be of great interest?

### **C. Carriage of goods in the twenty-first century**

*Chair: Rafael Illescas  
University Carlos III, Spain*

I am to chair this first afternoon session, which will deal with the carriage of goods in the twenty-first century. As you are all aware, this topic is currently under discussion in UNCITRAL Working Group III (Transport Law), which is in the process of drafting a convention on the subject.

You are also aware that the uniformity stage at which we are aiming with respect to carriage of goods, and primarily carriage by sea, is the second, the first stage being the coexistence of two conventions presently in force, generally known as the Hague Rules, which date back to 1924, and the Hamburg Rules of 1978.

Uniformity has to be achieved by the superseding of both currently valid instruments by a new one, and that is the difficult objective of UNCITRAL Working Group III.

The opposing views, positions and interests arising in the course of the Working Group's deliberations are known and clear, and a fair balance must be achieved between them. That will probably emerge in the series of speeches to follow.

The first speaker is Professor Jan Ramberg of the University of Stockholm, who is Chair of the Advisory Council on the Convention on Contracts for the International Sale of Goods.

Professor Ramberg will take the floor to give a presentation on freight forwarder law.

### 1. Freight forwarder law

Jan Ramberg

University of Stockholm, Sweden

#### *The freight forwarder as service provider*

At least one common denominator of the freight forwarder is universally recognized. He could be described as a service provider. The difficulty starts when the need arises to distinguish between different types of services. One such service would be assisting the customer with export and import of the goods.<sup>214</sup> The freight forwarder would offer his services to fulfil whatever obligations are imposed on the exporter to declare and clear the goods for export as he could assist the importer in clearance of goods for import and paying duty and other official charges. In some countries, the latter function might require a licence to act as a customs broker. Traditionally, clearing the goods for import might require taking the goods in charge from the transportation vehicle for transport through customs or into customs warehouses. As a result, the freight forwarder would also be engaged in physical handling of the goods.

Additional services might involve loading the goods on transportation vehicles or discharging them from arriving transportation vehicles. If the goods are intended to be carried further inland, then the freight forwarder might undertake to arrange for their reloading on the on-carrying vehicle. Or, where goods are to be stored pending delivery to the consignee, then the freight forwarder might arrange for storage or store the goods in his own storage facility. The services now described are performed domestically and the liability of the freight forwarder for such services will usually fall within the category of obligations to exercise due diligence or best efforts, with liability for failure to do so. In French law, most of the services would be performed by *transitaires* (cf. *commissionaires expéditeurs* in Belgium) as distinguished from the functions of a *commissionaire de transport*.

In recent years, services offered by freight forwarders have been considerably extended.

Freight forwarders prefer the title of “logistics service providers”, owing to the expansion of their services to perform complete distribution according to the principles of logistics. As the term “logistics” is used in order to describe any rational system for management and distribution of goods, the outsourcing of such functions to freight forwarders would appear under the name of third-party logistics.

#### *Agency and disclaimer of status as carrier*<sup>215</sup>

Traditionally, freight forwarders offer their services in connection with international transport by contracting with carriers as agents for the customer. They could also be retained

<sup>214</sup>This is still in many areas the dominant function of freight forwarders. See, for example, M. V. Ofobrukwa, *Shipping & Forwarding Practice—Imports*, Lagos 2001, passim.

<sup>215</sup>The traditional reluctance of freight forwarders to accept liability as carriers is well explained by Johann G. Helm, *Speditonsrecht* (Berlin, de Gruyter, 1973), p. 77: “Die Anwendung des Frachtrechts auf die Spedition zu festen Kosten erweist sich angesichts seiner starken Zersplitterung als nicht sehr praktikabel.”

by carriers in soliciting cargo for their benefit and as their agents. In ports served by liner shipping companies, freight forwarders are often appointed as liner agents. Consequently, they would have a dual function representing both parties in the contractual relationship that they have arranged as agents.

The activity of freight forwarders in connection with rail and road transport is different. Here, freight forwarders would usually have their own arrangements with the railways, reserving space on railway wagons to be used for consolidating individual shipments from a number of shippers destined for a number of consignees. In these cases, the freight forwarder would offer the customers carriage of the goods according to his own tariffs and issue his own document to each of the customers, with himself retaining the consignment note for the whole wagon. International carriage of goods by road would usually be performed either by the freight forwarder with his own vehicles or, alternatively, by arranging longer periods with owners of such vehicles, reserving the needed capacity for the freight forwarder. In these cases, the freight forwarder would not qualify as an agent as he has his own interest in the freight charged by him. As an agent, he would have had to give an account for the freight actually paid to railways or road hauliers and agree with the customer on an appropriate commission. Nevertheless, as we shall see, freight forwarders, at least traditionally, prefer to disclaim status as carrier in these cases.

#### *Regulations of freight forwarder activities in statutory law*

German law has considerably influenced law and practice in the Scandinavian countries and to some extent also in Italy. As was expressed in the German Commercial Code (*Handelsgesetzbuch*) prior to the 1998 amendments:

“A forwarding agent is a person who carries on the business of delivering consignments of goods, by freight operator or by shipping company, for the account of others (consignors) in his own name.”<sup>216</sup>

This principle is reflected as the main principle in the 1998 amendments,<sup>217</sup> where the freight forwarding contract<sup>218</sup> implies that the freight forwarder is obliged to arrange for dispatch of the goods.<sup>219</sup> A similar definition as in earlier German law appears in the Italian Civil Code (*Codice Civile*)<sup>220</sup> describing the Italian *spedizioniere*.<sup>221</sup> Concluding the contract with the carrier in his own name would make him a contracting party with the carrier, according to the principles relating to commission agents. He may not escape his liability to the carrier under the contract made with him by later disclosing the name of his customer—unlike the case in English law, under the principles of the undisclosed principal. Nevertheless, his customer remains the interested party in the contract of carriage, so that the freight forwarder would have to account to him for whatever follows from the contract of carriage. Hence, the freight forwarder would have a right to reimbursement for freight

<sup>216</sup>“*Spediteur ist, wer es gewerbmässig übernimmt, Güterversendungen durch Frachtführer oder durch Verfrachter von Seeschiffen für Rechnung eines anderen (des Versenders) in eigenem Namen zu besorgen*” (section 407 (1)).

<sup>217</sup>In section 454 (3).

<sup>218</sup>In section 453.

<sup>219</sup>See I. Koller, “CMR und Speditionsrecht”, *Versicherungsrecht*, 1988, pp. 556-563.

<sup>220</sup>Article 1,737.

<sup>221</sup>See A. Dani, “L’intermédiaire (‘commissionaire’) de transport en droit italien”, in *Les Auxiliaires de Transport dans les Pays du Marché Commun* (Rouen, Institut du droit international des transports, 1977), pp. 203-214.

and other payments arising under the contract of carriage, in addition to the remuneration agreed in the contract of commission with his customer.

French law differs from the German, Italian and Belgian law as to the status of the *commissionnaire de transport*. The French Commercial Code (*Code de Commerce*) definition of the commission agent<sup>222</sup> is the same as in the other jurisdictions. However, although the *commissionnaire de transport* falls within the category of intermediaries, he has a particular liability that in effect equals the liability of a carrier. According to the Commercial Code,<sup>223</sup> he warrants the arrival of the goods at the agreed destination with the exception of force majeure. Further,<sup>224</sup> he warrants that the goods will not suffer any loss or damage in transit, again with force majeure the only exception. In addition, he is responsible for the acts or omissions by persons engaged for the performance of the contract. Article 99 is regarded as a rule imposing upon the *commissionnaire de transport* a *del credere* liability for the subcontractors (*une règle légale du croire*). However, the liability incumbent upon the *commissionnaire de transport* according to the Commercial Code may be avoided by contrary stipulations in his contract. So far, the liability of the *commissionnaire de transport* differs from the liability imposed upon carriers, who often fall within mandatory regimes. Following the principles of *del credere* liability, when the *commissionnaire de transport* incurs liability for acts or omissions by persons engaged for the performance of the contract, he will be subject to the same liability as would be imposed on the persons engaged (*le système caméléon*). Thus, the *commissionnaire de transport* will have to respond to his customer but would have a full right of recourse against the persons engaged, provided, of course, that he succeeds in proving that loss or damage could be attributed to them. The liability of the *commissionnaire de transport* rests upon a pure network liability system, as not only the liability at law for the persons engaged but also their contractual regulation would apply.<sup>225</sup>

Belgian and Italian law is different insofar that the particular liability of the French *commissionnaire de transport* has not been adopted. Instead, the Belgian *commissionnaire de transport* is regarded as a carrier as distinguished from the *commissionnaire-expéditeur*, whose duty is limited to dispatching the goods, while the *commissionnaire de transport* has undertaken the duty to procure the transport from point to point. It does not matter whether he performs his duty by his own means of transport or by means belonging to persons engaged.<sup>226, 227</sup> Italian law is basically to the same effect in distinguishing between a *spedizioniere* and a *spedizioniere-vettore*. According to the Italian Civil Code,<sup>228</sup> the *spedizioniere* is defined as a person who undertakes the duty to conclude a contract in his own name for the account of his customer and to perform accessory operations, while the *spedizioniere-vettore* undertakes to procure a transport from point to point which, under the Civil Code<sup>229</sup> imposes a liability upon him as a carrier.<sup>230</sup>

<sup>222</sup> Article 94.

<sup>223</sup> Article 97.

<sup>224</sup> According to article 98.

<sup>225</sup> See René Rodière, *Traité Général de Droit Maritime*, vol. III (Paris, Dalloz, 1967-70), p. 155; and L. Peyrefitte, "Le commissionnaire de transport et les autres auxiliaires de transport en droit français", in *Les Auxiliaires de Transport dans les Pays du Marché Commun* (Rouen, Institut du droit international des transports, 1977), pp. 3-23.

<sup>226</sup> Articles 91-108 of the Belgian Commercial Code (*Code de Commerce*).

<sup>227</sup> See J. Libouton, "L'intermédiaire ('commissionnaire') de transport en droit belge", in *Les Auxiliaires de Transport dans les Pays du Marché Commun* (Rouen, Institut du droit international des transports, 1977), pp. 87-192.

<sup>228</sup> Article 1,737.

<sup>229</sup> Article 1,741.

<sup>230</sup> See A. Dani "L'intermédiaire ('commissionnaire') de transport en droit italien", in *Les Auxiliaires de Transport dans les Pays du Marché Commun* (Rouen, Institut du droit international des transports, 1977), pp. 203-214.

In Spanish law, the *comisionista de transporte* traditionally<sup>231</sup> had the same characteristics as the French *commissionnaire de transport*. Nevertheless, according to the present Commercial Code (*Código de Comercio*),<sup>232</sup> if the undertaking is not limited only to arranging contracts of carriage but amounts to procuring the carriage (*la realización del transporte*), it is suggested that the Spanish *comisionista* becomes equivalent to the Italian *spedizioniere-vettore*. The particular regulation of road carriers<sup>233</sup> is restricted to performing road carriers but this does not affect the interpretation of the notion of *comisionista*. Although, in principle, the liability of the *comisionista* is non-mandatory, he may be caught by mandatory carrier regimes to safeguard the interests of his customer.<sup>234</sup>

Although the distinctions mentioned in French, Belgian, Italian and Spanish law seem to clarify the position of the freight forwarder, depending upon the duties undertaken, it is not easy to make the distinction in practice. Basically, however, what matters would be the duty to procure transport (*faire transporter*) from point to point (*de bout en bout*) and it is irrelevant whether transport procurement is implemented by the freight forwarder's own means of transport or by using transport subcontracted from somebody else. In determining whether the freight forwarder has limited his duty to conclude the contract or contracts needed to take the goods from point to point or whether he has undertaken a duty to procure the transport, the fact that he has charged his own price<sup>235</sup> for the whole transit without a duty to give account for what he has paid to his subcontractors would become decisive, as would, of course, any express undertaking evidenced by the document issued. Normally, analysis of the document would suggest whether it represents a transport document or merely a receipt for the goods.

When German, Belgian, Italian and Spanish freight forwarders are considered pure intermediaries without carrier or equivalent liability, they may limit such liability in their general conditions. However, this appears not to be possible if they fall under a mandatory carrier liability regime. This is now clarified with the 1998 amendments to the German Commercial Code.<sup>236, 237</sup> Hence, the most important distinction between the French *commissionnaire de transport* and the commission agents under Belgian, German, Italian and Spanish law seems to be as follows:

(a) The French *commissionnaire de transport* may avoid carrier liability by contractual stipulations;

(b) This does not seem to be generally possible for the Belgian *commissionnaire de transport*, the Italian *spedizioniere-vettore* or the Spanish *comisionista del transporte*;

<sup>231</sup>In article 232 of the Commercial Code of 1829.

<sup>232</sup>Article 379.

<sup>233</sup>Law governing road transport (*Ley de Ordenación de los Transportes Terrestres*) of 1987.

<sup>234</sup>See Alberto Emparanza Sobejano, *El Concepto de Porteador en el Transporte de Mercancías* (Granada, Comares, 2003), pp. 160-161 and 175-177, and Luis Manuel Piloñeta Alonso, *Las Agencias de Transporte de Mercancías* (Barcelona, Bosch, 1997), pp. 57, 77, 114 and 132.

<sup>235</sup>See, for example, the French cases DMF 1952.497 and BT 1972.321.

<sup>236</sup>Sections 438-460 compared with sections 466 and 449.

<sup>237</sup>See R. Herber, "The New German Transport Legislation", *European Transport Law* (1998), pp. 591-606. The position under the Swiss law seems to be different as carrier liability for freight forwarders seems to be limited to multimodal transport. See Giovanna Montanaro, *Die Haftung des Spediteurs für Schäden an Gütern*, *Zürcher Studien zum Privatrecht*, No. 166 (Zürich, Schulthess, 2001), pp. 6-7.

(c) In any event, is not possible for the German *Spediteur* in the situations specified in the German Commercial Code.<sup>238, 239</sup>

#### *Regulation of freight forwarder activities in general conditions*

The Scandinavian countries have no statutory law regulating the liability of freight forwarders. Instead, the Nordic Association of Freight Forwarders has since 1919 agreed on general conditions applicable in Denmark, Finland, Norway and Sweden—and now also in Estonia and Latvia. As of 1959, the general conditions were drafted in cooperation with organizations representing customers. As they could be regarded as an agreed document, they would, in practice, fulfil the same function as statutory law, although they would normally require incorporation into the individual contracts in the same way as other standard form contracts. Until the 1974 version of the General Conditions of the Nordic Association of Freight Forwarders (NSAB), the freight forwarder disclaimed liability as carrier unless he had physically performed the carriage. However, as from the 1974 version the Nordic Conditions recognize the freight forwarder's liability as carrier, in particular where he has quoted his own price for transport without a duty to account for charges paid to subcontractors. Thus, the Nordic conditions—now NSAB 2000—contain a separate regulation for the liability of the freight forwarder as an intermediary and a separate carrier liability, which is akin to the liability imposed upon an international carrier by road under the Convention on the Contract for the International Carriage of Goods by Road, supplemented by a network liability where a particular mode of transport has been agreed or where loss of or damage to the goods could be localized to a particular mode of transport. Thus, the carrier liability of the freight forwarder under the NSAB would, in practice, be more or less equivalent to the liability of a French *commissionnaire de transport* according to the provisions of the French *Code de Commerce*.

#### *Adoption of liability as contracting carrier*

As we have seen, freight forwarders may themselves clarify the legal position either by avoiding the status of carrier whenever this is possible under the applicable law or, alternatively, by adopting liability as contracting carriers. Provisions on carrier liability could be found in general conditions used in Canada, France, Hong Kong, Indonesia, Kenya, the Netherlands, Poland, Singapore, South Africa, Sri Lanka, Switzerland, the United Kingdom and Viet Nam and in the countries where NSAB 2000 are used.<sup>240</sup> Hence, most freight forwarders undoubtedly prefer to clarify the position rather than to leave it uncertain and subject to the vagaries of courts of law.

Voluntary adoption of carrier liability has been enhanced by the competition between contracting and performing carriers. In particular, the advent of containerization in the 1960s forced freight forwarders to properly evidence their contracts of carriage when receiving

<sup>238</sup> Sections 458-460.

<sup>239</sup> See Ingo Koller, *Transportrecht: Kommentar zu Spedition und Gütertransport* (Munich, Beck, 2004), p. 732, regarding section 459 ("Fixkostenspediteur") and section 460 ("Sammelladungspediteur") where the distinction between carrier and freight forwarder becomes unnecessary. Similarly, K.-H. Thume in Fritz Fremuth and Karl-Heinz Thume, eds., *Kommentar zum Transportrecht* (Heidelberg, Recht und Wirtschaft, 2000), pp. 482 and 485, adding that the mandatory law of carriage of goods only applies to the carriage as such but not to additional services.

<sup>240</sup> Denmark, Estonia, Finland, Latvia, Norway and Sweden.

goods from their customers for containerization. It would not be a commercially viable option to receive goods from individual shippers, to stuff the goods into containers in the country of shipment and to arrange break-bulk of the containers at destination, while at the same time insisting that the contract of carriage as such was arranged by the freight forwarder for the sole purpose of achieving a contractual relationship between their customer and the performing carrier(s).

This would explain the creation in 1971 of the International Federation of Freight Forwarders Associations (FIATA) combined transport bill of lading (FBL), as it was then called. This was met with some scepticism by traditionalists who preferred a disclaimer of carrier liability. However, commercial realities made use of the FBL a global success. As the FBL is used in relation to each individual shipper, while in the contractual relationship between the freight forwarder and the performing container lines bills of lading covering the whole container would be used, FBLs by far outnumber liner bills of lading in international trade. The FBL, as an international document of transport, is used independently of the freight forwarder's general conditions but the carrier liability under the FBL is often used to reflect carrier liability under general conditions as well.<sup>241</sup> Freight forwarders wishing to tender a document to customers evidencing receipt and an obligation to deliver the goods at destination to the consignee, but without incurring liability as carrier, could do so by the FIATA certificate of transport, where carrier liability is expressly excluded.

General conditions for the service of freight forwarders undoubtedly contribute to consistency and transparency. But this does not extend beyond the countries or regions in which such general conditions are used. Thus, international trade would have to suffer from the different approaches and levels of liability following from general conditions. Countries and regions where organizations representing customers have participated in the deliberations with freight forwarders in the drafting of the general conditions have succeeded in achieving a better balance between the interests of the parties concerned. Nevertheless, any comparative analysis of general conditions used would demonstrate a considerable and harmful variety.

*The 1967 Unidroit draft Convention on Contract of Agency for Forwarding Agents relating to International Carriage of Goods*

The law of freight forwarding is not subject to any international convention, because the efforts of Unidroit to achieve such a convention have not materialized. The work of achieving an international convention started in the mid-1950s and progressed simultaneously with the work to elaborate a convention on contracts for combined international carriage of goods. In 1963, the Governing Council of Unidroit approved the draft Convention on the Contract of Agency for Forwarding Agents as well as the draft Convention on the Contract for the Combined International Carriage of Goods. The aim of both these proposed international instruments was to promote international trade. Although general conditions sponsored by the forwarding agents' organizations would have established a certain uniformity, the conditions were considered a poor substitute for uniform legislation. First, as they were issued by private organizations, their validity might be contested. Second, the general conditions varied from one country to another.

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<sup>241</sup> See, regarding the freight forwarder carrier documents FBL and FIATA transport waybill, Jan Ramberg, *The Law of Freight Forwarding* (Zürich, International Federation of Freight Forwarders Associations, 2002), pp. 42-88.

It was not an easy task to bridge the different concepts in statutory law relating to freight forwarders. In particular, the French notion of *commissionnaire de transport* created difficulties. With that in mind, one approach to avoiding any difficulty involved replacing reference to *commissionnaires de transport* by the words *contrat de commission en matière de transport international de marchandises*.

Regulating the freight forwarder's liability for incidental services carried out by himself included: all operations incumbent upon him before the first stage of carriage, between two stages of carriage or after the last stage, and, in particular, the taking over of the goods at the designated place; their custody, storage, trans-shipment and moving; that the documents necessary for their export or import are obtained; that the customs and other formalities are complied with; that the duties, dues and other expenses incumbent upon the principal are paid in advance or that security is furnished therefore; that the condition of the goods and of its packing is checked; that the carrier is furnished with data necessary for the making out of the carriage documents; and that assistance is made available for loading and unloading.<sup>242</sup>

In carrying out these functions, the forwarding agent would be liable for the acts and omissions of his agents, servants and representatives when they acted within the scope of their employment.<sup>243</sup> But the freight forwarder would not be liable for the due performance of contracts that he has concluded in order to ensure the carrying out of the international carriage.<sup>244</sup> His liability in this respect was reduced to a liability for proper choice of subcontractors and for the instructions given to them (liability for *culpa in eligendo vel instruendo*). The principle that the forwarding agent avoided liability for the due performance of the contracts that he had concluded would follow naturally from his function only to act as an agent. A monetary limitation of the forwarding agent's liability was contemplated but the amount was left open for later decision. Interestingly, loss of the right to limit liability did not follow the Convention on the Contract for the International Carriage of Goods by Road concept of wilful misconduct that had been accepted only a few years earlier. Indeed, by the mid-1960s the meaning and scope of the concept of wilful misconduct had already been the subject of notable controversy in both doctrine and case law. Instead, the conduct defeating the right to limit liability was expressed as "either a deliberate disregard of the prejudicial consequences that might result from such conduct, or inexcusable lack of awareness of such consequences".<sup>245</sup>

The particular French concept of a *del credere* liability for the *commissionnaire de transport* was taken care of in a particular chapter on forwarding agency contract with special liability.<sup>246</sup> Here,<sup>247</sup> it is noted that the parties may agree that the forwarding agent is responsible from the time when he takes over the goods until he delivers them to the consignee for the due performance of all contracts made to ensure the carrying out of the international carriage. In case of non-performance of such contracts, the forwarding agent would be responsible according to the rules governing the contract concluded with the

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<sup>242</sup> Article 1.3.

<sup>243</sup> Article 12.

<sup>244</sup> Article 13.

<sup>245</sup> Article 21.1.

<sup>246</sup> Chapter III.

<sup>247</sup> In article 22.

respective subcontractor, i.e. the network liability system, which would naturally follow from the *del credere* principle. This would not reduce the liability of the forwarding agent for failure to observe the duties incumbent upon him as an intermediary. Additionally, the forwarding agent would not benefit from any special clauses in his contract with the subcontractor and which would not regularly be used in such contracts.<sup>248</sup> Insofar as “special liability” would follow from an express contract, it would not be difficult to accept the system of a *del credere* liability for subcontractors. However, in other cases one would have to resolve much-debated issues. As to situations where the forwarding agent has agreed on a flat rate for the contract of carriage, he would have to accept liability in the same way as would follow from an express agreement.<sup>249</sup> Further, in case of grouping the goods under one single carriage document it should be presumed that the forwarding agent has accepted liability.<sup>250</sup>

The draft Convention also contains<sup>251</sup> provisions relating to an international forwarding note (in French, *titre de commission de transport international*). That document might be issued upon request. It would contain the information usually to be found in bills of lading, so that the forwarding agent would have more or less the same duty as a carrier, that is, to check the accuracy of the statements in the international forwarding note as to the description of the goods and their apparent condition including their packaging, and, if found incorrect, enter appropriate reservations. If no reservations were made, it should be presumed that the goods were in good order and condition when taken over unless the contrary is proved. However, it will not be possible for the forwarding agent to disprove the contents of the document against a consignee who has acquired the international forwarding note in good faith. In the same way as under the Convention on the Contract for the International Carriage of Goods by Road,<sup>252</sup> any stipulation directly or indirectly derogating from the provisions of the convention would be null and void.<sup>253</sup>

As we have seen, the special liability of the forwarding agent is not exactly the same as liability of the carrier. However, in practice, the result would be more or less the same as if the forwarding agent had accepted liability as contracting carrier. This, under ordinary principles of law, would include vicarious liability for any persons used in the performance of the contract of carriage. That invites the question whether it would serve any purpose to introduce a middle category between the ordinary liability of the forwarding agent and the ordinary liability of a carrier.<sup>254</sup> However, of course, the special liability may be explained as acceptance of the particular liability of the French *commissionnaire de transport*, which under the draft Convention would be recognized in some circumscribed situations.

When the draft Convention was approaching the stage of a diplomatic conference, the International Federation of Freight Forwarders Associations had already started to consider the possibility of a particular combined transport bill of lading to be used by freight forwarders in consolidating cargo for container transport. Such a document, it was believed, would be much more appropriate than the international forwarding note

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<sup>248</sup> Article 22.4.

<sup>249</sup> According to article 22.

<sup>250</sup> In accordance with the provisions of article 22.

<sup>251</sup> In chapter IV.

<sup>252</sup> Article 41.

<sup>253</sup> Article 42.

<sup>254</sup> See Piloñeta Alonso, *Las Agencias de Transporte de Mercancías* (see footnote 234 above), p. 132.

contemplated by the draft Convention. Additionally, it was considered premature to deal with any special liability for the freight forwarder until his position under the contemplated draft Convention on the Contract for the Combined International Carriage of Goods had been ascertained. Although, as we have seen, such an international convention is now available for ratification in the form of the 1980 United Nations Convention on International Multimodal Transport of Goods, it has not yet entered into force and would have to await further development in this field. So, in spite of the shortcomings of rules available for voluntary adoption, such as the 1991 UNCTAD/ICC Rules for Multimodal Transport Documents, there is as yet no other alternative to achieve international uniformity.

In countries where freight-forwarding services have been regulated by statutory law, the conditions follow that law or at least use the law as a point of departure, whereas in Germany, the law relating to the freight forwarder as contracting carrier is mandatory, to that extent no option is available for him to regulate his liability differently in his general conditions.<sup>255</sup> Instead, the mandatory liability may be absorbed by a more or less sophisticated insurance system.<sup>256</sup> The Austrian General Conditions also replace liability with insurance but in a different way, since no mandatory law exists as in Germany. Among the countries where liability closely follows statutory law, we find, among others, France, Germany, Portugal, Slovakia, Spain and Uzbekistan. However, overall limits of liability differ. For example, French conditions (50,000 euros) contrast with Spain, which has no overall limit as to loss of or damage to goods but a limit to an amount not exceeding the remuneration for the service as to delay in delivery or any indirect loss or damage. In some countries, such as the Czech Republic and Poland, limitations of liability are allowed only if following from national law or international conventions. Again, in the Russian Federation reference is made to the monetary limits of international conventions.

At the other end of the scale we find countries still accepting almost a total freedom of contract which is used by some associations in their disclaimers of liability (e.g. in Australia, Greece, India, New Zealand and Singapore). The traditional disclaimer of liability as carrier appears in Belgium, Bulgaria, the Czech Republic, Egypt, Italy, the Netherlands and Poland. The distinction between the freight forwarder as agent and principal is particularly apparent in the common law jurisdictions, where the lead of the British conditions (British International Freight Association) have been followed in Bulgaria, Hong Kong, Ireland, Kenya, South Africa, the United Arab Emirates (National Committee of Freight Forwarders) and Viet Nam.

In some countries, distinctions are made between the different functions of the freight forwarder, with carrier liability sometimes accepted by reference to the FBL, e.g. the Scandinavian and Baltic States using NSAB 2000, Canada (Canadian International Freight Forwarders Association), France, Greece, the Republic of Korea, the Russian Federation, Switzerland and Ukraine. In the United States, the notions of indirect carrier and non-vessel operating common carrier have been launched in the regulatory statutory

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<sup>255</sup> See Johannes Trappe, "The reform of German transport law", *Lloyd's Maritime and Commercial Law Quarterly*, 2001, pp. 392-405.

<sup>256</sup> See regarding the system under the German Freight Forwarders' Standard Terms and Conditions (*Allgemeine Deutsche Spediteurbedingungen*) and freight forwarders liability insurance (*Speditionsversicherung*) of 2002, the observations by Jan Ramberg, *The Law of Freight Forwarding* (Zürich, FIATA, 2002), pp. 30-31. The system triggered excessive premiums and was discontinued already in 2003.

provisions.<sup>257</sup> However, the private law aspects of the freight forwarder's liability have so far attracted less attention, except in efforts to extend maritime liability to cover multimodal transport by amendments of the Carriage of Goods by Sea Act and the Hague Rules.

*Impact of an international door-to-door maritime regime on freight forwarder law*

The present regulation of freight forwarder law according to different principles in domestic statutory law and various general conditions is confusing and unsatisfactory.

In my view, an extension "door-to-door" of a maritime international regime on carriage of goods by sea would further aggravate the situation. At worst, such an extension may create additional difficulties for establishing a separate international legal regime for freight forwarders, which in my view is desirable, if not unavoidable, in order to create some order and transparency replacing the contemporary disparities within the field of freight forwarder law.

The draft convention on the carriage of goods by sea,<sup>258</sup> in article 1.1, defines the contract of carriage and delimits the application of the convention by the requirement that the contract "shall provide" for carriage by sea. It is then added that the contract "may provide" for "carriage by other modes of transport in addition to the sea carriage". Further, in article 6.2 (b) dealing with non-liner transportation, the convention applies when a transport document evidences a contract of carriage and the receipt of the goods by the contracting or performing carrier. Thus, the convention applies to a freight forwarder having issued an FBL, provided that it appears from that document that the carriage includes a maritime segment. However, the draft convention does not deal with cases where another mode or modes are added to the maritime segment so that, in essence, the transport becomes non-maritime, e.g. when timber products are carried from northern Sweden to southern Italy and road or rail carriage is added to a short carriage by ferry from Scandinavia to Germany. This makes the application of the convention exceedingly difficult, particularly to freight forwarders when acting as carriers. In the example mentioned, they would normally evidence the contract by a waybill pursuant to the Convention on the Contract for the International Carriage of Goods by Road, the International Convention Concerning the Carriage of Goods by Rail or the International Federation of Freight Forwarders Associations, but may also elect to use an FBL, in particular where the option to use carriage by sea from Swedish to Italian ports is still open. Understandably, the International Federation of Freight Forwarders Associations opposes the application of the convention to other modes than maritime carriage. But, in any event, the convention should as clearly as possible define that it does not apply where maritime carriage does not constitute the preponderant part. With such delimitation of the scope of application of the convention, the problem of conflict of conventions would be considerably reduced.

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<sup>257</sup> See William J. Augello, *Transportation, Logistics and the Law* (Huntington, New York, Transportation Consumer Protection Council, 2004), passim; and John Guandolo, *Transportation Law* (Washington, 1971), passim.

<sup>258</sup> A/CN.9/WG.III/WP.81.

## 2. *Sea carriage goes ashore: relationship between multimodal conventions and domestic unimodal rules*

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### (a) *Introduction*

Historically, ocean cargo carried from an inland location in one country (such as a manufacturing plant) to an inland location in another country (such as a retailer's warehouse) would travel under three contracts of carriage. The cargo would first travel by land under a railroad or trucker's bill of lading from the manufacturing plant to the port of loading. It would then travel by sea under an ocean bill of lading to the port of discharge. The cargo would then complete its journey by land under another inland bill of lading. Each of these three contracts of carriage would be legally distinct and thus subject to its own legal regime.

In the modern world, the business practices are typically very different. Today, a single multimodal contract of carriage commonly covers both the ocean voyage and one or more inland legs. The shipper does not have distinct contracts of carriage for each leg of the journey (even if its carrier may have distinct subcontracts for some or all of the separate legs). From the shipper's perspective, there is only a single contract of carriage—a "mixed contract" covering both land and sea elements—that should logically be governed by a single legal regime.

Although many variations arise in practice, a simple hypothetical might help to illustrate the different approaches. Suppose that a shipper in Berlin wishes to have cargo transported to Chicago, and that it arranges to have the cargo carried by road from Berlin to Rotterdam, by sea from Rotterdam to Montreal and by rail from Montreal to Chicago. Historically, the shipper would have been likely to have had three separate contracts—one with a European trucker, one with an ocean carrier and one with a North American railroad. Some or all of these three contracts would have been concluded through agents, but the shipper's legal relationship would have been with each of the three carriers.

Today, it is more likely that the shipper would enter into a single contract of carriage to transport the goods all the way from Berlin to Chicago. It might contract with an ocean carrier that will perform the ocean carriage under that contract itself while subcontracting with inland carriers to perform the other two legs. Or the shipper might contract with a non-vessel operating carrier that will perform none of the carriage itself but will instead subcontract with ocean and inland carriers to perform all three of the legs. In either case, the shipper's legal relationship is with a single carrier under a single contract for the entire journey (and it generally has little interest in its carrier's subcontracts).

### (b) *The governing legal regimes*

When the first international transport convention was negotiated in the early 1920s, separate contracts for each leg of the journey were still the norm. Thus the period of responsibility under the Hague Rules of 1924 was carefully limited to ocean transport

alone. Indeed, the Hague Rules apply only to the so-called tackle-to-tackle period—the time between loading and discharge—and do not apply even to the time when the goods are under the ocean carrier’s control in the port area.<sup>259</sup>

The Hague-Visby Rules do not change the period of responsibility. They were negotiated early in the “container revolution,” before multimodal contracts had become the norm, and thus the drafters of the Visby Amendments did not perceive a pressing need to make any change to that provision.

The Hamburg Rules extend the period of responsibility, but only to cover the time when the goods are under the ocean carrier’s control in the port area. This is not a fundamental change; the Hamburg Rules are still a unimodal regime.

Because the three international maritime conventions all have limited periods of responsibility, other law must fill the void for inland carriage. Because there is no international regime for inland carriage comparable to the Hague, Hague-Visby and Hamburg Rules, different nations have filled that void differently. In some regions (most prominently Europe), regional unimodal conventions generally apply to international road and rail carriage. (Thus, the Convention on the Contract for the International Carriage of Goods by Road (CMR) governs European road carriage and the International Convention Concerning the Carriage of Goods by Rail (CIM)-Convention concerning International Carriage by Rail (COTIF) governs European rail carriage.) In some countries, mandatory domestic law applies to inland carriage. In some countries (such as Canada), this would be unique domestic law. In other countries (particularly in Europe), the domestic law is closely modelled on the relevant regional regime. Many countries have no mandatory law, however, thus effectively leaving the parties to address the issue in their contracts of carriage.

In the United States, the country with which I am most familiar, confusion reigns on this issue. The federal appellate courts in some parts of the country have held that the 1906 Carmack Amendment to the Interstate Commerce Act (which has itself been amended many times) is mandatorily applicable to the United States portion of the inland leg of a multimodal shipment such as we saw in our original Berlin-to-Chicago hypothetical. Under these decisions, the Carmack Amendment would govern the carrier’s (and the railroad’s) liability if the cargo were damaged on the train after crossing the United States border. The federal appellate courts in other parts of the country have held that the Carmack Amendment does not apply, even to the inland United States leg, if a single bill of lading has been issued. Under these decisions, the carrier’s (and the railroad’s) liability would be governed by the terms of the bill of lading (subject to the restrictions of maritime law) if the cargo were damaged after crossing the United States border. Earlier this year, the United States Supreme Court agreed to resolve the conflict among the lower federal courts, but the parties settled the case before the Court could hear argument.<sup>260</sup>

Under our original Berlin-to-Chicago hypothetical, therefore, as many as six different legal regimes could govern each of the six distinct segments of the single multimodal journey under a single contract of carriage: (a) the European Convention on the Contract

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<sup>259</sup>The drafters felt that the immediate need at the time was for international uniformity during the ocean voyage, and that it would be unnecessarily complicated to extend the new rules to situations in which the domestic law of a single country could provide a single, predictable rule.

<sup>260</sup>See *Altadis USA, Inc. v. Sea Star Line, LLC*, 127 S. Ct. 1209 (2007) (noting dismissal under Rule 46).

for the International Carriage of Goods by Road would govern any cargo damage that occurred during the Berlin-to-Rotterdam road leg; (b) the bill of lading would probably govern any cargo damage that occurred in the port of Rotterdam after delivery by the trucker before loading on the vessel (although the bill of lading terms could be displaced by mandatory Dutch law to the extent applicable); (c) the Hague-Visby Rules would govern any cargo damage that occurred during the Rotterdam-to-Montreal sea leg; (d) the bill of lading would probably govern any cargo damage that occurred in the port of Montreal after discharge from the vessel before delivery to the railroad; (e) the mandatory Canadian law governing domestic rail carriage would govern any cargo damage that occurred on the train before crossing the United States border; and (f) the United States Carmack Amendment might (or might not) govern any cargo damage after crossing the United States border (depending on the United States court in which the dispute was heard).

(c) *Prospects for improvement*

In the United States, the Supreme Court recently recognized the value of having a single contract of carriage, even a multimodal one, subject to a single legal regime during the entire period of its performance. As the Court explained in the context of a multimodal contract for carriage of goods from an Australian port to an interior point in the United States, “[c]onfusion and inefficiency will inevitably result if more than one body of law governs a given contract’s meaning.”<sup>261</sup>

Despite our clear recognition of the problem, the prospects for improvement do not look very good at the moment. The international community has already tried at least once. Under the 1980 United Nations Convention on International Multimodal Transport of Goods (the Multimodal Convention), a “multimodal transport operator” would generally have been governed by a single legal regime throughout the performance of its contract of carriage, but article 19 would have created a “network” exception to preserve the operation of national or international unimodal regimes that impose greater liability on the carrier. Even this limited effort to unify the law for multimodal carriage failed. The Convention achieved virtually no support, and there is essentially no prospect of its entering into force in the foreseeable future.

The current UNCITRAL transport law project holds out the most promise for improving the situation, but it would still produce only a partial step toward a true multimodal convention. It would not create a single regime to govern a single multimodal contract’s meaning. Under article 11 of the current<sup>262</sup> draft Convention on the Carriage of Goods [wholly or partly] [by sea], the period of responsibility is defined by the contract of carriage. Thus a multimodal contract would produce a door-to-door period of responsibility for the carrier (which is equivalent to the Multimodal Convention’s “multimodal transport operator”). But article 26 also creates a “network” exception to preserve the operation of unimodal regimes, and article 19, which makes maritime performing parties liable under the draft Convention, does not apply to inland carriers. Thus inland carriers would be outside of the new regime entirely, and the carrier’s liability for damage on an inland leg would often be defined by reference to a unimodal regime.

<sup>261</sup> *Norfolk Southern Ry. Co. v. James N. Kirby, Pty Ltd.*, 543 United States 14, 29, 2004 AMC 2705, 2715 (2004).

<sup>262</sup> A/CN.9/WG.III/WP.81.

What is the explanation for this failure to address such an obvious and pressing problem? The simple answer is that industry does not want it. Experience has shown that efforts to impose an unwanted legal regime on unwilling commercial parties are doomed to failure. We have seen this in the Hamburg Rules and again in the Multimodal Convention. In both Europe and North America, inland carriers have been particularly vocal about their desire to be excluded from any new convention.<sup>263</sup> Ocean carriers and non-vessel operating carriers—the carriers who typically enter into multimodal contracts—wish to have their liability defined on the same terms as they have recourse against their inland subcontractors, and thus they have insisted on the network exception.

Because the current UNCITRAL project is driven by commercial needs, legal elegance has sometimes had to take a back seat. In a pragmatic world, there is no point in having a perfect convention that no one ratifies. It is far better to have an imperfect but nevertheless useful convention ratified by nations representing as much of world trade as possible. Although logic may demand that a single body of law should govern a single contract's meaning, commercial demands seem more than strong enough to preserve the fractured approach that the world now follows.

There can be no doubt that sea carriage will continue to go ashore. The container revolution has guaranteed that as a matter of economic necessity. It also appears that for the foreseeable future, we will continue to face questions about the relationship between multimodal conventions and domestic unimodal rules.

### 3. *Transfer of rights and transport documents*

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Transportation law would be very simple and straightforward if the law only had to respect the needs inherent in a contract of carriage: all the legislator would have to regulate would be the rights and duties of both contractual parties, the carrier and the shipper. The main content of the contract would be (a) for the shipper to hand over the goods to the carrier, (b) for the carrier to then transport the goods safely to destination and (c) from there to hand them back to the shipper. The transport document would—if at all needed—be a receipt and proof of a contract of carriage for the sole purposes of proof for both the shipper and the carrier, should a disagreement arise in the course of their dealings.

Transportation—and indeed transportation law—is not, and never was, that simple. The reason for this lies in the almost pleonastic economic function of transportation, namely that it very rarely serves a self-fulfilling purpose but, instead, only mirrors the logistical necessities deriving from any international sales/trade contract in which goods are sold and bought with a view to their being shipped from one place to another. The *raison d'être* of the transportation is the sales contract and the necessity under this sales contract to move the goods from the seller's sphere into the sphere of the buyer. Traditionally, the sales law (e.g. the CISG) and the contractual terms, in particular the

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<sup>263</sup> Inland carriers oppose uniform multimodal regimes whenever an international convention is under discussion. In the context of individual litigation, however, when inland carriers might benefit from the maritime rules, their story can be very different.

trade terms (Incoterms 2000), will determine which of the parties to the sales contract (seller or buyer) will have to organize and pay for transportation.

Delivery in the sales contract under the F or C clauses of Incoterms 2000—i.e. free alongside ship (FAS), free carrier (FCA), free on board (FOB), cost and freight (CFR), cost, insurance and freight (CIF), carriage paid to (CPT) and carriage and insurance paid to (CIP)—is made when the goods are handed over to the carrier/ship. As a consequence, the transport document established in the transportation contract is, in most trade transactions, the proof of performance of the sales contract in question. Therefore, such a transport document—for purposes apart from actual transportation—will have to provide sufficient indications as to the date of the handing over of the goods, the quantity and the quality of the goods and possibly also other points which the buyer will have to be able to verify prior to the payment of the purchase price (e.g. whether or not the freight is to be prepaid). Looking at the reliance on the facts as stated in the transport document, one must realize that this reliance is not the one of the contracting party (contracting shipper) but of the bona fide third-party buyer/consignee. In the context of a customary trade finance scheme (letter of credit), this reliance of the buyer/consignee is—as a rule—shared by his letter-of-credit bank, which needs to be able to rely on those facts and figures for its finance agreements and for the security interests such a delivery to the carrier may provide.

This reliance aspect and the interdependence of carriage and sales contracts underline the fact that the law of carriage of goods by sea has to satisfy many more aspects than just transportation issues between carrier and shipper. As third parties take substantial risks in their trade and trade finance agreements, they need to be able to rely on the statements and contents of the transport document.

In a normal trade context, it is not the shipper who requests delivery of the goods at destination, but a third party (consignee). Therefore, the transportation law must provide for the right to request delivery to that third party. This means that the law of contract of carriage must transfer in one way or another rights from the shipper to the consignee.

Where the national law recognizes the concept of a contract to the benefit of a third party (e.g. in civil law), the basis for such a transfer of the right is feasible. It is more complicated for national laws that do not accept such a concept.

As the transfer of these rights must be done at very precise moments in time (e.g. once payment for the goods has been made), the law of contract of carriage must define the circumstances under which the rights are indeed transferred to the consignee.

String sales are very common, in particular in the commodity trade. This obviously complicates matters as a single and unique transportation contract for the same goods (entered into by the first CIF seller) will serve a number of subsequent sales contracts between a great number of subsequent sellers and buyers. The consignees (buyers under each subsequent sales contract) and the ultimate receiver will be identified long after the contract of carriage has been entered into, and all rights vested in the contract of carriage and possibly in the transport document must also be transferred to any new “consignee”.

Things are made even more complicated by the fact that the shipper needs to keep control over the goods vis-à-vis the carrier while they are in transit. He needs to be able to

instruct the carrier or give him specific orders or renegotiate new terms under the contract of carriage. This is not only necessary for issues relating purely to carriage and logistics but, more importantly, as a tool to control the goods before the shipper (in his function as seller) has obtained payment from the buyer. Sales law, and in particular CISG article 71, provides for such a right of stoppage in transit. The law of contract of carriage must, in turn, provide an equivalent right to enable the seller to enforce his right under his sales contract by using mirroring rights as vis-à-vis the carrier.

In this context the transport document receives a crucial function. It traditionally embodies the function of the contract of carriage (based on which transportation to destination and delivery to the consignee is made), as well as the function of a receipt relating to the quality and/or the quantity of the goods. In a maritime context, these functions were secured by issuing a bill of lading, a transport document which, in addition, had the function of a document of title. While the first two functions were sufficiently codified on a harmonized level (Hague Rules 1924; Hague-Visby Rules 1968; Hamburg Rules 1978), the crucial aspect of its role in enabling the transfer of rights from the shipper to any third party (consignee, holder of the bill of lading) was left up to national law.

Furthermore, parties involved in special trades and, in particular, in in-house transactions forming part of deliveries within multinational production systems needed an informal transport document, a simple receipt, in the form of a sea-waybill. This alternative to the traditional bill of lading became very popular; apart from a set of uniform rules for sea-waybills prepared by the Comité Maritime International, however, no harmonized regime existed in favour of commerce and trade to provide harmonized and legally enforceable rules for such documents.

Both alternatives—bills of lading and sea-waybills—are nowadays “translated” into electronic formats of different kinds. In addition to the generally applicable rules on electronic commerce, these new electronic trading methods require much broader regulation in the scope of transportation, since these electronic equivalents are not just bilateral messages, but will be relied on by third parties; in cases of negotiable “documents”, all the rights vested in the “holdership” of the original message will have to be legally transferred from one party to the other in the course of the performance of their trade and sales contract.

*(a) Transport documents and transfer of rights in the new draft convention*

From all of this, it follows that the following issues must be put on the agenda for a new international regime for the contract of carriage (in particular by sea):

(a) The new convention (A/CN.9/WG.III/WP.81 and Corr.1) must regulate the entire contract of carriage and cannot just regulate—as the older (or, to be more precise the existing) conventions do—selected liability issues relating to typical transport documents;<sup>264</sup>

(b) The provisions of the new convention must differentiate between three groups of “transport documents”:<sup>265</sup>

(i) Traditional negotiable transport documents (bills of lading);

<sup>264</sup> Art. 1, para. 17, of the draft convention.

<sup>265</sup> Art. 1, para. 16, of the draft convention; see also chap. 9, arts. 36-43, of the draft convention.

- (ii) Contracts of carriage which are not specially documented or for which simple sea-waybills are issued;
- (iii) Contracts of carriage which are not “documented” but are issued by electronic means,<sup>266</sup> either to provide the equivalent of a negotiable document or simply to provide an electronic evidence of the contract of carriage.

As the contract of carriage by sea has long gone ashore, the documents must cover the entire period of transportation and custody by the contractual carrier (door-to-door) irrespective of whichever mode of transport is used to move the goods. Today, the legal status of multimodal bills of lading is not entirely clear. Clarity on this is important and needs to be provided by the new instrument.

In addition to this list of transport documents, the new convention needs to deal with other typical transport arrangements, including the traditional charter party<sup>267</sup> and the more modern form of a general umbrella agreement for shipment, the so-called volume contracts<sup>268</sup> (e.g. ocean liner service agreements). This special treatment is important, to allow sufficient room for the well-established practice of special shipment arrangements which are explicitly negotiated in and for specific markets.

The new convention must define the scope and the extent of the evidentiary value<sup>269</sup> of any entry relating (a) to the description of the goods (identity, quality and quantity) and (b) to any other important fact or agreement (e.g. freight prepaid<sup>270</sup>) also for the benefit of the subsequent holder of such a document. The criteria and the standards are—of course—very different for each of the types of transport documents.<sup>271</sup>

A definition of the right to control<sup>272</sup> relating to the goods while in transit must clarify the rights and obligations of both cargo interests and carriers and then must clearly state in what circumstances such a right of control is transferred from the shipper to the next party, and then to the controlling party, who from then on will be the only party to give instructions to the carrier or to otherwise control the goods in transit. It is clear that the applicable principles will differ depending on the format of transport document which was issued and chosen in a particular shipment.

The new convention must also regulate how and in what circumstances the rights vested in one party (shipper, subsequent holder) are then transferred to the next party and eventually to the final receiver/consignee. Again, the mechanism for such a transfer will depend on the format of the transport document.<sup>273</sup>

Finally, the new rules will have to cover the role of such a transport document (if needed) in order for the consignee to have the right to request the delivery of the goods at destination. It is clear that—due to the role given to the negotiable transport document (or its electronic

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<sup>266</sup> Art. 1, para. 19, of the draft convention, see also arts. 8-10 of the draft convention.

<sup>267</sup> Art. 6, para. 1 (a), of the draft convention.

<sup>268</sup> Art. 1, para. 2, of the draft convention. See further art. 89 of the draft convention.

<sup>269</sup> Art. 42 of the draft convention.

<sup>270</sup> Art. 43 of the draft convention.

<sup>271</sup> Art. 42 of the draft convention.

<sup>272</sup> Arts. 52-58 of the draft convention.

<sup>273</sup> Arts. 59-61 of the draft convention.

equivalent) for the benefit of international trade—the bill of lading will be crucial for the exercise of such a right to request delivery—while, in cases where sea-waybills are used, the document will practically have no impact for this final phase of the transaction.<sup>274</sup>

*(b) Where do we stand, and what needs to be done?*

I have often made reference to the new UNCITRAL draft convention. I do not intend, nor would I have sufficient time, to describe and discuss the individual provisions that have come out of the very interesting process of harmonization within Working Group III of UNCITRAL. Let me give you, instead, my personal thoughts on the situation in light of the desire and need for the right balance of international harmonization and national interests to regulate matters on a national level. In doing so, I will, of course, restrict my comments to the scope of my speech: transport documents and transfer of rights.

Historically, the international community has not been that interested in these issues, as for more than a century now the discussion has been focused on the liability regime under bills of lading. This historical focus shifts the focus even today to those issues and indeed to an extent that is hardly explainable by economical needs. This has an influence primarily on issues like liability standards and levels and freedom of contract, but it also has some effects on the issues of transport documents and the transfer of rights.

One tendency noticed within Working Group III is that of opting for an automatic transfer of all the benefits which were traditionally given to a third-party holder of a bill of lading also to a third-party receiver of goods transported under simple sea-waybills or even on the basis of just receipts. Those benefits are not limited to the value of the documents but to a number of other issues. Here my position is that only those parties in a trade transaction should be able to rely on a given piece of information or document if the document was drawn up in a form justifying such a reliance. In my view, such reliance is justified only when bills of lading are issued and circulated to third parties.

Another tendency noticed within Working Group III, which is explained by the limits of the stamina of the international community in a harmonization process, is that all issues which fall outside the historic focus (i.e. liability) are put in danger. They are put in brackets and are then brought to execution in the phase of the last reading of the instrument. While the starting point of the entire exercise was the harmonization of the mechanism of transfer and control of rights in all variants of modern transport documentation, the pivotal point of the new draft instrument, very much like the Hague Rules 1924/1968 and Hamburg Rules 1978, has remained the liability system. My opinion—while accepting the need to provide a modern liability system—is that the issues of rights of all parties and the exercises and transfer of such rights remain the real added value in terms of harmonization and that they need to remain in the draft convention.

One often hears the argument that the time needed for harmonizing these new areas has not been available and the time for promulgating a new liability regime is pressing. Now, looking at the page count of the reports of Working Group III, one can easily see that the balance on a time-spent basis per issue is clearly in favour of the historic liability

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<sup>274</sup>Arts. 46-49 of the draft convention.

issues. This is not a criticism of the work, not at all. It is clear that this highly sensitive, if not political, issue of liability absorbs much energy—well-spent energy; but to sacrifice areas of added value would be sad.

The other argument often heard in the process of harmonization exercises is: “This issue is too sensitive; it needs to be left to the applicable law (whatever that means), to the national law.” Many provisions of the new draft instrument in the current version do exactly this. Often, such reference to national law is provided as a substitution for a specific substantive provision. Again, this is not a criticism of the way Working Group III has decided to deal with the issues. It is an example of how issues are withdrawn from the harmonization agenda. Every one of the highly successful international conventions has a long list of such “deletions” or “referrals”. It is, therefore, a fact of life. It is important, however, that one remembers the items on this list, that one mentally puts them on a silent agenda and that other opportunities are created where such issues can be harmonized further in the future. The different instruments of UNCITRAL in the context of arbitration can, to a certain extent, be seen as an example for such a step-by-step, multi-instrument approach.

Having said that, it is interesting to see that the degree of harmonization (and the degree of specification) is much higher for traditional negotiable instruments, such as the bill of lading. And this is a good thing, as it is the bill of lading (and its electronic equivalent) that will be and will remain for a long time the backbone of international trade and trade finance.

For the remaining contracts, where no bills of lading were issued, the new convention is less specific and leaves much to national law. Trade and commerce might claim one day the same degree of specification and request yet a further harmonization in whatever form.

The challenge for the international community will be that those issues which were left to national law are not always controllable by contract, as they will depend on national laws covering areas like third-party rights, possession, securities, title to sue etc.

But, first things first. We first need to bring the new convention safely to water in a seaworthy condition, fit to withstand the rough waters of the real test: the commercial reality.

#### 4. *Comments, evaluation and discussion*

*Patrice Lyons*

*Law Offices of Patrice Lyons, United States of America*

My name is Patrice Lyons. I am corporate counsel to the Corporation for National Research Initiatives (CNRI) in Reston, Virginia.

A few days ago we heard about the intersection of economics and the law. Most of my work over the years has been at the intersection of technology and the law, particularly doing business in an Internet environment. One of the projects I have been working with CNRI on is the representation of value in the form of persistently identifiable data structures. We call them digital objects. I will not go into detail. I know there is not much time. But a matter that has come to my attention is the representation of bills of lading,

letters of credit and other documents in the form of digital objects that are accessible on the Internet. This effort would build on a system, called the Handle System, that was developed by CNRI and implemented in other areas of commerce (information on the system and reference software is available at [www.handle.net](http://www.handle.net)). I would appreciate your reflections on whether it would be timely to develop a pilot project in the maritime industry, as well as related segments of the transportation sector more generally, such as the railroad and trucking companies involved in a multimodal-type situation, where you could uniquely and persistently identify an original bill of lading at a moment in time, and when the bill of lading is transferred, the new holder could authenticate that it is actually the original bill of lading.

Further, if this pilot project were to get under way, what would be the role for UNCITRAL insofar as working with such a project to develop legal understandings that might facilitate the deployment of the system in the Internet environment? I understand that the launching of such a project would require very detailed discussions, but I would appreciate any initial thoughts about the feasibility of such an endeavour.

*Alexander von Ziegler  
Schellenberg Wittmer, Switzerland*

I can try to cover a section of your question. Concerning what UNCITRAL is able to do, I think we should ask UNCITRAL. But I think, first of all, you put your finger exactly on the issues relating to electronic trade. The importance is because this information (I am tempted to say the “electronic document” but, of course, this is not the right term), this electronic equivalent, needs to have the function of being able to always keep the format of the original, despite the fact that it will be handed over to a third party and by the third to a fourth party etc. So the challenge at the technology level is very sizeable because you have to destroy the function of the first holder. His document must be destroyed as an original and has to be handed over. There are many projects in the past which tried to do that, with a central entity handling this by always giving new keys to the parties. I would say that it would definitely be of great interest if technology could make it unnecessary to have a central organization who would handle that. It would actually be floating freely and accessible to the carrier. For instance, he would know at all times who is the holder of the original at any given time. There are maybe even possibilities that do not currently exist. For instance, if the Swiss banks hold bills of lading, the carrier would not necessarily know whether this is in Geneva or in Zurich or elsewhere. New technology could at least give the information to the carrier at that stage that they are currently held in Geneva etc., if that is wished by the parties, of course.

*Michael F. Sturley  
University of Texas at Austin, United States of America*

I could just add a little bit to what Alex has said. I think one thing that is inevitable in any international project of unified law, but I think is particularly true, historically at least in our field, is that regulation tends to regulate what has already happened. And when we are talking about regulating your field, you move so much faster than we, as lawyers, move—as UNCITRAL as an organization with international lawyers can possibly move—that I think the most important thing to remember in this context is the

importance of facilitating what is about to happen rather than trying to regulate what the current technology already provides because by the time you tell us about the current technology, and by the time we hear it, it is no longer the current technology.

Certainly one of the most interesting aspects of Working Group III's current project is that of facilitating electronic equivalents; "electronic records" is the term that the instrument uses. But the idea is not to regulate what is happening or attempt to regulate what is about to happen (which is, in large measure, unpredictable), but to set up a legal framework that will facilitate what you and your colleagues do in the years ahead, because these conventions last a very long time before we can get around to doing the next one. So I think it is very important that you be sharing your thoughts with UNCITRAL but the goal has to be to facilitate what you are doing, not to regulate what you are doing.

*Ibrahim Hassan al-Mulla al-Mansouri*

*Emirates International Law Centre, United Arab Emirates*

I have three questions. I do not know whether they have already been taken into consideration in the UNCITRAL law or not. The first concerns payment for goods through banks, through the original bank and the intermediate bank. Whose responsibility is it to verify the correctness and soundness of the documents, i.e. whether those documents are genuine or not?

The second question is: if a ship has carried certain goods over a distance for a certain country and if the goods are not delivered or not unloaded, who is responsible?

The third question: what is the responsibility of UNCITRAL vis-à-vis the flying of flags by ships?

*Alexander von Ziegler*

*Schellenberg Wittmer, Switzerland*

I will take the first question because it relates to documents. Again, this convention is confined to the questions which are put in the context of carriage, of course, always on the interfaces with the sales law and trade finance. So what this product will deliver are rules on the documentation—now approved documentation within the UNCITRAL framework—which will define what elements of the content of the transport document are required and might also define what happens if one or two of these elements are not there. The consequence might be a claim against the issuer of the document or a claim against the shipper because the information provided was not right and raised problems. Those are the issues. The issue you are raising is the issue who will look after this document and what is the level of the right to rely on its content. And that, in my opinion, is first of all looked after by the Uniform Customs and Practice for Documentary Credits in the form of UCP 600 of the International Chamber of Commerce in Paris, which defines how the banks look at a document, whether they look into the details and whether they have to verify the content of the documents. Those issues are not covered in the project and I do not think they were ever discussed. Those are issues on the use of the documents now in the interfaces with the law but also, I would say, in the Uniform Customs and Practice or the letter of credit environment.

*Michael F. Sturley*  
*University of Texas at Austin, United States of America*

As I understood it, you want to know, if the carrier does not deliver the goods at the place of delivery, who is responsible?

Going back to the hypothetical I talked about in my paper, if the carrier does not deliver the goods in Chicago, who is responsible? And the answer to that is: I need more information. You need to tell me more in your hypothetical before I can answer. Because what we are looking at here, as in most commercial law, is a risk allocation. Historically, shipping goods was viewed as a common adventure. Historically, the merchant, the seller, would often travel with the goods—we are talking about a thousand years ago now—and the seller and the ship owner would share the proceeds of the enterprise. We do not do things exactly like that any more, but to some extent that model is still with us. And what we need to develop in any commercial convention is really a risk allocation so that the parties can know in advance who will be responsible for what risks. And there are some risks that are quite properly the carrier's responsibility and the carrier will be responsible if the goods are not delivered.

There are other risks that are quite properly the shipper's responsibility. For example, if the goods have been inadequately packed and as a result are damaged, then the shipper will be responsible for that. There are situations in which one of the performing partners, one of the subcontractors, should be responsible.

One of the things that UNCITRAL is trying to do with this new draft convention is to come up with a clear risk allocation that will specify in various contexts who is responsible for what and to ensure that this risk allocation is fair and balanced. We do not put too much of the responsibility on the shipper. We do not put too much of the responsibility on the carrier. We are left with a balanced risk allocation that becomes acceptable or at least that all parties are willing to live with and to which all parties can acquiesce.

So the answer is—it is a classic law professor answer, but I am a law professor so I will give the classic answer—that it depends.

*Rafael Illescas, Chair*

I will answer the third of your questions. The UNCITRAL draft convention being prepared does not for the time being refer and is not expected to refer to the question of vessel flag registration. This matter is the responsibility of other United Nations agencies but not specifically that of UNCITRAL.

However, with regard to the issues which I imagine you wish to raise in connection with vessel flag registration, I have to tell you that, at the present stage of the negotiations of the draft convention, the text stipulates that carriage must take place in a seaworthy vessel, seaworthy meaning fit to navigate, and that the vessel's seaworthy condition must, at the current stage of our deliberations, not only exist upon the conclusion of the contract and at the beginning of the voyage but also be maintained throughout its duration.

*Innocent Fetze Kamdem*  
*University of Ottawa, Canada*

A number of questions have come to mind, technical questions that I would like to ask, even if it is perhaps not the appropriate forum. I would actually just like to make a remark and then ask a question of each of the panellists.

On a number of occasions we have heard that, in the area of sea carriage, we have seen difficulties when it comes to harmonization. Since there is a strong will to move forward, I think that things are on the right path. But the problem is still there and I think it is the technique of the multilateral convention. This technique, or this tool, if you like, is not suitable. It is not able to react appropriately to the exigencies of international trade. It seems to be that the multilateral convention would be the right way to achieve modern commercial law for the world, in an ideal world. But I am wondering whether, on the basis of your experience, you have the sense that once UNCITRAL does manage to adopt a new convention dealing with the carriage of goods by sea, this would not lead to a fifth legal regime which will be added to the four major legal regimes which already exist?

*Jan Ramberg*  
*University of Stockholm, Sweden*

I think that, of course, this is a matter which is of great concern to everyone: the proliferation of conventions and the Hague Rules, the Hague-Visby Rules, the Hamburg Rules, all in force, and then, of course, if you have this one, that is at least four. But speaking with the hat of the International Chamber of Commerce on, I can say that the International Chamber of Commerce wishes to see unification and harmonization of the law in this field because anything else is to the detriment of international trade. Now in order to achieve that, I think that one has to put in place very stringent requirements for the coming into force of a new regime so that you do not get a situation where a great number of States fail to denounce the previous conventions. But if you have all in force simultaneously, then you will have colossal problems.

*Alexander von Ziegler*  
*Schellenberg Wittmer, Switzerland*

Yes, well, I think your question is the question. Whenever one embarks on a project in this area, where you have conventions and you want to develop them and go ahead, you should tremble. As Montesquieu said, “Once you have a law, you should tremble to change it.” That is, if you look at it, it is, of course, right to tremble, but to tremble does not mean to stand still. I think that if we stand still, we just have to look at what happens. The Hague Rules 1924 made reference to some national laws already: the currency, for instance, as an exchange ratio for the calculation of the limitation. Then you have the Protocol, which allowed each country to transform it into national law (the Swiss, Germans, and others did that). A lot of “disunification” already happened at that stage. Then you had the Hague-Visby Rules 1968. All these attempts to go further and do better created yet another layer. And now you are in a situation with the Hamburg Rules 1978 in place in some countries but development has somehow been stopped; and if you persist with that situation, you create the danger—which already materialized around the world—that one is not happy. I mean that nations or carriers or shippers or traders are not happy. What are they asking

for? They are requesting us—national law—to progress. And then you have an X law and a Y law, and they are all very good and the background is good; but it destroys the harmony which I tried to show is needed because those interfaces are not just for the liability issues but for others.

So I do not think we have the luxury of saying, well, we should not attempt it. We need to attempt it and I have a very good example. Examples are dangerous. I do not want to misuse the example, but they had the same—if not—worse situation in aviation law with the Warsaw Convention 1929/1955 or the Protocol of 1975 of Montreal etc. And today with the Montreal Convention. I do not want to compare our project to Montreal; that would be cheap. But just a few years ago, 1999, I think, the Convention of Montreal was finished. Today, it really shows that it is possible that it could actually be a convention which supersedes all others. And I very much hope that this is the case, because what we do not need is a fifth coexisting system. I think that we could cope with it but it should not be an acceptable risk. We should go all the way and we should try to find a consensus which allows hope that this will be a new, modernized, more complete and more adequately created convention than in the past. It is a hope.

*Michael F. Sturley*

*University of Texas at Austin, United States of America*

I only want to add one brief comment. You mentioned that there were four, I think, existing regimes. It is really much worse than that. For example, the United States is a Hague Rules country, but the United States' interpretation of the Hague Rules is very different than the Canadian interpretation of the Hague Rules or anybody else's. And there is so much that the Hague and Hague-Visby Rules do not cover that we really have variations in each Hague Rules country.

We also have countries that do not fit clearly in a single regime. For example, the Scandinavian countries are parties to the Hague-Visby Rules, but the Nordic Maritime Codes adopt a Hamburg Rules approach. China has a mix between the Hague-Visby and Hamburg Rules. So there are maybe a hundred different regimes currently in force.

Your theory is definitely well-founded. We do not want to make it a hundred and one different regimes. But on the other hand, the dominant regime in the world right now, if you had to pick a single dominant regime, would be the Hague-Visby Rules. The Hamburg Rules are more modern, but a very small proportion of world trade is actually governed by them. The Hague-Visby Rules, however, are really just a slight modification to the Hague Rules. On the fundamental issues, the Hague-Visby Rules are not that much different from the Hague Rules. The Hague Rules were directly modelled on a 1910 Canadian statute that was itself modelled on an 1893 statute that was designed to deal with the problems at the beginning of the age of steam in the middle of the nineteenth century. The current regime has worked amazingly well considering how old it is and how many things were not under consideration when it was adopted. There are risks in going forward but there is also a risk in standing still. You have all heard the saying that "the perfect is the enemy of the good". If we hold out for the perfect regime, we will be even worse off. Commerce demands that we have a more up-to-date regime than we have now. There are risks in attempting it, but personally I think there are even worse risks in not attempting it. So we should be aware of the risks but not let them scare us away from the work that needs to be done.

*Emmanuel Kofi Mbiah*  
*Chief Executive Officer, Ghana Shippers Council*

I am grateful to the distinguished professors for their elucidation of the basic concepts involved in the unimodal and multimodal liability regimes under the carriage of goods. It is also important to mention that the new concepts of electronic transmission, service contracts, the mish-mash of network and uniform liability as well as the problems related to transferability, have all been mentioned, and it seems to me that it is important in all of this work that one takes due cognizance of the interests of developing economies. I am not here referring to the Chinas, the Koreas, Indias and what have you. I am referring more to countries in sub-Saharan Africa in particular. I am trying to see the extent to which these new concepts have been factored into the development of the new rules. If you look at the Hamburg Rules for example, you would realize that predominantly they have been ratified by so called “non-maritime nations”, but these are countries which have peculiar needs which need to be addressed. In the light of these difficulties, we, through UNCITRAL, are seeking now to achieve uniformity, a balance of interests and modernization with the new rules. I see this as a real and formidable task confronting UNCITRAL at this moment. I know that by asking this question, I may be pushing my dear professors to the wall; nevertheless, let me ask. Having regard to what the last speaker said and the difficulties I have just outlined and noting the compromises so far reached, is there a real likelihood that this convention would see the light of day without taking cognizance of the interests of these developing economies?

*Michael F. Sturley*  
*University of Texas at Austin, United States of America*

You have, of course, chosen exactly the wrong panel. You are asking a group of professors what is going to happen in the real world and obviously that is a mistake. So I hesitate to predict what the political organs will do. But I do want to comment on your point on recognizing the needs of the world’s developing economies and, of course, you are absolutely right. I think part of the problem that we face here and a part of the problem that we saw with the Hamburg Rules (part of the explanation for why the Hamburg Rules have not been as successful as we all would have wished at the time) is that there was an unfortunate tendency in the negotiation at Hamburg to focus on a few hot-button issues without examining the more basic fundamentals.

For example, there was considerable discussion as to what the package limitation should be under any of these regimes. One of the focuses in Hamburg was to make sure that the package regime was increased. The talk was that this would somehow benefit those nations to which you referred because they are more likely to be “cargo-owning” nations than “carrier” nations. But if you think more carefully about the actual practical application, that conclusion is not at all clear. A number of the countries about which you are concerned are shipping goods that do not have a per-package value or a per-unit value in excess of what the Hague-Visby Rules already supply. If you were shipping a cargo of cocoa beans, for example, it does not matter if the limitation amount is at the Hague-Visby level or the Warsaw-Montreal level, because the cocoa beans will get full recovery regardless. So the focus on things that do not really matter, I think, was a mistake that was made in Hamburg that I hope will not be made here.

I think much more important, particularly to the developing economies, where a number of the market participants do not have the kind of bargaining power that you see in the big multinationals, is ensuring that there is a uniform regime in place. If there is a uniform regime in place, it tends to put all of the players on more of an equal footing, whereas if you have a hundred different laws, then the more powerful market participants will insist on their chosen law governing the transaction, and it will disadvantage developing economies. So I think having a uniform regime is much more important for the developing economies even than it is for the industrialized world. And I think that if the focus is on that instead of on what I view as red herrings—things that do not matter as much—then they will have a greater chance of success and that it is the developing economies that will proportionally benefit the most as a result of that.

*Zafar Iqbal Gondal*

*International Development Law Organization, Afghanistan*

One of our tasks at the International Development Law Organization project in Kabul is the training of judges, employees of ministries and prosecutors in commercial, corporate and international trade laws and financial crimes. I would like to draw the attention of UNCITRAL to one of the practical problems which I am observing vis-à-vis international conventions and domestic law.

It always happens that an international convention is forward in time and the domestic law is always behind in time. In some countries with a monistic legal system, a convention becomes part of domestic law once it is ratified by the parliament of that country. In such countries, normally there is no problem. International conventions and treaties are directly applicable once signed and ratified by a country, just like European regulations. In the majority of countries with a dualistic legal system, international conventions are considered as a matter for Government alone and are not enforceable unless enacted as a domestic statute or ordinance or decree. The latter is the case, for example, in the United Kingdom, Afghanistan, Pakistan and many developing countries.

What is happening on the ground is that a country has ratified many conventions. Those conventions are passed by parliament as required by the constitutional law, but those conventions are not yet enacted into domestic law. Rather, domestic commercial law is in conflict with those ratified international conventions. So at the enforcement level, judiciary and other regulatory authorities face this problem. On one side, there is a convention that it is ratified by the parliament, but on the other side there is the existing commercial law that conflicts with a convention or treaty.

How is UNCITRAL taking care of this problem and what steps are recommended to overcome such problems? There is a plethora of laws in each country that lack genuine implementation, thus discrediting domestic international and national justice systems.

*Rafael Illescas, Chair*

I understand that this is a question relating to sphere of application and that an international regime can coexist with a domestic regime without any difficulty. The application of the international instrument will be in accordance with its implementation provisions; otherwise, national law applies.

*Zafar Iqbal Gondal*

*International Development Law Organization, Afghanistan*

Let us discuss a hypothetical example. Suppose the constitution requires ratification of international treaties by parliament. The parliament of a certain country has ratified a certain treaty on a certain subject. However, the existing law on that subject is in conflict with the ratified treaty. A matter comes before a judge to decide on in which he finds a conflict between the ratified treaty and enacted domestic law. The constitution says that a law will be implemented in that country once it is ratified by the parliament of that country. The treaty is ratified but there is existing domestic law in direct conflict with this treaty which has not been amended accordingly. In such circumstances, how should a judge proceed? Should he apply the existing domestic law or should he apply the provisions of a treaty which has been ratified by the Parliament, ignoring the existing domestic law on that subject?

*Michael F. Sturley*

*University of Texas at Austin, United States of America*

I think I understand the problem. I have much more trouble foreseeing the solution. As you say, in many countries, it is not a problem. In the United States, if the Government ratifies the convention, it becomes automatically federal law and, therefore, is binding on the judges. Under the British system, as I understand it, when the British Government ratifies a convention, it is a binding obligation of Her Majesty's Government, but it is not a law that British judges need to follow unless the Parliament enacts it into law. It is certainly a problem, but I think the solution has to be under domestic law of the nations that ratify it and that nations need to take care when ratifying the convention to do whatever is necessary under their own domestic system to, in fact, implement it. Thus, when the British Government ratifies a convention, it typically will pass an act of parliament to give effect to it, and that is the appropriate course for other nations.

The Secretariat will no doubt tell us what it does in these matters. I have noticed that many of the UNCITRAL instruments have advice on how they should be implemented, and ratification procedures should certainly be part of the advice. I am guessing that it probably is, but obviously each domestic regime in ratifying a convention needs to ratify it properly.

*Lauri Railas*

*Krogerus Attorneys Ltd., Finland*

Electronic transport documents are used in commercial platforms such as Bolero and Trade Electronic Data Interchange (TEDI) in Japan and probably in the envisaged system of the SWIFTNet Trade Services Utility. The parties will have to join these systems, so that an individual company, for instance a bank or an insurance company, has to be a member of each of these commercial platforms in order to take full advantage of electronic documents comparable to the paper-based world. That is a problem that is encountered as compared to the paper-based world, where paper documents are valid commercially in various banks (documents in credits, for instance).

Another matter is that mentioned by Professor Ziegler: the interfaces with contracts of sale. The draft convention has been worked on by Working Group III, but I recall that

Working Group IV has also shown interest in the transfer of rights; and maybe we will be discussing that in the next session. But have you had any discussion on this aspect in Working Group IV?

*Alexander von Ziegler*  
*Schellenberg Wittmer, Switzerland*

Thank you for this question. I think that you are right. Much will also be discussed in the next panel, but it is obvious that the first trigger of this project was made in the other Working Group, where it was realized that the transfer of rights was much more complicated in the context of electronic commerce, because of the mechanism I have explained. So there was cooperation on a secretarial level, but also on an expert group level, to make sure that it would be consistent and workable. Now, we are somehow in another position than the group which is actually looking at electronic commerce as itself, because we are looking at one of the possibilities of doing contract of carriage with electronic means and to offer this electronic record, data, whatever, to the world as an equivalent. What we were very careful about was to ensure that every single aspect which we do in traditional paper situations is feasible in what we think the electronic environment will ask from us in the future. Were we putting in an obstacle to that development with a certain provision or not? And when we found an obstacle, we made sure that this obstacle was overcome by an open formulation which allowed a future development to take care of. That is possibly all we did, not much more. I do not think that you can take our document and say, well, this is exactly now the way, the road map for an international electronic commerce system. What it is, however, is—now—a much clearer and (at the time—the only—I think) internationally harmonized set-up which shows how the rights are dealt with and what issues and how they are dealt with in terms of contract of carriage in the umbrella of international trade. And it is sort of the first road map you can take to actually then start to do a project on an international level on the electronic side, a sort of a building which you can now take photos of and say, okay, those aspects need to be translated into a digital version. And some parts we might not need anymore because trade has changed; and electronic trade will definitely, at one stage, not just be a copy of paper: it will be more creative than that, I hope. And so, it is just the beginning. But really, the test we have before us is: have we done anything wrong to facilitate development in the right direction, the electronic direction? We hope that the answer there is no. We have done everything right at this stage. But, of course, we are human and we might have missed this or that, here and there.

But to come back to your initial question, yes, we had very close cooperation on that. We had an initial starting group, a little group which was looking only at that. We had a joint expert group, and the Secretariat, of course, is very helpful in making sure that this happens.

*Didier Opertti Badán*  
*Secretary-General, Latin American Integration Association*

You said at one point that the whole question of charters is outside of the scope that is currently being analysed or negotiated, and here I would like to put a specific question in two parts, if I may.

The first part: would it not be worth addressing the whole question of charters at the international level, in particular passenger transport, where there is a very keen sensibility and sensitivity as regards liability?

Now, my second question. I recognize that charters are mainly linked up with aeronautics law, which you are not dealing with at the moment. The lack of regulations, both in the specific field of aeronautics law and in multimodal transport, would enable us to think that, in order to compensate this gap or this vacuum, if you will, would it be possible to resort to principles or rules which have gradually been built in the field of international transport law?

It seems to me that a contribution to this arena would help national jurisdictions and arbitration tribunals which find themselves very perplexed in having to deal with these situations.

*Jan Ramberg*  
*University of Stockholm, Sweden*

I would limit my answer to carriage of goods because with respect to passengers you enter into consumer protection laws and there, indeed, directives within the European Union apply, to mention one. As for chartering with respect to carriage of goods, I am sufficiently old to remember that this was debated in connection with the elaboration of the Hamburg Rules and that it was suggested by some delegations that one should include charter parties, but they were rather few and there was an overwhelming majority saying, "Let us keep that out". Now, you may ask, "Why?", and I think the answer is that charter parties are very ill-suited to squeeze into mandatory law. They are negotiated between parties, usually of the same financial strength, and they exist in various variants depending upon the commodities. There are forms which are used—and brokers refer to them—and it would simply not be possible to squeeze that into a regime which is mandatory in principle.

That explains how the situation was in the 1970s, and I think that it has not changed since then.

*Michael F. Sturley*  
*University of Texas at Austin, United States of America*

I just want to add a brief comment. I have studied the Hague Rules enough to know that exactly the same kind of conversation occurred in the 1920s when the feeling was the same. I think that the one thing that has changed now is that the borderline between charter parties and traditional bill of lading shipments has become much hazier than it used to be. It used to be that it was fairly clear whether you had a shipment under a charter party or a liner shipment under a bill of lading. And now there is a much greyer area in the middle. The new convention is trying to address that. There is a defined term "volume contract" that covers these grey areas in the middle. Unlike charter parties, volume contracts will be covered by the convention, but unlike traditional bills of lading, there will be greater freedom of contract for the parties. Thus there is an intermediate approach that picks up things that are in some ways like charter parties, but not exactly like them.

## D. Electronic commerce: going beyond functional equivalence

*Chair: Jeffrey Chan Wah-Teck*

*Principal Senior State Counsel, Head, Civil Division, Attorney-General's Chambers, Singapore*

*José Angelo Estrella Faria*

*United Nations Commission on International Trade Law*

I have an important announcement to make. We have a replacement on this panel. Mr. Mal Nuhu Ribadu, the Executive Chairman of the Economic and Financial Crimes Commission of Nigeria, was prevented from being with us by the need to attend to some important matters at home. He and the Government of Nigeria were kind enough to ensure the participation of another high-ranking, highly qualified official to participate in this panel. The speaker is Mr. M.K.G. Ibrahim, a graduate of the University of New Haven and the Head of Information and Communications Technology at the Economic and Financial Crimes Commission of Nigeria.

*Jeffrey Chan Wah-Teck, Chair*

Today, for this session, the topic for discussion on our table is “Electronic commerce: going beyond functional equivalence”. To help us in our discussion, we are very privileged to have with us on the panel three distinguished speakers.

Before they speak, I shall give you further details of their respective credentials, and let me assure you we have very eminent speakers with us today.

Before we begin, it might be useful to recapitulate the role of UNCITRAL in the area of electronic commerce. Not that much is known internationally, although I expect that most of us here do know about the work done by UNCITRAL in this area. But many of us may not know that UNCITRAL, as an institution, was actually a pioneer—the pioneer—in the area of regulation of electronic communications and trade.

In 1986, as early as 1986, even before the term “electronic commerce” was coined, UNCITRAL worked on and produced a legal guide on electronic transfers. There was a time when I was involved in the area of electronic communications and trade, with particular emphasis on electronic records, and when the only publications at that time were those of UNCITRAL. Here, we must recognize the work of Dr. Eric Bergsten, a former Secretary of UNCITRAL. He started this work even before he became Secretary of UNCITRAL. I think we should acknowledge Dr. Bergsten’s Trojan contributions in this area.

So as early as 1986, UNCITRAL was already in this area. And then, of course, we know that in 1996, 10 years later, UNCITRAL produced a seminal work—the Model Law on Electronic Commerce—followed by the Model Law on Electronic Signatures in 2001. In 2005, there was another seminal achievement in UNCITRAL: in record time, it formulated and produced the Convention on the Use of Electronic Communications in International Contracts, properly known as the Electronic Communications Convention and that, may I remind everybody here, is now open for signature. Ten countries have already signed the Convention and, of course, we are looking for more countries to come on board.

These are very substantial contributions in the area of regulation of electronic commerce and I dare say that UNCITRAL is foremost among all the international agencies working on the legal aspects in this field. So it is only appropriate that at this time we conclude today with an in-depth discussion on electronic commerce and look beyond what we have been trying to achieve so far, which is to try to achieve functional equivalents between electronic communications and paper communications.

For the first speaker today, we have Mr. M.K.G. Ibrahim from the Economic and Financial Crimes Commission of Nigeria. Mr. Ibrahim comes from a distinguished background. He is from the University of New Haven in Connecticut and he pioneered the signing of the first of numerous memorandums of understanding between the Government, his Commission, and Microsoft and other service providers to control cybercrime. He also represented the Commission in collaborating with international agencies in addressing the issue of cybercrime and commercial fraud.

It just so happened this morning that, when I turned on my computer upon arriving at these chambers, this e-mail message from Nigeria came in [*image displayed on screen*]. It was from a certain barrister, a legal practitioner, in Nigeria. Of course, he started off with all the compliments and said that he was writing to me in good faith based on the contact address given to him by a friend who works in the Nigerian Embassy in my country. Very interesting—because there is no Nigerian Embassy in my country. And then he goes on, of course, to make a fairly by now well-known proposition that he would like my bank account number to transfer an amount of 75 million United States dollars, and that this would help in this case the son of the late General Sani Abacha, who was the former military Head of State in Nigeria. They are residing somewhere in Switzerland and their funds have been frozen by the Swiss Government. For this, he promised that he will be willing to give me a reasonable percentage of this money. I draw your attention to the conclusion where he says that, “Please, this transaction requires absolute confidentiality and you would be expected to treat it as such until the funds are moved out of this country”. So, of course, I am sharing this with all of you today.

Now this, for all of us who have many similar experiences, this is known as a “419 fraud”, 419 being the section of the Nigerian Criminal Penal Code that criminalizes such offences. I am sure that you all are looking forward eagerly to what Mr. Ibrahim can tell us about how his agency is addressing matters such as this.

### *1. Cybercrime and commercial fraud: a Nigerian perspective*

*Mal Nuhu Ribadu*

*Executive Chairman, Economic and Financial Crimes Commission, Nigeria*

*Presented by M.K.G. Ibrahim*

*Head, Information and Communication Technology, Economic and Financial Crimes Commission, Nigeria*

I feel greatly privileged and appreciative for the kind invitation to be in your midst for this very important event. As you all probably are already aware, I head the Nigerian law enforcement organization—the Economic and Financial Crimes Commission—that

specializes in the investigation and prosecution of financial and economic crimes and which was created in the year 2004, in part, as a major response to offences that international law has today characterized as cybercrime.

Although we operate, regarding all cybercrime offences, on the basis of a parliamentary act called the Advance Fee Fraud and Other Offences Act of 2006, cybercrime laws, in the best of circumstances, function best within the framework of a clearly dedicated law and not as an appendage that allows remedies to fall short of liabilities. I will speak a little more on this later in my presentation.

In its import and practice, the law deals with offences that fall within the ambit of section 419 of our Criminal Law Act, which deals with the offences of obtaining by false pretence through different fraudulent schemes, such as contract scam, credit card scam, inheritance scam, job scam, lottery scam, currency scam, marriage scam, immigration scam, counterfeiting, religious scam, as well as cases of cybercrime. For years now, businesses, learning institutions and government departments have been receiving e-mails from senders posing as Nigerian/West African Government or business officials offering to share large sums of money. So pervasive is this scam that we have a dedicated section led by some of our best operatives to investigate and prosecute these crimes. However, as you can see from what I have described so far, it does not embrace the robust framework of what the Council of Europe has distilled so clearly in its 2001 Budapest Convention on Cybercrime. Let me say in passing, however, that we are currently in consultation with sister nations in our subregion with a view to coming up with a clear regional statute regarding cybercrime and we welcome partnership and collaboration with UNCITRAL in this effort.

Having said that much, I must say here that cybercrime in the manifestation that other parts of the world understand it also manifests itself in Nigeria, perhaps more than in any other African nation today. Our Advance Fee Fraud team members therefore deal with myriad offences under the omnibus cybercrime definition, which straddles matters of data interference, system interference, illegal interception, illegal access and the misuse of devices in the very typology derived from the characterization of the Council of Europe.

The truth is that cybercrime is depressing trade and investor confidence in our economy and, to that extent, it is a present and clear danger to our national security and the prosperity of our citizens. Indeed, of all the grand corruption perpetrated daily in our communities, most are of the nature of cybercrime executed through the agencies of computer and Internet fraud, mail scam, credit card fraud, bankruptcy fraud, insurance fraud, government fraud, tax evasion, financial fraud, securities fraud, insider trading, bribery, kickbacks, counterfeiting, laundering, embezzlement, as well as economic and copyright/trade secret theft. From our experience also, while in the main such acts have been driven by the existence of an environment where power is monopolized over the long term by only a few social and political elites, it must be understood that greed is the defining character of the crime.

The truth is that we came into full awareness of this pattern of crime in 2002 and went straight to work, but by 2004 it has dramatically mutated into a huge subregional crisis in West Africa. A lot needs to be said about the social context of the origin and development

of this crime: in many of the countries in our region, decades of military autocracy cemented a practice where the networks of criminality hid behind consensual agreements of illegality concealed from the public and shielded by bayonets.

Two months ago in Abuja, at a subregional police seminar organized by INTERPOL to discuss the challenges of transborder crimes, I had the opportunity to share thoughts with many of our colleagues from the West African subregion regarding the mutation of aspects of cyberscam. I asked them to understand keenly how a crime replicated itself between 2002 and 2004. In two years a multimillion dollar crime has migrated from the Nigerian geographical space to embrace a wider canvas of the whole subregion.

The factors which explain this transformation also draw attention to what we must do to overcome the challenge. Two main factors aided this pattern: the free travel protocol which was granted by the Economic Community of West African States (ECOWAS) treaty; as well as the increasingly developed information technology infrastructure in the subregion. These two factors yoked with the poor attitude initially shown towards this fraud because it presumably preyed on foreign victims. These factors originally provided little incentive to do anything about the scammers, whose boiler rooms were growing by the day in other ECOWAS nations that had now become particularly attractive to the scammers, such as Benin, Burkina Faso, Côte d'Ivoire, Ghana, Senegal and Togo, among others.

While this criminal practice took root, erstwhile law-abiding citizens of host countries, enticed by juicy criminal offers, got recruited into this garish scheme; meanwhile, as our own research pointed out, the Nigerian scammers in exile were moving into a second generation of the criminal practice by acquiring choice properties within the subregion and laundering their tainted money in the world of real estate. The liberating opportunities of the cyberworld had ironically fostered a crime pattern that became the main mechanism and predicate reference for a huge money-laundering scheme in our region.

Significantly, the half-a-decade-old "Nigerian cybermail" had, by 2004, acquired a subregional character as a "West African mail", even as Australian, British, Canadian, South African and Spanish "lottery letters" exploded on the Internet.

Today the patterns are also growing in different dimensions: we now deal more with issues of cloning of websites; false representations; Internet purchases and other e-commerce kinds of fraud. The criminals notably use fake credit cards unlawfully acquired from websites that provide compromised credit cards as well as from Nigerians legally residing in Western countries and who work in the postal systems of such countries. Other typologies we have noticed are through the manufacture of fake cheques, gift cards and other instruments of legal transactions.

Locally, the harm is also growing and the domestic economy is groaning. The Nigerian banking industry that hurriedly embraced the credit card system did not carry the law enforcement and criminal justice sector along in the capacity to understand the intricacies and multiple dimensions of the problem. The result is that today we have a huge and rising incidence of cybercrime, which, sadly, is underreported and for which the law enforcement agents, prosecutors and judges are unable to match the crime with appropriate punishment. I speak here of a gap in knowledge which I shall speak more about in a while.

In fully characterizing the practice of cybercrime in Nigeria, some issues are fairly settled:

(a) The perpetrators are youths: thousands of unemployed but highly knowledgeable young people who are computer-savvy are involved and they actually drive the process;

(b) They are well connected through local, insider conspiracy in the financial institutions locally as well as with Nigerian immigrant community elements abroad;

(c) Knowing full well that the Nigerian enforcement process has become so vigorous, they have migrated mostly to West African and other African nations with weak enforcement mechanisms;

(d) They also use a mechanism of reshippers, mostly in Dubai, the United Kingdom and West African way stations;

(e) They enjoy the fact that there are no cybercrime laws in any of these African jurisdictions that they have chosen as their relay stations.

The implications for the national economy as well as for international trade are enormous: between 2003 and 2007 we successfully disrupted and blocked transactions worth £300 million, €200 million and US\$ 500 million respectively. In the same timespan, we successfully prosecuted 97 specific cybercrime offences. As you can imagine, the large and broader import is more disturbing. It is leading to the erosion of confidence in genuine Nigerian commercial credibility and today many Western countries—with France taking the lead—have moved to deny legitimate Nigerian businessmen and women the rewards of e-commerce. France today requires Web camera verification for most online business transactions from Nigeria.

For our part, we continue to soldier on, but we believe the answer lies more in vigorous enforcement strategies. We have excellent working relationships with international enforcement programmes that have helped advance these programmes. Today we work with the United States Secret Service and Federal Bureau of Investigation, the Serious Organised Crime Agency of the United Kingdom, the Amsterdam Police as well as the Australian police.

However, there is a need for regular engagement with industry to develop strategies that can prevent and curtail these practices. It is sad to say that some private sector entities have proved unhelpful. We in particular have failed to enjoy the cooperation of Western Union, while on the other hand we have enjoyed the full cooperation of MoneyGram. There is also a need to enjoy the confidence and cooperation of the level-three providers of Internet facilities, like the Yahoo, Google and Hotmail message carriers. When help came, the result was wonderful. We successfully shut down 70 websites that provided cloned service for criminality with the assistance of the Internet Crime Complaint Center in the United States.

I see training—and vigorous training—as the cornerstone of any worthwhile success in the law enforcement programme that will support our effort at attacking cybercrime in Africa. Our region's capacity to own its own century will depend in large measure on its capacity to promote and maintain a regime of economic security and enhance trade and commercial progress without reference to crime. In this march, effective policing that is in tune with modern democratic culture will be the key. The challenge and focus of training will therefore need to embrace a wingspan that stretches from cyberstudies, law, criminal justice systems,

heavy crime prevention education, international relations, international business practices and forensic science to the intricate numeric depth of the capital markets jigsaw.

In all these efforts, we look forward to collaboration and principled assistance from the international community.

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*Jeffrey Chan Wah-Teck, Chair*

Thank you very much, Mr. Ibrahim. The importance of combating cybercrime and commercial fraud in the context of global commerce, especially in electronic commerce, cannot be understressed. Over time, this affects the integrity of the global trading system. As differing legal rules are an obstacle to global commerce, global crime is an even greater obstacle to global commerce.

We have Mr. Bart Schermer as our next speaker. I hope I got the pronunciation of your name right. He is the Head of the United Nations Centre for Trade Facilitation and Electronic Business (UN/CEFACT) Legal Group. Mr. Schermer is a legal consultant. He has two degrees from the University of Leiden in the Netherlands, in criminal law and in information technology. This was what was earlier stated in the curriculum vitae that he submitted. But, of course, since this is a session on electronic commerce, we made use of electronic resources to find out a bit more about him. We found out, among other things, that he has published numerous books on radio frequency identification (RFID). All of us are wearing these tags and they may well all be RFID tags. I am sure we will be very interested in what Mr. Schermer has to tell us. Mr. Schermer will be talking about developing a single window for foreign trade, which is squarely within what we are here to discuss, i.e. electronic commerce and moving beyond functional equivalents.

## *2. Developing single windows for foreign trade*

*Bart W. Schermer*

*Chair a.i., United Nations Centre for Trade Facilitation and Electronic Business Legal Group*

### *(a) Introduction*

Information and communication technologies (ICTs) have made such an impact on the way we structure our society, that our society can be characterized most accurately as an “information society”. In the context of international business, ICTs have been used primarily to facilitate existing business processes, such as communication and contract formation. While the use of ICTs in this manner has been a great boon to global commerce, they have also raised new legal issues.

Over the years UNCITRAL has addressed many of these legal issues through (model) laws and conventions such as the Model Law on Electronic Commerce (1996), the Model Law on Electronic Signatures (2001) and the Convention on the Use of Electronic Communications in International Contracts (2005).<sup>275</sup> However, technological, cultural,

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<sup>275</sup> See [www.uncitral.org/uncitral/en/uncitral\\_texts/electronic\\_commerce.html](http://www.uncitral.org/uncitral/en/uncitral_texts/electronic_commerce.html).

economic and political factors continue to enable the development of new business models and business processes. In particular, business models and processes inspired by the idea of networked organizations, where information quickly flows between the different nodes of the network, raise new legal issues. One of the new business processes is the single window for international trade. In its simplest conception, the single window for international trade is a facility where parties involved in trade and transport can lodge all the necessary information and documents simultaneously.

The goal of this article is to describe the single-window concept and explore possible legal issues that flow forth from this concept. Furthermore, we shall examine the role (if any) of the United Nations in addressing legal issues of single-window facilities. The article is structured as follows: section (b) describes how single windows operate, section (c) identifies the most prominent legal issues and section (d) examines whether the United Nations in general, and UNCITRAL in particular, have a role to play in addressing these legal issues. The article shall be concluded in section (e).

*(b) Description of a single window for international trade*

Companies engaged in international trade, whether through smaller operations or as part of global supply chain networks, have to submit large volumes of information and documents to governmental authorities on a regular basis in order to comply with regulatory requirements. This information and documentation often has to be submitted through several different agencies, each with its own specific (manual or automated) systems and paper forms. These extensive (and often repetitive) requirements, together with their associated compliance costs and enhanced risk of error, can constitute a serious burden to both businesses and governments. The goal of a single window for international trade is to provide a single point of entry for all of these different data, thereby reducing costs and simplifying the administrative processes.

By streamlining the administrative processes involved in the international trade of goods, a single window offers the potential to provide enhanced efficiencies and cost savings that can significantly stimulate global commerce. Examples of services provided by existing single windows are: the submission, processing and return of customs declarations (Mauritius); application for import and export licences (Sweden); and the electronic submission of cargo manifests (Netherlands).<sup>276</sup>

The United Nations Centre for Trade Facilitation and Electronic Business (UN/CEFACT), whose mission is to improve the ability of business, trade and administrative organizations to exchange products and relevant services effectively, has embraced the concept of a single window for international trade.<sup>277</sup> To stimulate the creation of single

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<sup>276</sup>For a complete overview of single-window facilities and the services they offer, visit the UN/CEFACT single window repository at [www.unece.org/cefact/single\\_window/welcome.htm](http://www.unece.org/cefact/single_window/welcome.htm).

<sup>277</sup>The United Nations Centre for Trade Facilitation and Electronic Business (UN/CEFACT) supports activities dedicated to improving the ability of business, trade and administrative organizations, from developed, developing and transitional economies, to exchange products and relevant services effectively. Its principal focus is on facilitating national and international transactions, through the simplification and harmonization of processes, procedures and information flows, and so contribute to the growth of global commerce. It encourages close collaboration between governments and private business to secure the interoperability for the exchange of information between the public and private sector. For more information about UN/CEFACT, visit [www.unece.org/cefact/](http://www.unece.org/cefact/).

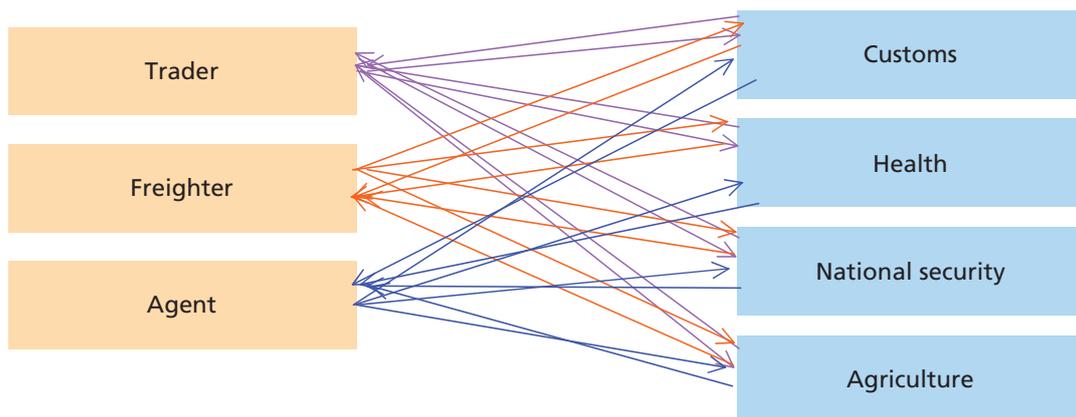
windows throughout the world, UN/CEFACT has issued recommendation No. 33, entitled “Recommendation and Guidelines on establishing a Single Window”, to enhance the efficient exchange of information between trade and government.<sup>278</sup> The recommendation describes a single window as “a facility that allows parties involved in trade and transport to lodge standardized information and documents with a single entry point to fulfil all import, export and transit-related regulatory requirements”.

While a single window does not necessarily imply the implementation and use of ICTs, the concept of a single window does, to some extent, flow forth from the idea of networked organizations where information can easily flow from organization to organization. Indeed, the feasibility of a single window can be greatly enhanced if governments identify and adopt relevant ICTs for use in their single-window implementations.

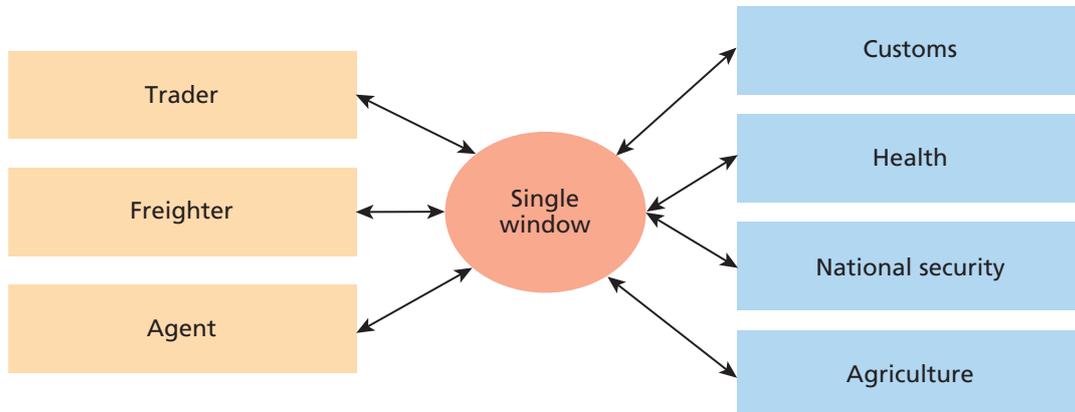
#### *Different types of single windows*

Single-window facilities can be implemented in a number of ways. The most “basic” type of single window is a national single window where a single authority receives information from traders and other parties involved in international trade, either on paper or electronically, and disseminates this information to all relevant governmental authorities. A more advanced type of single-window facility is a single automated system for the collection and dissemination of information. Such a system integrates the electronic collection, use, dissemination and storage of data related to international trade.

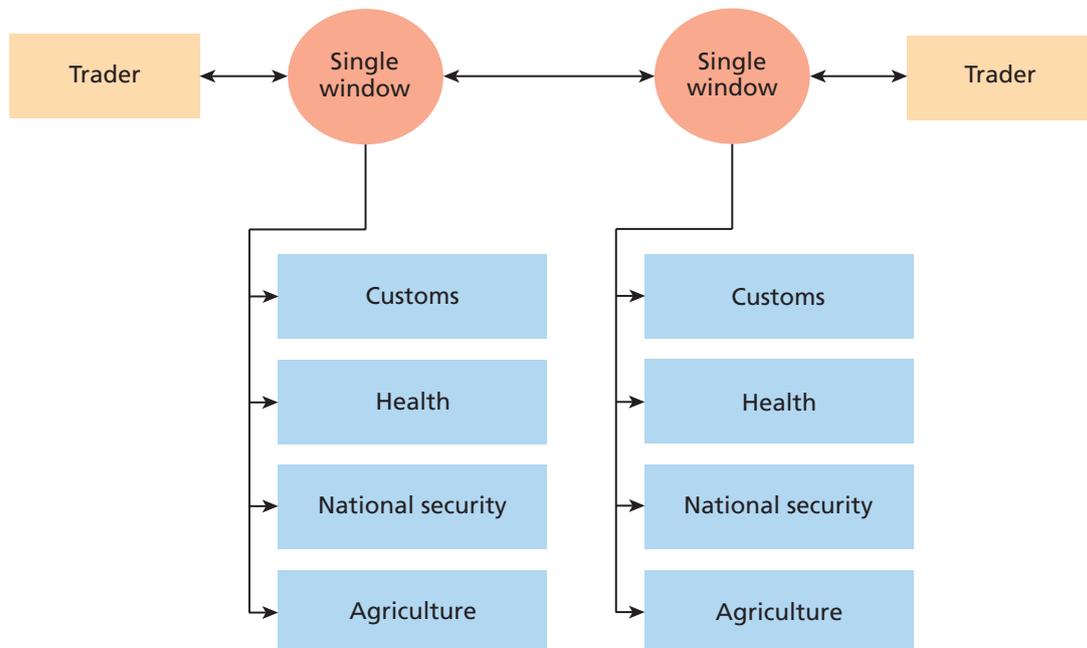
**Figure I. Graphical representation of administrative processes without a single window**



<sup>278</sup> See [www.unece.org/cefact/recommendations/rec\\_index.htm](http://www.unece.org/cefact/recommendations/rec_index.htm).

**Figure II. Graphical representation of a national single-window facility**

While single-window facilities can be operated on the national level (i.e. for use with the governmental bodies of a single country), single-window facilities can also cooperate on an international level. In such case, information submitted to a national single window can be forwarded to other national single-window facilities, thereby further reducing administrative costs. An example of an international single window is the ASEAN single window for international trade.<sup>279</sup>

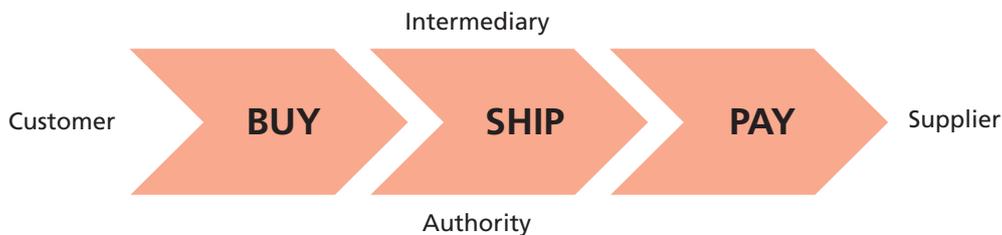
**Figure III. Graphical representation of an international single-window facility**

<sup>279</sup> See the Agreement to Establish and Implement the ASEAN Single Window, available from [www.aseansec.org/18005.htm](http://www.aseansec.org/18005.htm).

*Beyond the single window: “paperless trade”*

While this paper is focused on the concept of the international single window for trade, it is useful to recognize the broader context in which single windows operate, particularly when considering the use of ICTs. This broader context is described in the ongoing work at UN/CEFACT as the UN/CEFACT International Supply Chain Reference Model. As you can observe from the diagram below, this model contemplates the wider range of parties to international business transactions, including not only the typical business-to-government (B2G) and government-to-government (G2G) connections of the international single window, but also the wide range of business-to-business (B2B) relationships and transactions that can be part of the global supply chain in international trade.

**Figure IV . UN/CEFACT International Supply Chain Reference Model**



As can easily be noted, there are a broad range of legal issues that can be anticipated within this broader model. In the traditional “paper” world, most of these issues are clear and there are existing technical and legal solutions for various elements of these transactions. Where, however, countries move towards models of “paperless trade” and the use of ICTs, particularly in the international context, new issues emerge that need resolution. At least one such issue related to the electronic transferability of documents of title is briefly noted in section (d) below.

(c) *Legal issues*

While single-window facilities may provide substantial benefits both to governments and businesses, there are various legal issues that need to be addressed in order to ensure that single windows operate correctly and safely. Essential to all single-window operations is the transparency and security of data exchange. A sound legal regime, which regulates the data collection, access and distribution, and clarifies the privacy and liability regimes, makes it possible to create a solid basis for the operation of the facility and to build a relationship of trust between all stakeholders.

The Legal Group and the International Trade Procedures Working Group of UN/CEFACT have identified numerous legal issues that may arise in the context of single-window development and operation. These legal issues will be examined in the forthcoming

UN/CEFACT Recommendation 35 on establishing a legal framework for an international trade single window.

While an exhaustive discussion of the potential legal issues related to single windows is not possible in this paper, a sampling of relevant legal issues would include at least the following:

#### *Establishment of a single window*

Single-window facilities can be established in a number of different ways, not only from a technological viewpoint but also from an organizational viewpoint. The way in which a single window is structured plays an important role with respect to possible legal issues that may arise. Single windows can be established by governmental organizations (such as the customs authorities), private businesses or public-private partnerships. For each of these different organizational forms, the authority and mandate of the single window needs to be established clearly in national law. Furthermore, when multiple organizations take part in the establishment and operation of the single window, it is important to have a formal agreement between the parties involved in the creation and operation of the single window that defines the different roles and responsibilities. Finally, it is necessary to establish “end-user agreements” with the users of the single-window facility (i.e. with freight forwarders, agents, traders, banks etc.). When national single-window facilities cooperate on an international level, bilateral or multilateral agreements often need to be established to govern the operations of each single window and that take into account a variety of legal issues that may arise to ensure “legal interoperability” between these single windows.

#### *Identification, authentication and authorization*

Given the fact that processing data is the primary role of a single-window facility, issues of identification, authentication and authorization will be of great importance. The process of identification, authentication and authorization applies to different actors in the single-window arena. They include, among others: the single-window facilities themselves, the users of the single-window facilities, the organizations that are part of the single-window environment and their respective employees.<sup>280</sup>

When single-window facilities from different jurisdictions wish to exchange data, it is necessary to have common, mutually recognized mechanisms for identification, authentication and authorization for transactions being processed through each single window involved.<sup>281</sup>

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<sup>280</sup> See generally “Possible future work on electronic commerce: comprehensive reference document on elements required to establish a favourable legal framework for electronic commerce—sample chapter on international use of electronic authentication and signature methods” (A/CN.9/630), available from [www.uncitral.org/uncitral/en/commission/sessions/40th.html](http://www.uncitral.org/uncitral/en/commission/sessions/40th.html). The note was prepared by the UNCITRAL secretariat for the Commission’s fortieth session, in 2007.

<sup>281</sup> Naturally, there may be international single-window environments that contemplate, for example, a regional single-window operator through which data are exchanged between national single-window facilities.

### *Data protection*

Within a single-window facility the issue of data protection is also of particular importance. Data protection is concerned with issues such as the access to data, the integrity of data and the accuracy of data. Without proper mechanisms for the protection of data, single-window facilities present major risks. To this end, adequate security and access protocols need to be established through the identification, authentication and authorization mechanisms mentioned above.

The issue of data protection is closely related to that of privacy (i.e., personal data protection). When personal data are processed, it must be determined whether this is done in compliance with all relevant privacy and personal data protection laws. In the context of international single windows that share data between different countries, this provision is even more relevant. However, the right to privacy is interpreted differently in various parts of the world and, as such, data protection law differs throughout the world. The highest level of international consensus is reflected in the OECD Guidelines on the Protection of Privacy and Transborder Flows of Personal Data.<sup>282</sup> However, these Guidelines are not binding. When single windows cooperate on an international level, it is of importance to examine and consider how differing national (or regional) data protection regimes might be harmonized or at least accommodated in bilateral or multilateral agreements between countries participating in international single-window operations.

### *Liability issues*

The use of inaccurate, incomplete or incorrect data by users of the single-window facility could lead to damages.<sup>283</sup> Due to the nature of single-window facilities, it is possible that the reuse of inaccurate, incomplete or incorrect data could lead to multiple instances where damages are incurred. As such, it is necessary to consider and address liability issues in the contexts of national and international legal recourse and indemnities for damages suffered.

Moreover, it is necessary to provide audit trails through logging mechanisms. If proper logging mechanisms are not implemented, it will be difficult, if not impossible, to establish responsibility for incomplete, inaccurate or (incorrectly) altered data. In this area, electronic signatures or other security mechanisms may play an important role.<sup>284</sup>

### *Competition*

The structure of single-window operations may also raise antitrust and protectionism concerns which may inhibit the use of single window by those who might otherwise benefit from it. Additionally, countries should consider their obligations under the General Agreement on Tariffs and Trade when establishing and operating single-window facilities.<sup>285</sup>

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<sup>282</sup> Organisation for Economic Co-operation and Development, Recommendation of the Council concerning guidelines governing the protection of privacy and transborder flows of personal data, 23 September 1980.

<sup>283</sup> Additionally, damages may result from a variety of other causes, such as data protection and privacy breaches.

<sup>284</sup> See footnote 280 above.

<sup>285</sup> See [www.wto.org/](http://www.wto.org/).

*Electronic documents*

The functional equivalence of electronic documents to paper documents and the acceptance of their evidentiary value in court are of great importance for the future development of single-window facilities. As such, the UNCITRAL Model Law on Electronic Commerce (1996) and the United Nations Convention on the Use of Electronic Communications in International Contracts (2005) are highly relevant to the operation of single-window facilities. While UN/CEFACT Recommendation 33 and its forthcoming Recommendation 35 can be applied to the non-automated single-window environments, those countries that seek to move towards e-trade or “paperless trade” are encouraged to consider adoption of these UNCITRAL texts for creating both their domestic and internationally oriented legal infrastructure for their ICT environment.

*(d) The role of the Commission: moving to the e-future*

Given the brief overview of key legal issues noted in this paper, we may now discuss whether and how work may be undertaken by UNCITRAL in its role as the core United Nations body for international trade law, in particular, to facilitate the establishment and operation of single-window facilities. We can distinguish between two different broad types of action when it comes to addressing the legal issues: (a) further harmonization of the legal framework in the context of single windows, and (b) raising awareness, providing education and guiding implementation of legal considerations within single windows.

*Further harmonization of the legal framework*

The mission of UNCITRAL is the facilitation of international trade through the harmonization and unification of international trade law. In light of the legal issues that may arise in the context of single-window operation, it appears that the liability, authentication and the legal status of electronic documents are among the issues that have been closest to the work programme of UNCITRAL in the area of electronic commerce.

Many of the legal issues important to the international single window are addressed in the existing UNCITRAL model laws and conventions related to electronic commerce. Therefore, to a large extent, the existing model laws and conventions provide an important legal framework for the operation of single-window facilities.<sup>286</sup> When we look only at the B2G and perhaps G2G aspects of the international single-window environment, the need for a new international framework for the operation of single windows may be limited. Moreover, it is important to note that many of the legal issues involved in the establishment and operation of both national and international single windows can be addressed in contracts, memorandums of understanding, for example between government agencies, and/or bilateral and multilateral agreements between individual States and regions that seek to implement regional single-window facilities for trade between them.

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<sup>286</sup>It might be noted, however, that the limited number of States that have actually enacted the UNCITRAL Model Law on Electronic Signatures suggests that de facto harmonization in the area of identification, authentication and authorization does not yet exist.

However, there are several areas (and undoubtedly others) in which international harmonization may be lacking. One revolves around issues related to personal data protection. While there may not be many situations involving single-window operations with “personal” data, we recognize that such issues have been addressed at the national and even regional level.<sup>287</sup> It is not certain, however, that some cross-border transactions may involve such data given the variety of national and regional privacy models emerging in recent years. Generally, the work of UNCITRAL has focused on international commercial and trade law and not on the area of international harmonization and unification of personal data protection law. It should be noted, however, that UNCITRAL considered work in this area at its thirty-ninth session, in 2006. In a paper on possible future work in the area of electronic commerce, the UNCITRAL secretariat suggested that this issue might be considered by the Commission as an area in which work might be undertaken.<sup>288</sup> However, given the scope of personal data protection law (which is broader than international trade law) and the activities of other international bodies such as the Internet Governance Forum, the International Chamber of Commerce and OECD, among others, in this area, as well as legislation at the domestic and regional levels, it seems that at this point in time UNCITRAL may not play a leading role in the international harmonization of personal data protection law.

An area in which harmonization is necessary is the electronic transferability of documents of title, a topic that is closely related to the functional equivalence of electronic documents. As noted earlier, the simplest view of the single window is one in which we deal with B2G and G2G transactions. However, looking towards the future, a broader trade facilitation viewpoint would suggest that this aspect is but one element of global supply chain networks. Further, and in the single-window contexts, some countries<sup>289</sup> and regional country groups have developed a more strategic vision for their single-window programmes that includes, for example, other parties to international business transactions in goods, such as financial institutions, transport operators, intermediaries of various types and so on. In effect, they have moved beyond the B2G and G2G aspects of the single-window model and looked at the longer-term B2B and “paperless trade” aspects of trade development and facilitation. In this context, it seems clear that there is no internationally harmonized solution. Given the expertise and knowledge resources of UNCITRAL in this field, it may be very beneficial for it to consider developing and expanding its work in this area in the future.

#### *Awareness, education and implementation*

While the legal framework for international trade and electronic commerce established by UNCITRAL is adequate at an abstract level, the actual implementation and interpretation of the legal framework in the context of single-window facilities is an area where much work needs to be done. Therefore, existing legislation should be clarified in the context of single-window operation.

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<sup>287</sup> See, for example, the European Data Privacy Directive.

<sup>288</sup> See “Possible future work in the area of electronic commerce” (A/CN.9/604), paras. 47-52, at [www.uncitral.org/uncitral/en/commission/sessions/39th.html](http://www.uncitral.org/uncitral/en/commission/sessions/39th.html).

<sup>289</sup> See, for example, the South Korean Act on Facilitation of Electronic Trade, Act No. 7751, 23 December 2005.

First of all, if the legal issues involved in the operation of single-window facilities are to be addressed effectively, single-window operators must be made aware of the existence of any legal issues, existing legislation and possible remedies to these issues. This is as much a “legal” exercise as it is an organizational and a technical exercise.

Once single-window operators are aware of the legal issues that may flow forth from the operation of a single-window facility, they must be offered adequate tools to address these legal issues. To ensure that the legal provisions are implemented correctly, tools such as checklists, implementation guides and model agreements should be offered to single-window operators.

Furthermore, where possible, the provisions of the model laws should be implemented in the technology that operates the single-window facility. At a practical level, this means that the legal framework for the single window and paperless trade are actually implemented in the business processes and the associated technology.

Given their respective mandates and areas of expertise, UNCITRAL and UN/CEFACT are uniquely positioned to cooperate in this area and ensure that this implementation actually takes place. Looking towards the future, UNCITRAL and UN/CEFACT should therefore further examine how the work of UNCITRAL can be “translated” by UN/CEFACT to both the business processes and the associated technology.

*(e) Conclusions*

We may conclude that the use of single-window facilities benefits international trade. However, certain legal issues may hamper the development and implementation of single-window facilities. It seems clear that UNCITRAL can and should continue to play an active and vital role in addressing electronic commerce legal issues in order to facilitate global commerce and the economic growth of developing countries. At an abstract level, this means that the legal framework set forth by UNCITRAL must be kept up to date and advanced in those areas in which work has been identified here (only briefly). At a more concrete level, this means continued cooperation with UN/CEFACT in order to implement the legal framework in the business processes and the associated technology, the key role that UN/CEFACT plays in this area.

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*Jeffrey Chan Wah-Teck, Chair*

Allow me to inform you that Singapore is actually presently upgrading our single window and I certainly, when I go back, will recommend to our Customs Department that they should attend this meeting in Stockholm that you spoke about.

Of course, this single window is one of the most useful facilities for the promotion of global commerce and we look forward to continued success in your endeavours.

For the final speaker for this evening, we have Professor Amelia Boss from Temple University who will speak to us on electronic registries and transfer rights becoming operational. For those of us who were present at the fortieth session of UNCITRAL, we will recall that the United States delegation actually made a proposal for UNCITRAL to study further the issue of electronic registries and transfer rights. I take it that Professor Boss's presentation will be a good introduction to the many of us here who are not that familiar with the issues in this area.

Professor Boss is no stranger to UNCITRAL. In fact, she was one of the pioneers of UNCITRAL work on electronic commerce and electronic signatures (and was among the participants who contributed significant expertise to the work). Apart from that, she is a very well-known academic at Temple University in the United States and has a long list of publications. She is editor of, among other things, *The Business Lawyer*. And more importantly, she has been ranked as one of the 50 most influential women lawyers in the United States. So she is definitely someone we want to get to know.

### 3. *Becoming operational: electronic registries and transfer of rights*

*Amelia H. Boss*

*Temple University School of Law, United States of America; and Director, Institute for International Law and Public Policy, United States of America*

Fifteen years ago in New York, at an earlier congress sponsored by UNCITRAL, on "Uniform Commercial Law in the Twenty-first Century",<sup>290</sup> the impact of electronic technologies and electronic commerce was the subject of lively debate in defining the future work of UNCITRAL. At that earlier congress, the point was made that electronic commerce raised fundamentally different challenges for an international law-making body such as UNCITRAL for several reasons.

First, few if any countries (developed or developing countries) had adopted a comprehensive legal structure governing electronic commerce. Thus, the first challenge was to take countries of divergent economic capabilities, countries of different cultural and legal heritage, and bring them together to develop common analyses of, and approaches to, new and difficult issues. In many ways, the current UNCITRAL emphasis on modernization of the law (rather than on mere harmonization or unification of the law) began in the area of electronic commerce.

The second challenge was to determine how to approach electronic commerce, a topic that may be used in different ways in different sectors of the economy. The choice for any law-making body, domestic or international, was between two approaches. A sectoral approach would consider discretely the use of electronic commerce in each industry or area of international commerce and develop a legal regime for each. Alternatively, lawmakers could follow a more broad-based approach, examining the fundamental nature of electronic

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<sup>290</sup> *Uniform Commercial Law in the Twenty-first Century: Proceedings of the Congress of the United Nations Commission on International Trade Law, New York, 18-22 May 1992* (United Nations publication, Sales No. E.94.V.14). It is worth noting that UNCITRAL has had the issue of electronic technologies on its agenda for over 20 years, since it first took up the topic of automated data processing in 1984.

commerce, identifying common themes and developing appropriate resolutions which could then be implemented either globally or on a sectoral basis.<sup>291</sup>

In the intervening 15 years since the last congress, UNCITRAL has become a pioneer and leader in the area of regulation of electronic commerce, producing three instruments worthy of consideration by all countries. These three instruments have followed a combination of these two approaches, with an emphasis on a functional approach that applies globally. Its two model laws<sup>292</sup> and the Convention on the Use of Electronic Communications in International Contracts<sup>293</sup> are attempts to deal globally with the issues of electronic commerce. At the same time, these products also contain provisions accommodating electronic commerce in specific substantive contexts: the new Convention on the Use of Electronic Communications in International Contracts contains provisions that modify the law of contracts,<sup>294</sup> while the UNCITRAL Model Law on Electronic Commerce contains sector-specific rules dealing with the carriage of goods.<sup>295</sup> Now, however, that UNCITRAL Working Group IV (Electronic Commerce) has completed its work on the Convention, the question emerges of whether UNCITRAL work on electronic commerce should remain concentrated in one working group, or whether it should become the charge of each and every working group with respect to its specific substantive area. For example, UNCITRAL Working Group III (Transport Law) has been considering the question of electronic bills of lading in the context of carriage of goods by sea.<sup>296</sup>

Considering electronic commerce issues in the context of work in concrete substantive areas has an inherent appeal. One writer in the United States has commented that speaking of the law of electronic commerce (or the law of cyberspace) is like speaking of the law of the horse or the law of the telephone:<sup>297</sup> electronic technologies are simply one means of communication used to accomplish broader commercial goals. Today, electronic commerce and electronic technology issues have permeated virtually every area of the law; attempts to single out these issues and treat them independently of the underlying subject matter would not only be difficult in many cases, but potentially counterproductive.

Yet there are difficulties as well with a purely sectoral approach. Strong arguments can be made for examining issues of electronic commerce independent of any particular substantive area or industry segment. First, the experts participating in a discussion in any

<sup>291</sup> Amelia H. Boss, "Electronic commerce and the law", in *Uniform Commercial Law in the Twenty-first Century: Proceedings of the Congress of the United Nations Commission on International Trade Law, New York, 18-22 May 1992* (United Nations publication, Sales No. E.94.V.14), p. 162; see also Amelia H. Boss, "The emerging law of international electronic commerce", *Temple International and Comparative Law Journal*, vol. 6, No. 2 (1992), p. 293.

<sup>292</sup> They are the UNCITRAL Model Law on Electronic Signatures, adopted by the General Assembly in its resolution 56/80 of 12 December 2001, available at [www.uncitral.org/uncitral/en/uncitral\\_texts/electronic\\_commerce/2001Model\\_signatures.html](http://www.uncitral.org/uncitral/en/uncitral_texts/electronic_commerce/2001Model_signatures.html); and the UNCITRAL Model Law on Electronic Commerce, adopted by the Assembly in its resolution 51/162 of 16 December 1996, available at [www.uncitral.org/pdf/english/texts/electcom/05-89450\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/electcom/05-89450_Ebook.pdf).

<sup>293</sup> United Nations Convention on the Use of Electronic Communications in International Contracts, adopted by the General Assembly in its resolution 60/21 of 23 November 2005, available at [www.uncitral.org/pdf/english/texts/electcom/06-57452\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/electcom/06-57452_Ebook.pdf).

<sup>294</sup> Articles 11 ("Invitations to make offers"), 12 ("Contract formation"), 13 ("Availability of contract terms") and 14 ("Error in electronic communications").

<sup>295</sup> Arts. 16 and 17.

<sup>296</sup> A/CN.9/WG.III/WP.81 and Corr. 1.

<sup>297</sup> Frank H. Easterbrook, "Cyberspace and the law of the horse", *University of Chicago Legal Forum*, 1996, p. 207. Many legal scholars in the United States took issue with this approach, however, arguing that an examination of the developments in cyberspace would allow for the development of generalized principles that might have broader application. See, for example, Larry Lessig, "The law of the horse: what cyberlaw might teach", *Harvard Law Review*, vol. 13, 1999, p. 501.

particular sector, while being knowledgeable and skilled in that substantive area, may not have the knowledge and expertise about electronic technologies and electronic commerce that are necessary to develop legislation that would appropriately accommodate electronic commerce.<sup>298</sup> Moreover, the time allocated to covering every issue, combined with the interest of the participants, may result in a failure to allocate sufficient time and resources to the electronic commerce issues. Second, dealing with electronic commerce issues on a sector-by-sector basis means that each drafting body must struggle with the electronic commerce issues as they arise, and leads to the possible adoption of different and potentially inconsistent resolutions of identical questions by different drafting bodies. A more comprehensive, integrated approach that can be used across the various sectors and provide a template for use avoids these problems, and maximizes the resources that are available. There is a third problem with a purely sectoral approach to dealing with electronic issues: the various sectors of industry (and the various bodies of law) rarely exist independently, and frequently interact with other sectors of industry or bodies of law. Law does not consist of separate bodies of law that are static silos that do not interact with one another; the same can be said for different industry sectors. Transactions created in one area may have implications outside that area, and one body of law may impact the application of another body of law. Let me give two examples. A bill of lading may be issued initially for carriage of goods by sea, but at some stage the goods covered by that bill of lading may be subject to another type of transport (e.g. land transport). Alternatively, the bill of lading may have intrinsic value to the extent that it represents the right to the underlying goods, and therefore may be desirable as security for banks that finance the sale, and may become the collateral for a financing transaction. Thus, even though the system of rules applicable to bills of lading allows for the creation of an electronic bill of lading, uncertainties within the financing community as to their status as transferees of these electronic bills of lading or as secured creditors claiming under the bill of lading may inhibit the growth in use of electronic transactions.<sup>299</sup> To adopt an analogy from the law of technology, there is a great need for the interoperability of the legal solutions that we create, legal solutions that can operate cross-platform in a variety of areas.

What, if any, are the issues that cut across different substantive areas but nonetheless may benefit from consideration in a context that cuts across substantive areas? What are the issues that may need a universal answer, or at least universal consideration? The two UNCITRAL model laws and the United Nations Convention on the Use of Electronic Communications in International Contracts go a long way towards addressing the use of electronic technologies in international commerce, particularly in the context of the recognition and enforcement of contracts created electronically. The focus of existing UNCITRAL texts in electronic commerce has been on the legal norms and issues bound up with the law governing obligations, contracts and commerce. To that extent, the impact of the work of UNCITRAL is primarily on the enforceability of contractual obligations between parties who have used electronic commerce.

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<sup>298</sup> There are some areas where knowledge about the use of technology in a particular sector is indispensable; this was the case with regard to the drafting of the UNCITRAL Model Law on International Credit Transfers (United Nations publication, Sales No. E.99.V.11). This is not the case in every situation, however.

<sup>299</sup> See, for example, Marek Dubovec, "The problems and possibilities for using electronic bills of lading as collateral", *Arizona Journal of International and Comparative Law*, vol. 23, No. 2 (2006), pp. 437-438, noting that previous attempts to create an electronic bill of lading raised questions as to the status of secured creditors and the acceptability of the electronic bill of lading under letters of credit. "If the secured transactions laws do not provide sufficient rules that would guide the bank or other prospective lender through the process of creation and perfection of a security interest in an electronic document of title, the electronic replication of paper documents of title would not be possible." *Ibid.*, p. 449.

Yet recognizing the existence or enforceability of a contract is only the first step; a second step is defining what is meant by the enforceability of any rights created by the electronic contract in the event of third-party claims or effects. In effect, once the validity and enforceability of contract rights are recognized, two important other areas are implicated: what is the impact of those contractual rights on existing property rights, and what is the enforceability of those rights as against third parties who are not privy to that contract? In other words, what (substantively) is the impact of the “electronic equivalent” of the paper document? The big issues today in the Internet have to do not so much with enforceability of contracts, but are concerned with property and ownership: who can claim certain rights (whether in goods or intangibles) to the exclusion of others; how those rights can be transferred; and how effective those rights are against other claimants. By phrasing the inquiry in this manner, it becomes clear that in wrestling with electronic commerce issues, it becomes necessary to examine the underlying substantive laws creating and enforcing property rights of different types.

The existence of property rights and their enforcement against others is an important issue in international trade: buyers, sellers and those who finance the international transaction want to know with certainty what their rights are in the property at issue during the performance (or after the breach) of the contract. These questions have received increasing scrutiny in several important areas: the area of investment securities has embarked on a re-examination of the entire system for recording title to and interests in securities; and attempts to introduce electronic bills of lading are causing a re-examination of negotiability and an exploration of alternative methods of documenting claims to goods covered by electronic bills.

Over the centuries, merchants have developed methods of establishing the existence of ownership (or possessory) rights, methods of transferring those rights and methods of determining priority to the property in the event of multiple claims. One method that has developed is transfer of physical possession of that property. While this might work in the case of tangible and moveable property which are capable of physical possession, such as cotton or chairs, it does not work in four other situations: where the property being transferred is real property; where the property being transferred, while tangible, is too large to be “possessed”, as is the case with manufacturing equipment; where the property is temporarily in the hands of a third party or bailee; or where the property is intangible in nature. As a result, many legal systems have developed replacements for the transfer of physical possession of the property. Three “possession substitutes” have evolved. The first is the transfer of a token rather than the property itself. Examples might include the transfer of a deed in the case of real estate, the transfer of a set of keys in the case of property whose use is “locked up” in some way; or transfer of a piece of paper that documents the right to possession, as in the case of a bill of lading, warehouse receipt or certificated security. The second (and somewhat related) possession substitute is the transfer of the means of control over the property. Control may be exercised by possession of a key required to use or access the property; or it may be exercised by attornment by the bailee, an acknowledgement by the party who has the property or by the debtor who owes the performance. Control may also be exercised by possession of a piece of paper that documents the ownership interest and is necessary in order to claim that property. A third possession substitute, that originated in the real property area but has since spread to other areas and particularly that of secured financing, is the recordation of the transfer of interests in a registry created for the specific purpose of documenting transfers of that nature and establishing rights against third parties.

In the area of commercial trade, the use of a “token”—more specifically, a piece of paper—became commonplace to control and transfer interests in property. That “token” was used to document the ownership interest, to transfer the rights and to determine priority. Tokens of this nature have been recognized in a variety of markets: in maritime and in transport generally, there is the bill of lading; in the commodities markets, parties in some countries use warehouse receipts (another document of title); in the area of corporate financing, businesses have issued paper “stock certificates” that evidence ownership interests in the company; alternatively, businesses attempting to raise money have issued paper “bonds” or negotiable instruments that represent the right of the holder to payments of money in the future. In each of these instances, the paper document has legal significance in the creation and enforcement of rights in other property.

What happens, however, if that paper document, that paper token, is put into electronic form? If the paper is to be dispensed with, what will take its place?<sup>300</sup> There are many products today (Incoterms being one example among many)<sup>301</sup> that admit of the possibility that the parties may agree to issuance or execution of these documents in electronic form. These products stop, however, without laying out the legal consequences of those documents and their effectiveness against third parties. The challenge now is to tackle that question and begin to give answers.

The issue is not a new one; indeed, it has been around in the international trade arena for over 25 years, when it was first raised by Hans Thomsen and Bernard Wheble in discussions within the Economic Commission for Europe and its Working Party for the Facilitation of International Trade Procedures.<sup>302</sup>

For many, it is not simply a question of what to substitute for a paper token but how to accomplish negotiability in an electronic environment. The concept of negotiability is one that cuts across substantive areas, and in many countries negotiability is one of the pillars of commercial law. Transfer of rights—whether they be rights in tangible items, such as goods, or rights in intangible items, such as securities or payment obligations—is accomplished today by the transfer of the piece of paper. The person in possession of the piece of paper may, if taking by due negotiation of the paper, obtain an interest in the underlying rights and the ability to request the goods, payment or other performance covered by the paper. Moreover, if the person in possession of the paper qualifies as a “holder in due course” or “protected party”, that person may take greater rights than its transferee had and may be able to cut off defences that exist to the exercise of those rights. In some countries, a financier who takes possession of these documents may be able to claim that its rights to the goods, payment or performance are to be given priority over claims of other financiers or transferees. Thus, this little piece of paper serves multiple

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<sup>300</sup>“The time has clearly arrived when the bill of lading must go. It has served us well and earned a place of honour in the museum of international trade (to whence it should be consigned), but with what will it be replaced?” John W. Richardson, “Key to international e-commerce”, *L/C Monitor*, January 2000 (see Dubrovec, “The problems and possibilities”, p. 79).

<sup>301</sup>According to the A8 clauses of Incoterms 2000, paper documents may be replaced by electronic messages provided the parties have agreed to communicate electronically. Such messages could be transmitted directly to the party concerned or through a third party providing added-value services including registration systems as BOLERO. But it has been acknowledged that “systems providing such services ... may require further support by appropriate legal norms and principles”. See *Yearbook of the United Nations Commission on International Trade Law, Volume XXXI: 2000* (United Nations publication, Sales No. E.02.V.3), p. 608.

<sup>302</sup>See Hans B. Thomsen and Bernard S. Wheble, “Trade facilitation and legal problems of trade data interchange”, *International Business Law*, vol. 13, 1985, p. 313. Subsequently, the Working Party on Facilitation of International Trade Procedures (predecessor of the UN/CEFACT Working Group) conducted a study on negotiability.

underlying functions in the context of negotiability, although even within one sector there may be regional differences on what those functions are.<sup>303</sup>

There are some that have envisioned that one day the “paper token” may be replaced by an “electronic token” that has the same characteristics of a paper token and performs the same function. Technological developments, however, have not yet provided us with such a digital object on any widespread, low-cost basis. The essential problem is that electronic documents can be perfectly copied, and tokens of value must be unique. Ensuring uniqueness and transferability is a major challenge, and there are genuine questions as to whether such developments will occur.<sup>304</sup> Even if token-based uniqueness is achieved, it will not be effective in general unless technological applications are both widespread and low-cost. The existing closed systems do not try to replicate a “token” system; instead, they adopt another of the methods used for decades to evidence the claims of an interest in property: the use of a registry (often, but not always, a central registry) that documents the claims to the property and becomes the source for determining ownership rights. Registries are increasingly being used in the context of secured financing on the international level, such as in the Cape Town Convention<sup>305</sup> and as recognized by the UNCITRAL Convention on the Assignment of Receivables in International Trade<sup>306</sup> and current UNCITRAL work on secured transactions,<sup>307</sup> as well as in the context of outright transfers of property (as is recognized in work done by the Hague Conference<sup>308</sup> and by Unidroit<sup>309</sup> on securities intermediaries). Increased computing power and lower costs are what make computer registries now a real alternative for dealing with third-party rights and enforceability.

The increasing use of registry systems evidences a new trend: the reconceptualization of negotiability, the destruction of a token-based system and the construction of a new and more modern business and legal structure. Reconceptualizing what is accomplished by the tender of a negotiable document of title or a negotiable instrument or other such paper token and how the purposes or functions served by a paper document may be replicated in an electronic environment is a complex and complicated undertaking. Given the importance and difficulty of the issues, should they be relegated to sector-by-sector resolution? And can these issues really be approached from a “functional equivalence” perspective, when the thrust of these developments is the rejection of paper (or its equivalent) as the resolution to these issues?

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<sup>303</sup> See Georgios I. Zekos, “The contractual role of documents issued under the CMI draft instrument of transport law 2001”, *Journal of Maritime Law and Commerce*, vol. 35, 2004, p. 99.

<sup>304</sup> On the ability of “digital objects” or records to represent “value”, see Robert E. Kahn and Patrice A. Lyons, “Representing value as digital objects: a discussion of transferability and anonymity”, *Journal on Telecommunications and High Technology Law*, vol. 5, 2006, p. 189. Kahn was a co-inventor of the transmission control protocol/Internet protocol (TCP/IP), and was responsible for originating the Internet Program for the United States Defense Advance Research Project Agency. He noted that digital object architecture has been under development by the Corporation for National Research Initiatives for a number of years, and discusses the use of “unique, persistent identifiers” for digital objects.

<sup>305</sup> See [www.unidroit.org/english/conventions/mobile-equipment/main.htm](http://www.unidroit.org/english/conventions/mobile-equipment/main.htm).

<sup>306</sup> United Nations Convention on the Assignment of Receivables in International Trade.

<sup>307</sup> Note by the Secretariat entitled “Security interests: recommendations of the UNCITRAL draft Legislative Guide on Secured Transactions” (A/CN.9/631).

<sup>308</sup> See the Convention on the Law Applicable to Certain Rights in respect of Securities Held with an Intermediary, available at [www.hcch.net/index\\_en.php?act=conventions.text&cid=72](http://www.hcch.net/index_en.php?act=conventions.text&cid=72).

<sup>309</sup> Unidroit has been exploring the preparation of a draft convention on substantive rules regarding intermediated securities. See Unidroit study LXXVIII, available from [www.unidroit.org/english/workprogramme/study078/item1/main.htm](http://www.unidroit.org/english/workprogramme/study078/item1/main.htm).

The solution may be to move away from the traditional drafting methods used in the electronic commerce area: methods that adopt the basic tenet of functional equivalence. UNCITRAL has made significant and impressive strides in the electronic commerce area over the years, with an approach grounded in the notion of functional equivalence. Under this approach, traditional legal notions need not be replaced by entirely new ones; from a legislative perspective, all that may be necessary—and prudent—to do is to identify the circumstances under which the same function envisaged by the law for, say, a “written contract” may be fulfilled by the exchange of communications in electronic form.<sup>310</sup> This “functional equivalence approach” has served UNCITRAL well, but it may well have outlived its useful life.<sup>311</sup> The new focus should be the creation of new legal structures, built on the old legal structures, that can provide the rules sets needed by business to fully accomplish the transition to an electronic environment. The challenge is to see the discussion from a different perspective, to focus not on what the functions of negotiability are and how they may be fulfilled, but to focus on the mechanics behind the creation of registries and the benefits that such registries may offer in the context of documenting rights to ownership and providing a legal structure that may be utilized by those industries that from day to day must cope with the passage of interests in goods and other property. Let us not try so hard to replicate the past in an electronic environment, to find a “functional equivalent”. Instead, let the electronic environment show us new and different ways to accomplish our goals. UNCITRAL could be a leader in that transition.

Admittedly, the lack of clear and certain legal rules is only part of the picture; there is also a need for the development of business practices. Some say the law should change, as business will not until there is certainty and predictability in transactions. Others say that business must lead, as the law itself cannot create new business practices. The answer is undoubtedly somewhere in between: the two are interdependent. Yet in the context of the transfer of property rights in an electronic environment, we are not writing upon a totally clean slate.

In the 25 years since issues concerning replacement of paper tokens were first raised in the international context, there have been developments in the industry. Many of those developments have been in the context of closed systems, where the parties to the transactions, by opting into the use of particular systems for trade facilitation, agree to a set of rules that will apply to their dealings; examples of that include the work by the Comité Maritime International<sup>312</sup> and Bolero.<sup>313</sup> Yet these private rule systems suffer from many of the same drawbacks as the “electronic data interchange agreements” drafted by parties 20 years ago; inability to enforce the agreements against third parties and overarching questions about the validity and enforceability of these agreements create costly uncertainty for commercial

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<sup>310</sup> José Angelo Estrella Faria, “Online contracting: legal certainty for global business—the new United Nations Convention on the Use of Electronic Communications in International Contracts”, *Uniform Commercial Code Law Journal*, vol. 39, No. 1 (2006), pp. 25-73.

<sup>311</sup> Admittedly, the three UNCITRAL instruments have included some departures from a purely functional equivalency approach. The United Nations Convention on the Use of Electronic Communications in International Contracts added a few substantive rules that extend beyond merely reaffirming the principle of functional equivalence where substantive rules are needed in order to ensure the effectiveness of electronic communications. See Estrella Faria, “Online contracting”. (Electronic commerce does not fully reproduce contracting patterns used in contract formation through more traditional means. Thus some adaptation of traditional rules on contract formation may be needed to accommodate the needs of electronic commerce.) The UNCITRAL Model Law on Electronic Commerce contained rules specific to the bill of lading context.

<sup>312</sup> Comité Maritime International, Rules for Electronic Bills of Lading (June, 1990). See Zekos, “The contractual role of documents” (see footnote 303 above).

<sup>313</sup> See [www.bolero.net](http://www.bolero.net).

parties. Nonetheless, these interchange agreements, while originally developed on an industry- or sector-specific basis, eventually documented the commonality of the issues raised in an electronic context<sup>314</sup> and provided the foundation for the promulgation of generally applicable legal principles on both the international and domestic level.

In a similar fashion, study of these private rule systems for the replacement of paper, as well as studies of how paper tokens have been replaced in other substantive areas,<sup>315</sup> may provide for the development of generally applicable legal principles concerning the use of registries to replace paper. The key is the development of a unified, thoughtful and coordinated approach.

It is time for UNCITRAL to assist electronic commerce to become operational, to move from merely removing barriers to electronic commerce towards creating a legal structure where ownership rights can be transferred and enforced. The time has come for UNCITRAL in the electronic commerce area to become operational.

#### 4. *Comments, evaluation and discussion*

*Patrice Lyons*

*Law Offices of Patrice Lyons, United States of America*

Professor Boss, I would like to take your last thought one step further. We are talking about a system for managing information in the Internet environment. While the system I mentioned briefly may be used to represent the functional equivalent of some pre-existing data structure represented on paper, there are many implementations of this system that have reconceptualized what a unit of information might be like. For example, instead of having just a passive paper equivalent, you could actually have a more dynamic unit that takes advantage of other capabilities of the system. A bill of lading represented as a digital object would likely move well beyond the confines of its functional equivalent form on paper. It may have many other capabilities such as dynamic links to related information.

But when you are talking about creating a system that will allow the transfer of rights, inherent in what I was suggesting earlier is that the transfer of rights would be accomplished through transfer of administrative control over the unique identifiers. So, indeed, I think there may be an overlap between what you were suggesting and what I was describing in my earlier comment; and perhaps it may be helpful to explore this intersection, while moving beyond mere functional equivalence.

*Amelia H. Boss*

*Temple University School of Law, United States of America; and Director, Institute for International Law and Public Policy, United States of America*

You are correct that there is some overlap in this notion of control in the sense that you are talking about it and what I am talking about, which was reconceptualization.

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<sup>314</sup> See, for example, Amelia H. Boss and Jeffrey Ritter, *Electronic Data Interchange Agreements: A Guide and Source Book*, Paris, International Chamber of Commerce, 1993; Amelia H. Boss, "Electronic data interchange agreements: private contract towards a global environment", *Northwestern Journal of International Law and Business*, vol. 13, 1992, pp. 31-70.

<sup>315</sup> Many of those prior efforts are detailed in the document entitled "Possible future work on electronic commerce: proposal of the United States of America on electronic transferable records" (A/CN.9/681/Add.1).

But the difference, I believe, is this: if I understand the digital object architecture, it is actually to create a specific object, one, for example, that can move with anonymity through the system. I do not believe that that is necessary in every area. My suggestion is that rather than try to replicate a piece of paper that can move anonymously through commerce in every area, that there may be structures, such as the registry systems, that can accomplish similar goals. I would use as an example what has happened in the securities area, where what you now have is essentially paper no longer circulating but central registries where ownership is documented. That is, I think, an example where there was no attempt to create an object that actually circulates.

*Patrice Lyons*

*Law Offices of Patrice Lyons, United States of America*

One of the areas of research that has emerged in implementing the digital object architecture, including in particular the Handle System in other areas, for example in the health industry, such as cancer research projects where there is an interest in generating many identifiers to enable simulations, is the need for registries of metadata. Systems of registries are being developed that will facilitate the creation and organization of information expressed in the form of digital objects, particularly in complex structures. And, again, such efforts may go well beyond any functional equivalent on paper and be dynamic entities. The use of metadata registries in this context has served to reduce complexities involved in archiving, sharing and retrieving information. For example, a registry project that may be of interest, called CORDRA, is being developed by the Corporation for National Research Initiatives as part of the Advanced Distributed Learning Initiative of the United States Department of Defense.

So yes, I would agree that registries may be viewed as key components of information management systems going forward.

*José Angelo Estrella Faria*

*United Nations Commission on International Trade Law*

Professor Boss, I have one question. We have considered the issue of transfer of rights by electronic means at least twice in the past seven years. UNCITRAL has developed rules that recognize the validity of electronic contracts. We also have rules that establish the conditions for use of electronic signatures and the duties of certification. The conclusion we came to when we looked at token systems or registry systems was that there was very little legislative work still left to be done. There are a lot of technology challenges out there, especially when considering developing an absolutely singular electronic token. But when it comes to registries, it seemed to us that the legal questions, either related to privacy protection or protection of the personal data held in registries from unauthorized access by third parties, were one set of issues, which other organizations were already trying to solve. Another set of issues was what kind of authentication methods people would be using to communicate with the registry. And that, again, seemed to us to be an issue of electronic signatures in which enough work had been done.

It seemed to us that, actually, all that a registry other than those that rely on a closed industry, such as the securities exchanges, needed to become truly operational would be to have some sort of general legislative recognition. This kind of enabling legal regime

can be developed, as we are trying to do with the new Transport Law Convention. So now the question is, are we missing anything? I would be very interested to know in which direction we have been failing to look.

*Amelia H. Boss*

*Temple University School of Law, United States of America; and Director, Institute for International Law and Public Policy, United States of America*

I think you are quite right that the challenge lies in moving from closed systems to the open systems. There are, indeed, closed systems operating now. There was some discussion earlier about the systems and the legal agreements arising when members joined. That creates a legal structure. The question is whether we can try to replicate that in an open environment where it is not necessary to have that membership notion as the *sine qua non*. No, you are quite correct on that next step. That does require a legislative solution and I think that is where the challenge to UNCITRAL would lie. It is coming up with a way that that might be dealt with. It is very similar, in fact, to some of the questions that Mr. Schermer raised earlier with regard to recognizing single-window issues. I think many countries now are being called upon to create registry systems in a number of different contexts, whether it be registry systems in the context of secured transactions, assignment of receivables or whatever, and they are all going to share that common characteristic.

To the extent that these are all electronic, it makes it much easier now for countries to implement these systems and we could give them guidance in that area.

*Ibrahim Hassan al-Mulla al-Mansouri*

*Emirates International Law Centre, United Arab Emirates*

As regards electronic commerce, we are talking about activities that go back many years and traditional means of trade are well known. Their categories are well known and the law is well known. My question for the experts relates to this.

With regard to all these means that are used for electronic commerce, are they means that have all been identified? We see new aspects emerging day after day, and technological experts seem to be the ones diagnosing the situation. What happens is that we lawyers, on the basis of that diagnosis, provide the medicine for whatever the problem or ailment happens to be. So with regard to all these new means available in the area of electronic commerce, have they all been identified; have they all been discovered; have they all been placed in categories yet or not?

*Bart W. Schermer*

*Chair a.i., United Nations Centre for Trade Facilitation and Electronic Business Legal Group*

Let me start off by saying “no”. Every day new issues pop up. This was also mentioned in a previous session: every day new technologies are being developed, as are the accompanying business processes. From an electronic commerce standpoint, an electronic commerce lawyer’s standpoint, it is very difficult. As you said, it is like creating the law of the horse. It permeates all the different areas. For this reason too, we are here at UNCITRAL, talking about international trade law. But much that has happened as a result of technological means and e-commerce is also bringing different subject areas closer to the work of UNCITRAL,

for instance, personal data protection. Until now, that had not really been an issue in the sphere of international trade law; it was more something that OECD addressed through its guidelines. But now, because of registries and the single-window concept and, of course, with radio frequency identification as a technology just around the corner, many new issues previously not part of the area of international trade law are being introduced to that area. So, there is still much work to be done for e-commerce lawyers.

When we are looking for solutions, I think—and this is also what we see in our work with UN/CEFACT—it is very important to have some kind of interpreter or translator between the technological people and the legal people, because what currently happens is that technology is created and then afterwards legal experts are invited to look at the technology and give their opinion: those two things diverge too much. It is really very necessary to have the technical people talking with the legal people and up until now that has been lacking.

*Jeffrey Chan Wah-Teck, Chair*

I sense that underlying the question was a concern that it may well be that by the time the legal solutions are established, the technology has advanced so that the legal solutions which a lot of resources are applied to in order to generate are no longer applicable.

*Amelia H. Boss*

*Temple University School of Law, United States of America; and Director, Institute for International Law and Public Policy, United States of America*

I agree that that is a concern. But if we accept that concern, then we give up—and I, for one, am unwilling to give up. That is the whole notion of the development of the rule of law; it is constantly developing. I think we do have some need to continue to struggle. We may not get it right every time. I think one of the challenges is that we find that we are constantly addressing one issue, only to have another pop up. There is a game that people play in the United States at fairs; it is called Whack-a-Mole. I do not know whether anyone has played it: there is a mole that pops up out of the ground, you hit it with a hammer, it pops up somewhere else and then you have to hit it with a hammer again. I think that what is going to happen here is that we think we have resolved an issue in e-commerce and it will change. We will think we have already resolved the issue, but the technology will have changed so suddenly that there will be a new twist that we have to deal with. I think that what we are talking about is really a continuing challenge to keep current.

*Lauri Railas*

*Krogerus Attorneys, Ltd., Finland*

A trade document could be defined as a set of data content recorded as such. I have seen this definition in legal literature and it sounds fine. In addition to transferring rights, trade documents are used for conveying information and the useful aspect of electronic commerce is, of course, that they use the same data content several times in various environments. Maybe there could be some link between transport documentation and the single window in the sense that the data content contained in commercial documents could be used in the administrative functions of the single-window system so that the two functions would converge.

*Agustín Madrid Parra*  
*University of Seville, Spain*

I would simply like to convey some of the concerns that I have as a member of the delegation of Spain to UNCITRAL Working Group IV (Electronic Commerce). I would like to put them in the form of a question with regard to a matter mentioned by Ms. Boss, among others.

In UNCITRAL, the work that we have done has been general in nature. It produced the Convention. But can we consider that the work has been finished, or should we look forward to doing something else? At the end of the model law, we talk about electronic documents and transport. Should we go further in that regard, or should we stop and make do with what we have got?

What I am trying to find out is how we can sort things out so there is no contradiction between the sort of documents that UNCITRAL is producing, for instance, on electronic commerce and other UNCITRAL conventions in the future.

*Seward M. Cooper*  
*Chief Counsel, Good Governance, Office of the General Counsel, African Development Bank*

My question, a brief one, is for Mr. Ibrahim. The Nigerian Stock Exchange has become a very viable stock exchange. Could you say to what extent, if any, you have been able to discern whether there has been any impact by these 419-type crimes on the stock exchange using electronic fraud?

And Professor Boss, I was wondering if perhaps you could elaborate within the context of secured transactions. We are looking at possibilities for moving towards electronic registries for secured transactions in a lot of countries in sub-Saharan Africa. I would be grateful for your input on what possible opportunities for fraud exist in the transfer of rights in the event of foreclosures and matters of that nature with secured transactions based on electronic mechanisms.

*Madhukar R. Umarji*  
*Chief Adviser, Legal, Indian Banks' Association*

Under the secured transactions law, there is a notice of recommendation to set up an electronic registry. It is on the lines of notice filing, where a secured transaction is filed with a minimum of information. If we think in terms of setting up an electronic registry for transfer of rights, it will have to be basically for the recording of ownership rights and then the transfer of such rights from the owner to some other person. For this, perhaps we may have to restrict registration to property rights that are frequently sold and traded, because if you extend it to all property rights, it may become too difficult to manage.

*M.K.G. Ibrahim*  
*Head, Information and Communications Technology, Economic and Financial Crimes Commission, Nigeria*

We have representation from the Stock Exchange Commission of Nigeria. They have dedicated staff that are, on a full-time basis, working with the Special Unit of the Advance

Fee Fraud Section of the Economic and Financial Crimes Commission. In that regard, they look at specific issues pertinent to the stock exchange-related issues, such as insider trading, stock scams and the rest of that. I do not have accurate statistics to furnish you with, but if you require more information in that regard I can send an e-mail across to provide such statistics as to the number of crimes that we have been able to identify with the Nigerian Stock Exchange. But definitely we have full-time staff who are working with the Economic and Financial Crimes Commission and they have been helping in that regard.

*Bart W. Schermer*

*Chair a.i., United Nations Centre for Trade Facilitation and Electronic Business Legal Group*

I do not really have an answer to the first question. I will gladly leave it to Professor Boss. One comment, though: what we are seeing in the development of single windows is a move towards the broader picture. Now, the focus is on trade but it will grow also to include other services, greater sense of security etc., and, therefore, the notice of registries and moving beyond what we are currently doing is very important.

*Amelia H. Boss*

*Temple University School of Law, United States of America; and Director, Institute for International Law and Public Policy, United States of America*

I will start with the first question you asked. I cannot answer it. I can say it is a very good question, and I think that that is precisely the kind of question that should be asked and it should be considered that that may be one approach that could be used.

That, I think, leads into the discussion of filing systems and two of the questions related to that. When I suggested filing systems or registry systems for transfer of rights, I by no means suggested that we impose such a system on every kind of property that existed. If I led anyone to that conclusion, I apologize for misleading you. I was talking about this as a substitution for other mechanisms that might be in place currently and in particular the problems that arise when we are talking about transfers of intangibles and examples of instances where there may be requirements of paper. So in terms of designing systems, yes, you should be careful about what kinds of property rights are going to be governed by that system.

Third, as to the opportunities for fraud that might exist in those systems, I think that there is potential for fraud in two areas. One is by those people who operate the system, and obviously there the question is, who is going to be in control and what are the rules that are going to govern?

Secondly, there is fraud by people outside the system. I would break that into two parts: (a) unauthorized access, where, of course, you are going to have to look very carefully at the security mechanisms you use; and (b) in terms of authorized access, who are the people who are actually being allowed to feed into that system and how do you control it? That is a very brief answer of where we are going to look.

In response to the last question, from the delegate of Spain, about the future work of UNCITRAL, I think the challenge when you have a continually evolving area like

e-commerce is always how to make sure that you adequately cover subjects as they develop without creating contradictions between earlier and later instruments. At this stage, I do not see that there are any blatant or obvious contradictions with the existing UNCITRAL instruments, which are, I believe, very flexible and can be adapted in the future.

## V. Government contracts and dispute settlement

### A. New procurement techniques and current issues on government procurement

*Chair: Tore Wiwen-Nilsson*

*Partner, Mannheimer Swartling Advokatbyrå, Sweden*

This session is about procurement and, more precisely, new procurement techniques and current issues. We have three very experienced and distinguished speakers, who have divided their topics among themselves with three different approaches. The first, who will present theoretical issues, will be Professor Steven Schooner. Then we will hear about practical issues from Mr. Knut Leipold of the World Bank, and finally we will have one further speaker, Mr. Robert Hunja (Kenya), who will speak on how to achieve socio-economic goals.

Although this is mainly about new techniques, there are certain things in procurement that are actually constant, and I know that Steven Schooner will have his views on what is constant. I believe he will say that there is only one constant and that is change. I have a different view, but I think we agree on the fundamentals. In my view, there are certain things that are constant in government procurement and those are the values and objectives of government procurement. They have been very well presented in the preamble to the UNCITRAL Model Law on Procurement of Goods, Construction and Services and I will just very briefly repeat what is actually said there: the objectives are to maximize economy and efficiency, to foster participation by suppliers, to promote international trade, to promote competition, to provide for the fair and equitable treatment of suppliers, to promote the integrity of and fairness and public confidence in the procurement process, and, last but not least, to achieve transparency. These things are not affected, or should not be affected, by new techniques.

I will now leave the floor to our first speaker, Steven Schooner, who is a Senior Associate Dean for Academic Affairs and Co-Director of the Government Contract Law Programme at George Washington University School of Law. He has also been an Officer of the Federal Procurement Policy in the Executive Office of the President. I am not going through the whole list. He did not want me to say anything, but I think it is fair to say something. So I will leave the floor to you, Steven.

#### *1. Modern public procurement techniques: benefits, concerns and regulation (with emphasis on theoretical issues)*

*Steven L. Schooner*

*George Washington University School of Law, United States of America*

Today I would like to give a little bit of a macro-level perception to some of the considerations that I think should be taken into account as UNCITRAL works towards

revising its Model Law on Procurement and maybe suggest some considerations that have not been fully flushed out. However, as was mentioned just a second ago, let me begin with the premise that when we talk about public procurement, the only constant is change. As someone who works in the field of procurement, when we talk about procurement reform, we find that there are often three graphic visualizations that are used to describe how the change occurs. Some people like to talk about cycles. They like to make big circles. Some people like to talk about waves. It depends on how your arm motion is. Some people prefer pendulums. The point though is still the same. If we were only to use the model of the United States procurement system, arguably the largest procurement system in the world—we are talking of hundreds of billions of dollars a year—everything that we consider new typically has been experimented with, tried and/or failed, some time within the last 15-20 years.

The cycle, at least in the United States, is a simple one: there is a scandal, our legislators react by reining in control over the system; they reduce the amount of discretion that the procurement officials are entitled to use; therefore, we have more legislation and more rules. Soon afterwards, the customers and the contractors become frustrated that the system is too difficult and expensive and so the system is freed up, it is loosened up and purchasing officials are given more discretion. Soon after that, the rate of scandals increases and the cycle repeats itself.

It is also important to keep in mind that, because there are so many different variables, changes in leadership, priorities, needs of the Government, the capacity of the marketplace and the markets themselves are all constantly contributing to change. This is one of the reasons why no matter how a model law is drafted, it will probably be out of date almost immediately if it goes in any direction past the broadest of principles with the most minimum standards. The other thing is, and this may be frustrating, that there is no easy answer, there is no optimal solution and there are many, many models, all of which are worth looking at.

And at a macro level, if I were giving advice to UNCITRAL Working Group I (Procurement), which I try not to do too often because I realize their job is very difficult, it seems to me that there are two massive holes that need to be filled. The first is that we need to broaden the definition of what procurement is. It seems to be at a minimum. Procurement should encompass what Governments buy. That should include goods, services and construction. One of the main divisions that we see around the world today is whether concessions should be included. Many countries take the position that if the Government is not spending money, it should not be considered procurement. However, this kind of fragmentation creates confusion and gives Governments incentives to opt out of the procurement system. So we need to include concessions, include build, own and transfer or build, own, operate and transfer, but in build-operate-transfer (BOT)-type vehicles.

The other massive hole is that we need to include defence. In the United States, defence procurement accounts for 60-65 per cent of all the procurement spending and is often the leader in procurement innovation. Many countries, particularly developing countries, exclude defence altogether, leading to a fragmented system.

The other key point that I would like to make is that in most countries around the world, I believe, and often in the Model Law as well, we make the mistake of assuming

that when a contract is awarded, the procurement has ended. I believe this is fundamentally flawed. In many countries, procurement describes the process up until the selection of the contractor and the award of the contract and, once the contract is awarded, the contract law of the State then takes over the relationship. This just does not make any sense. If we are going to have an outcome-driven regime, we need to include the post-award, the period after the award, the management of the contract, the relationship between the contractor and the Government, until the contract is completed, because post-award contract management and ultimately oversight of the process is critical to getting value for money.

If the organizers had given me two or three more hours to talk, I would have spoken today on how to determine, to figure out what we want out of our procurement process. I think fundamentally this is the most difficult thing for nations and for any group trying to get agreement with regard to a procurement law. If you do not know what you are trying to achieve, it is very difficult to come up with parameters or rules for achieving those ends. I can make a compelling case that a good procurement regime stands on a three-legged stool: it is a transparent regime; it has high standards of integrity and thus corruption is controlled; and it maximizes competition.

Most times experience will tell us that if you focus on those three elements, you will do reasonably well in the procurement system. If we were to step away and look at the most successful procurement regimes around the world today, however, I think we would find that they are driven by the pursuit of value for money or getting best value and customer satisfaction with a heavy dose of efficiency worked in as well.

Somewhere lower on a scale of importance one could find other important goals like uniformity. So, for example, if a system is uniform across goods, services, construction, defence and non-defence, it creates tremendous economies of scale for the private sector and makes it much easier to manage the system from the standpoint of the Government.

The issue of wealth distribution, which Robert will talk about later, is, I believe, tremendously important, because in many States, particularly developing States, what we see is that wealth distribution is the single most important element driving procurement reform, whereas in other States we look at wealth distribution as something that is antithetical to achieving the ends we are trying to achieve.

During the question-and-answer period, we can talk about how each of these elements plays off against each other, but I leave you with a simple fact on each of them. Whichever one of these goals or aims you seek to fulfil, it will be fulfilled at the expense of one, if not all, of the others. So there is a constant balancing act. If you fail to keep that in mind, it is impossible to achieve any of the goals.

So, very briefly, I just wanted to make a few points about the transition from a model law to practice, some of the harsh realities that are important to keep in mind no matter how the revised model law comes out. The first is that the drafting of the model law is an important exercise, but that is the easy part. Writing rules is easy compared with implementing them or putting them into practice. And what experience around the world shows us is that, no matter what your laws say, the most important issue is the acquisition workforce, the people who actually attempt to purchase for the Government. I believe the experience around the world is that nations underinvest. They do not spend enough money,

choosing, training, retaining, developing and incentivizing the acquisition workforce. So it is really not relevant what the law says because most nations are incapable of achieving the aspirations they pursue in their procurement regime.

The second point I wanted to make is that, because we are talking about government procurement, we often end up with the division between good governance and good procurement and they are not necessarily synonymous. I will just give you one quick anecdote here. If you were to take a group of procurement professionals and put them in a room, the odds are very high they would agree that value for money is the single most important aim, but if you bring together a group of government officials and ask them about procurement, they might agree that controlling corruption is the single greatest aim. These two can work together but they can also, at some level, be mutually exclusive, because one way to control corruption is to simply always go with the lowest priced technically acceptable outcome rather than giving flexibility to the purchasers to pay more for higher quality, and thus we often have a little bit of a divide.

The last point that I want to make in connection with moving from law to practice is that you do not need to walk before running. This is a complicated one, particularly for developing countries. Most consultants and experts around the world will attempt to tell countries that they need to do basic procurement before they move to the more advanced stages, particularly what we refer to as negotiated procurement, best value procurement or trade-off between cost and technical importance. The analogy that I would give you is, if you were going into a developing country today to set up a telephone system, I do not think that you would encourage them to create a landline system so that they could wait a generation to move to a mobile or wireless network. I think we have the technology today to go straight to mobile telephony. We have sufficiently developed systems that if we are going to talk about procurement, we have to give nations the flexibility to engage in the pursuit of best value, not focus exclusively on corruption control.

Again, Robert will speak about this a little bit later, but at the end of the day, no matter what we do in procurement, we have to understand that political leadership will be distracted by, and often driven by, the attempt to distribute wealth through the public procurement system. Many procurement officials may fantasize about a world in which procurement was driven by best value and had no wealth distribution elements to it; I do not believe we will see that in our lifetimes. And so we have to create the flexibility so that nations can do what they feel they need to in distributing wealth through procurement.

To the extent that change is important, I think that innovation is critical, but one important thing to remember about innovation is that, when you innovate, when you experiment, mistakes will be made. Most nations, I might say all nations, find it very difficult to protect their procurement officials when they experiment and fail. When someone tries an innovative technique and the result is suboptimal, that does not make it criminal, it is an experiment. Unless nations permit their personnel to experiment, however, they will never be able to get to the best value solutions.

The final point I would like to make here, and I admit this is a rather sad point, is that no matter what the law says, scandal will drive reform. I am not familiar with any nation around the world that prints procurement success stories in the media. The only thing

you read about in the newspaper is things that go wrong. Unless you are prepared to react and defend the system, what will happen is that mistakes are made, scandals arise and then reforms are rolled back as Governments become defensive. It is a very difficult way to do business.

I want to leave you with one brief thought: at the end of the day, any amount of law has to give nations sufficient flexibility to adapt or react to their own cultural differences. I could talk to you at great length about comparing the way we are driven by rules in the United States and the way that in other countries we might be driven more by principles. And, in fact, I can draw an analogy between our procurement systems or our accounting systems and the difference between American football, one of the most boring, labour-intensive and inefficient sports ever created on the planet, and the football played in the rest of the world, which, at the end of the day, has very little equipment, very few officials and is a free-flowing and entertaining game, driven by the spirit of fair play. Again, we can talk much more about that later, but the point I want to make is that culture will ultimately drive the way that people do business far more than the law.

I challenge all of you to be engaged in the process because I think it is a fascinating one, and if I have learned nothing else in my years in public procurement, I have learned that we understand our own systems best when we look at other systems and learn from their successes and failures.

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*Tore Wiwen-Nilsson, Chair*

I would just like to make two comments for the benefit of those who are not following the UNCITRAL work on procurement so closely. You referred to concessions and there is actually a legislative guide on concessions, the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*, that contains a wealth of information and also suggests that concessions should be part of the procurement scheme, with certain modifications. There are also some model legislative provisions prepared by UNCITRAL for those who want to adopt that system.

Secondly, also of interest, you referred to post-award aspects, which may be as important as the procurement procedures themselves. That is actually being or has been discussed in the ongoing work of UNCITRAL Working Group I (Procurement), which is discussing possible amendments to and updating of the Model Law. This is, of course, a very difficult thing to address because of the great variety of possibilities, as there are considerable differences when you buy a concession, a construction work or simply goods, but it is being discussed and those who are here from the Working Group have taken on board what Steven has just said.

So now we are moving on to Knut Leipold, a Senior Procurement Specialist at the World Bank, in particular in electronic government procurement. And I can tell you, having listened to him, that I know he really is an expert on this; it is hard for normal people to understand everything here, but he will certainly describe it in a simple fashion.

2. *Modern public procurement techniques: benefits, concerns and regulation (with emphasis on practical issues)*

*Knut Leipold*

*Senior Procurement Specialist, Procurement Policy and Services Group, World Bank*

*Introduction*

According to Forrester Research,<sup>316</sup> worldwide online trade was estimated at \$12.8 trillion in 2006. Following the explosive growth of e-commerce in the private sector, Governments all over the world have started to pay close attention to electronic government procurement (e-GP) as a tool to modernize and improve their public procurement systems.

The use of electronic means to enhance the management of the public procurement process is one of the central components of public sector reform programmes because of its potential development impact. Keeping in mind that Governments are the single largest purchaser in a national economy and that the public procurement systems in low- and middle-income countries are typically far away from spending money in a transparent and efficient way, the application of digital technology offers opportunities for improvements that the public sector cannot afford to ignore. Benefits of e-GP are in line with the objectives of internationally recognized public procurement systems: enhanced transparency and compliance, increased performance and quality, and economic development.

Realizing the full potential of these technological advances in the area of public procurement is a challenge in itself. To perceive these developments simply as technological issues is to misunderstand their reach and relevance for policy, training, infrastructure, design, production and delivery, as well as technical literacy and awareness. As established ways of doing business and managing government procurement have long traditions and significant change will often encounter professional and vested interests, the most important ingredient for change will be government leadership, vision and change in management capabilities.

This note draws on lessons learned from e-GP initiatives in low- and middle-income countries with the objectives: (a) to provide an overview of the development impact resulting from e-GP programme adoption; and (b) to emphasize the need to understand successful e-GP implementation and regulation as an integral part of the public procurement reform agenda.

*Development impact*

Breaking down the physical barriers of space and time, e-GP allows a more transparent and efficient information flow as well as improved access to information and services. Beneficiaries include not only Governments and suppliers but also the public at large in having access to transparent information on the public expenditure of taxpayers' money.

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<sup>316</sup>www.forrester.com.

E-GP facilitates higher-quality outcomes for public procurement through improved accessibility and interoperability, which enable:

- (a) Greater business access and competition for government expenditure (creating commercial benefits for business and price and quality gains for government);
- (b) Integration and automation of many workflow processes for transactions and other supply chain management activities improving efficiency and reducing processing costs;
- (c) Greater and easier access to real-time and historic information for management and audit (enabling higher-quality decision-making and planning as well as greater transparency and accountability).

The implementation of e-GP offers the opportunity to add value to the relationship between government buyers and private businesses. An effective e-GP programme can deliver a broad range of benefits to taxpayers, the economy and the community generally. Online technology provides the potential to significantly reform the accountabilities and performance of public procurement systems.

#### *Enhanced transparency and compliance*

At an early stage, e-GP can provide access to a whole range of public procurement information at low cost and independently of time and location. Governments achieve a high level of transparency if they use the Internet for the free disclosure and distribution of public procurement information. Such information typically includes the relevant legislation, policies and guidelines, procurement plans and notices, bidding documents, minutes of procurement activities and contract award results. In reducing the asymmetry of public procurement information, e-GP contributes to increasing the competition in terms of quantity (participation) and quality (openness and fairness).

The application of online technologies can ensure compliance with the existing procurement policy and legislation. An e-GP system can automate the required procurement procedures thus allowing neither purchasing agencies nor bidders to deviate from the public procurement process. In this way, e-GP helps Governments to reduce opportunities for corruptive practices.

While enhanced compliance contributes to avoiding corruption and fraud, the transparency of real-time procurement information allows the early detection of corruptive and fraudulent activities. In addition, e-GP contributes to reducing corruption and fraud by conducting the procurement process online and collecting all procurement data into a securely operated electronic system. Consequently, in-person contacts between purchasing agencies and bidders are no longer required, the risk of manipulating procurement information and documents can be minimized, and the availability and completeness of public procurement audit trails can be improved.

#### *Increased performance and quality*

The benefits of online technology for the efficiency and effectiveness of government operations reflect the impact of e-GP on the cost of transactions and value-for-money

outcomes. Typically, countries report efficiency gains of from 10 to 20 per cent of the total volume procured through electronic means resulting from the reduction of transaction costs and prices.

The potential impact of e-GP on the cost of transactions is linked to savings that not only are related to workflow but also include significant savings in time due to the automation of the procurement procedures for both sides, purchasers and bidders. The fact that bidders do not have to travel any more to submit a bid on paper not only prevents physical attacks on bidders on their way to submit the paper bid, but also saves them a lot of time. Transaction costs of the public procurement process drop considerably by using the less expensive Internet rather than print media as the public procurement information channel and reducing paperwork in general.

Price reductions can be achieved as a result of three intrinsic features of e-GP: price transparency, stimulation of competition, and innovative public procurement procedures. Price transparency by disclosing contract award results online has reportedly avoided the conclusion of overpriced public contracts and contributed to adjusting prices for goods, works or services in line with true market price levels. The online publication of procurement notices provides an effective tool to reach out to private businesses in the market, thus increasing the participation in public procurement. To that end, increased competition contributes to reducing the prices paid by the Government. Innovative approaches in the area of public procurement include the managed aggregation of demand and electronic reverse auctions, when lower prices can be attributed to aggregated purchases and to online negotiation, respectively.

In addition to the measurable outcomes, e-GP can be expected to provide significant but less quantifiable benefits through greatly improved management information and analysis. Currently, most large government organizations will have only limited insights into the wealth of public procurement information scattered around in multiple data formats and different archives and places. The application of digital technology for procurement information disclosure and transactions lays the foundation for the collection of those data, which provide the basis for performance measuring and monitoring. Besides the safekeeping of public procurement information and data, e-GP ensures a much higher quality of public procurement reporting and decision-making.

### *Economic development*

The level of transparency, compliance, performance and quality of public procurement due to the application of e-GP can achieve a dimension that not only provides for the development of a public procurement system that meets internationally recognized standards, but also establishes the basis for a sound market economy with significant gains in productivity and competitiveness.

The efficiency gains due to the application of e-GP can have a clear economic impact. The total public procurement volume of a national economy typically counts for 10 to 20 per cent of GDP. Procuring only 10 per cent of all public purchases through electronic means with a moderate 10 per cent in price and cost reductions would result in total annual savings equal to one per cent of GDP.

With government accounting for a substantial proportion of the economy, the speed of take-up of technology by the economy will be significantly influenced by the rate of government adoption. To that end, e-GP catalyses e-commerce and encourages the participation of small and medium enterprises, promotes the use of modern technology and the implementation of a national technological infrastructure, and supports the development of appropriate capacity and skills with the overall objective of economic growth and development.

### *Implementation challenges*

The complexities and risks of e-GP programme implementation are frequently misunderstood. Effective e-GP implies that changes occur across areas of personnel and executive behaviour, skills, regulations and legislation, operational policies and business behaviour. Few, if any, of these changes will occur simply through the acquisition of some hardware and software, and if this is the understanding and intended starting point of e-GP, then jurisdictions may find that the funds might better be spent on other priorities.

The full benefits resulting from adoption of e-GP will only be realized through significant changes in the organization of public procurement operations and as such will require effective change management and excellent leadership bringing about collective commitment across government constituents and partnership with the business community. In the absence of such change management and leadership, the outcome may be at a net cost with technologies operating alongside or simply replicating traditional operational methods.

Rather than being a technological add-on to an already complex environment, e-GP needs to be understood as a tool to reform public procurement underpinned by an appropriate policy and legal framework, effective buyer and supplier activation, including strong awareness-raising and capacity-building programmes, technological infrastructure development, established standards and sustainable operational e-GP applications.

Only if Governments understand the potential benefits of e-GP and demonstrate professional leadership and political will in managing the adoption of e-GP programmes as an integral part of reforming their public procurement systems, will they be able to tap the full potential of e-GP and move forward their development agenda on the basis of increased public procurement governance and performance standards.

### *Practical issues*

The following questions reflect some major issues that the e-GP working group of the multilateral development banks has been repeatedly faced with when assisting countries in introducing the use of electronic means in public procurement.

*Does electronic government procurement really improve governance and reduce corruption?*

There are multiple examples where the use of electronic means for public procurement has reduced opportunities for corruptive, fraudulent, collusive and even coercive practices.

Bad practices such as attacking bidders on their way to the bid submission, manipulating access to procurement notices, submitting overpriced bids, bypassing mandatory public procurement procedures, colluding with competitors or bribing public procurement officials can be prevented by using e-GP systems. However, e-GP is not a guarantor of improved governance and reduced corruption. Strong political will, leadership and management are required in order to design and implement appropriate e-GP systems that ensure a maximum of transparency and compliance. Interestingly, a recent study<sup>317</sup> on the introduction of e-GP in 14 countries showed that, in most cases, there was little penetration of procurement technologies back into management systems, thus missing the opportunity to support good monitoring of procurement performance and compliance, market trends, and planning future government procurement.

*Does electronic government procurement really save money?*

The same study found efficiency gains such as reduced costs and time among the key benefits of e-GP. While it is easy to understand the potential savings in costs and time for purchasing agencies and suppliers as a result of automated transactions and price reductions, it is not easy to quantify these gains in efficiency. Countries typically report savings of up to 20 per cent due to a combination of increased price transparency, use of e-reverse auction systems and reduced transaction costs, while other countries report savings of about 10 per cent due to increased competition and reduced transaction costs. Most countries reported these savings on the basis of estimates, since it is quite cumbersome to quantify the savings as a result of subtracting the cost of online public procurement from the cost of traditional paper-based public procurement.

*Does electronic government procurement eliminate procurement officials?*

The introduction of e-GP requires a sound implementation plan, which, among other things, needs to address the concern of a considerable number of public procurement agents who fear the loss of their jobs when public procurement is moved online. The e-GP implementation plan should include appropriate programmes, for example, awareness-raising, capacity-building, retraining or professional reorientation programmes, in order to resolve these fears.

*Are there security risks?*

Integrity, confidentiality, non-repudiation and authentication are critical attributes of public procurement systems. Technology is available to ensure security of e-GP systems, if applied appropriately, but attention needs to be paid in order not to create a situation of unfair competition by using certain technologies. Public key infrastructure, for example, is a technology that provides a high level of security through encryption and digital signatures. Authentication on the basis of digital certificates, however, requires interested suppliers to go and get the digital certificate, which can put them at a competitive disadvantage in relation to

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<sup>317</sup>MDB e-GP Survey (see [www.mdbegp.org/www/eGPIInteractiveus/tabid/69/language/en-US/Default.aspx](http://www.mdbegp.org/www/eGPIInteractiveus/tabid/69/language/en-US/Default.aspx)).

other suppliers. There is no higher security risk if the authentication during the bidding process is based on an electronic signature without certificate and verified as part of the due diligence during the post-qualification procedure.

*What if my suppliers are not connected to the Internet?*

Since non-discrimination is one of the basic public procurement principles, e-GP can only be adopted if the infrastructure allows suppliers to participate in public procurement. All countries are aware that it does not provide any benefit if an e-GP system is designed and implemented without addressing infrastructure constraints. Some countries have decided not to make the use of an e-GP system mandatory but leave it up to the bidders to opt for the electronic or the traditional paper-based approach. Interestingly, this approach does not help to build confidence among bidders in an e-GP system. In other countries, legislation mandates the use of electronic means for public procurement. While this does not raise major issues in countries with good infrastructure, it may risk excluding suppliers from competition in countries with infrastructure constraints. Typically, these countries address the connectivity or accessibility issues by providing Internet access points for potential suppliers. There is also evidence that the announcement and introduction of e-GP in a country activates the majority of suppliers to get ready and connected for web-based government business.

*Is new legislation required?*

The use of electronic means in the area of public procurement needs to be supported by appropriate legislation as the basis of the legal validity of electronic procurement procedures and documents. While many countries support the use of electronic documents and signatures in their cyberlaws, an increasing number of countries modify their public procurement legislation to include electronic procurement. Some public procurement laws provide a short paragraph on the use of electronic means in public procurement and refer to related policies and procedures as part of the secondary legislation, whereas other public procurement laws support electronic procurement in a more comprehensive and prescriptive way. Europe's public procurement directives and the current revision of the UNCITRAL Model Law on Procurement are both good examples of how to address the use of electronic means in public procurement legislation.

*Is electronic government procurement expensive?*

The identification of the cost of e-GP in the 14 countries participating in the e-GP survey by the multilateral development banks proved to be difficult since cost records were not or were only partly available with sufficient levels of detail and were considered to be commercially sensitive. In addition, it is a challenge to quantify the initial cost beyond the design, implementation and operation of an e-GP system, that is, the cost of setting up an appropriate policy, legal and institutional framework as part of the e-GP programme implementation. Investing in the required infrastructure can increase the cost considerably even though the infrastructure could be shared with other applications. According to the e-GP survey by the multilateral development banks, the cost of

developing and implementing an e-GP system (e-tendering and e-purchasing) ranges from \$1.07 million for a small system with less than 10,000 suppliers to \$39.96 million for a large system with more than 50,000 suppliers. The annual operation costs amount to \$0.37 million and \$5.5 million, respectively.

*Who pays for the electronic government procurement system?*

Governments select different business models in order to cover the cost of an e-GP system. In some countries, the initial investment and recurrent operation costs are financed from the government budget, while in others revenues are generated from system users to cover the cost of operating an e-GP system. Some business models include a public-private partnership approach, that is, a private firm providing e-GP application services. The outsourcing of fee-based e-GP systems can only be successful if they are part of a sustainable business model that offers a win-win situation for both the Government and the operator of the e-GP system. In addition, user fees need to be kept at a reasonable level in order not to run the risk of discouraging interested suppliers.

More information on the opportunities and challenges of e-GP can be found on the website (see footnote 317 above), which was developed under the leadership of the heads of procurement harmonization initiative of the multilateral development banks. The website provides guidance and tools for the design and implementation of e-GP programmes based on international experience.

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*Tore Wiwen-Nilsson, Chair*

This is a very complex area and it is good to know that, in the ongoing updating of the UNCITRAL Model Law on Procurement, e-GP is one of the most important topics. One of the difficulties is first to understand, not in broad terms but in very specific terms, how these things work in practice. I want to refer to the objectives of procurement, which, I believe, are constant, as I think you will remember. You have to check the solution against the objectives so you do not lose any of them when implementing a procurement scheme, and it is interesting to see that some countries, such as Brazil, are very advanced in applying e-GP, so there is a lot of experience to draw on.

Now we have our final speaker, Robert Hunja, who is now the Interim Director-General of the Public Procurement Oversight Authority of Kenya. Before that he was a procurement manager at the World Bank for 10 years and he was also, which makes him extremely suitable for our session, an officer in the UNCITRAL secretariat.

*3. Achieving socio-economic goals through public procurement: what is at stake?*

*Robert Hunja*

*Interim Director-General, Public Procurement Oversight Authority, Kenya*

I should plead guilty to some of the work UNCITRAL has done in procurement because I was slightly involved in the past. I am pleased to see what has since been done

and that we are still progressing. I will discuss a couple of things that I understand are still on the agenda of UNCITRAL.

I start by a couple of assumptions that are inherent in the issue that we are discussing.

The first assumption is that public procurement-related trade is important and I think that is obviously not controversial. If it were not the case, UNCITRAL would not have taken this as a subject and devoted the resources it has in dealing with the matter. I want to give you an example of one area of procurement that not many of us think about: procurement for United Nations-related activities. Here we are not even talking about procurement between countries, but about procurement related to what the United Nations organizations are purchasing every year. The total economic activity around United Nations-related procurement (i.e. not only the value or the volume of purchases) is estimated at around \$30 billion and the work leading to this sum has been fairly empirical research, so we are talking about a significant amount of money here.

The second assumption is that achieving socio-economic goals through procurement is legitimate. Now this is an assumption that is sometimes controversial and there are people who think that it is not the business of the procurement function to achieve goals other than the narrow focus on monetary value. I think that is a debate that has ended. I think it is now accepted that value, as far as procurement is concerned, goes beyond monetary value and includes other benefits that society can get by utilizing procurement.

Now, by bringing up the subject at this Congress, the early assumption that has been made is that these issues may affect global commerce. We are going to look at this to see how this effect arises.

I would like to do two things. One is to look at two areas that are fairly present in the minds of many procurement professionals all over the world and see how they could both provide opportunities and create risks in terms of how public procurement and especially its relationship to global commerce is progressing. I decided to pick three areas: firstly, the question of sustainable procurement; and secondly, the issue of preferences in favour of so-called disadvantaged groups. (In those two, I'll describe the risks that I see.) Thirdly is the question of corruption, which Professor Schooner has mentioned in relationship to procurement, and especially the issue of corruption and the democratic deficit.

The question I am going to discuss in these three elements, fairly quickly, is: do they affect global commerce in any way and can something be done? Let us move to the whole issue of sustainable procurement. Over the past couple of years it has come to the attention of many public policy officials, especially procurement policy officials, that the scope of the question has moved quite a bit beyond what is called "buying green" towards other social and economic benefits. For example, in Maryland, where I lived, one of the interesting discussions was that the state government should not buy from companies that did not pay a living wage: in many instances the living wage was much higher than the minimum wage. The question was on what basis could the State impose those kinds of limitations. There has been discussion—I think it was yesterday on corporate governance—about not doing business with companies that are not good corporate citizens, by which

we mean they are paying their taxes, they are treating their workers right and so on. This is an attempt to push private entities, if they are going to do business with the public sector, to achieve certain goals rather than just be able to provide best monetary value to the public purse.

This is a subject that is evolving. Many countries and many organizations are actually now beginning to put in place a sustainable procurement approach. The United States, for example, has a very well thought through sustainable procurement approach. Many countries are beginning to put in place rules and processes to ensure that environmental and social work criteria are built into the procurement process.

What you find—at least, I think we run some risks—is that there is a whole patchwork of national legislation that is beginning to define how you apply sustainable procurement criteria in purchasing. One of the risks arising, when I look at what it is happening in many countries, is that they can greatly reduce the benefit that is brought as a result of procurement regimes opening up, because they do not have a common, harmonized approach.

Many different people have many different angles on this issue. Some of the benefits that have been brought about for example by the adoption of the UNCITRAL Model Law on Procurement are greatly at risk by really reducing competition and restricting openness by applying (in an overly exhaustive manner) criteria based on social or environmental benefits. The question is: where is the balance? I think that is really what has to be discussed and not to say this cannot be done. I think that debate is closed. The question is what is the proper balance so that you can be able to achieve this goal and I think Professor Schooner put it to you well. I think most of the goals are fulfilled at the expense of balance. The question is: where is the balance? That is one issue that is at stake.

The second very complicated question is the whole issue of preferences in favour of disadvantaged groups, because the groups that are targeted in these efforts are very different in various countries. In South Africa, for example, it is actually built into the South African Constitution that one goal of public procurement is to assist disadvantaged groups. It is a constitutional principle, that is the furthest as far as I am concerned that a State has gone, but you find that in many other countries there are attempts to put in systems that make sure that women's groups, youth groups and others have better access to public procurement, which means that what we are trying to do is not necessarily to achieve the best monetary value, but to try and bring some social benefits—very important for many of us from developing countries, especially the whole question of equity. What we are finding is that, we can have, let us say, women's groups accessing contracts in the rural areas, that is probably one of the best ways of fighting poverty, especially rural poverty, because the Government has agreed to spend in rural areas. If you increase the ability of women to earn income, you are probably getting the children into school, you are probably helping families gain stability and this therefore becomes a very important social benefit. Now again the question is: where is the risk?

What you find is the political temptation and Professor Schooner has talked about this. The political temptation especially among politicians is then to begin to talk about protectionism—you know the old policies that were there in the 1960s and 1970s—and about closing markets to foreign competitors.

I can give you the example of my own country, Kenya, because that is where I am working now. When we were trying to get our parliament to legislate and pass a new public procurement and disposal act, one of the very fascinating things that happened in parliament was that parliamentarians were really only interested in ensuring that the clauses on preferences were passed. And we realized quite early on that this was a bargain we were going to have to make, because if you try to consider all the risks and why a risk may be wrong, the chances are that you will not get the legislation passed. It was quite clear that, once the clauses on preferences were in the legislation, the parliamentarians really did not care too much about some of the other things. They managed to pass some very interesting clauses, for example on conflicts of interest, that bar politicians from doing business with public entities. They were quite ignorant of that fact, because what they were interested in was preferences. The point I am making is that because of that political temptation towards protectionism, you find that there is a great risk of eroding the benefits that have risen from opening up procurement markets.

The question again is: where is the correct balance? That is the issue we should be debating: where is the balance between accepting that there will be a move towards assisting disadvantaged groups, and there is in fact benefit from doing so, and avoiding great risk.

The third element is something that we have not talked about so much in the context of UNCITRAL work since we are talking about non-public procurement and private sector-related trade. There are a lot of preference schemes that exist for goods coming from developing countries into the more developed economies. One of the things that I think has never been discussed even in the context of the work of WTO is whether some of those preferences could be extended to public procurement from developing countries. I think this is one of those issues which probably have a place here. If we are talking about trade, this is one of the issues that I think should also be put on the table. Again there is also inherently a risk, and again the question of balance is, what is important?

Finally, the third topic I want to discuss very briefly is the whole question of fighting corruption and beginning to reduce the democratic deficit. This is a great opportunity, especially for UNCITRAL and its work in promoting good procurement systems. It is quite clear, I think Professor Schooner said, that corruption in public procurement is not only a thing existing in many countries, but one that is very visible especially in developing countries. In my country, Kenya, we have found that we are a country with great potential to do very many good things and some of them we are trying now, but we are affected by this great animal called “corruption”, and especially corruption in public procurement, and now we are focused on doing something about it. What is clear is that a country should move very fast; it would have to be very far ahead in terms of achieving economic development when addressing this problem. The problem is that public procurement corruption corrodes public confidence in government; the public no longer believes that this is a Government that can manage the country’s resources well and frankly what it does is to weaken States. We all know that weak States are not trading States; a weak State cannot engage in global commerce the way it should and therefore promoting better procurement systems is not only good because you get value for money and efficiency and all those things we have talked about, but also a great socio-economic benefit by promoting better democracy, reducing the democratic deficit and making States stronger. Stronger States are trading nations and thus benefit greatly from global commerce.

Therefore, I feel very strongly that we should promote good procurement regimes not only because of their inherent value and efficiencies, but also because ultimately we have stronger nations and stronger nations are trading nations, and if we are talking about commerce, this is extremely important.

What can be done? I think that there are couple of things that UNCITRAL could do in the context of the review of the Model Law on Procurement, especially with regard to issues of sustainable procurement, issues of how to support regimes that promote disadvantaged groups. I think that the whole question is: where is the right balance? UNCITRAL will really help us, who are struggling with these issues, by coming up with some models or standard clauses that represent what is thought by the international community to be the best balance. It would help us when we are talking to legislators and our policymakers to prove that this is what the international community thinks is the best way of handling this issue. That has great value, especially for those of us who are trying to introduce reform in very difficult political environments.

I would emphasize especially two areas: sustainable procurement and the question of preferences. Should we go beyond just saying that we come up with some really good model clauses that take care of the issue of optimal balance and beyond sharing the best practice in this area? We should aim to show what bad practice is, what the risks are that you run. I think this would also help us very much in addressing the risk that is run by being overly enthusiastic about these two fairly important policy goals. The second one would be significant capacity-building efforts, and here I mean not only trading in procurement, but also to begin to think how UNCITRAL could increase its efforts to assist countries to develop good procurement regimes.

Assistance to countries in terms of developing their procurement regimes has been taken seriously by the World Bank, which has moved very aggressively into this area because it was seen as an area of great business opportunity.

I think UNCITRAL is the father and the mother of all this work. In Kenya, I do not see UNCITRAL coming and telling us: how can we help you? This is what we should be doing. I really urge the Commission to think very hard about getting back into the technical assistance business because frankly we in UNCITRAL started it and I think we should not shy away from helping countries; I think we should be aggressive, we should be very tough in making the case why this is important, from trade and other perspectives.

Finally, in all these areas what we need to remember is: “do no harm”. I think most policymakers approach this area with the intention to do good, but there are great risks if you are overly enthusiastic: if you are not very clear about what goal you want to achieve, you can undermine the central core purpose of what a procurement regime is supposed to achieve and so I think we should all approach this on the principle of “do no harm”.

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*Tore Wiwen-Nilsson, Chair*

What you say and what you demand of UNCITRAL is certainly a challenge. In the present work of Working Group I, we have looked a lot at e-procurement. The difficulty

there is to move procurement into the digital world, so we are devoting a lot of effort to this. What you are talking about, Robert, and what you ask UNCITRAL to do, I would say, the Working Group has not really been able to solve. You are talking about something that is vague and, to some extent, subjective, and that makes it much harder to deal with in the context of legislation. And I must say we may have to reconsider this after listening to you. That is not for me to say, but it is very interesting to hear the issues you have raised and we have really failed in the discussions on that topic. So we will leave it for those of the Working Group who are here to consider this again.

We are running so short of time that I will allow first very brief comments by the speakers on what other speakers have said, then we will open the floor for interventions, comments and statements. Let me first ask the speakers, then, is there anything you would like to say briefly?

#### 4. *Comments, evaluation and discussion*

*Steven L. Schooner*

*George Washington University School of Law, United States of America*

I just wanted to start with a point that Knut made. Firstly, when we talk about electronic procurement, I think what experience shows is that most of the gains are with regard to commodities and empirically the commodities tend to be less than a quarter of what we think of as public procurement. So a lot of times the benefits get lost.

Secondly, I think that one thing that Knut's presentation makes very clear is how important it is down the road to include post-award contract management because e-procurement ignores the reality that after you have struck an electronic agreement, you need to actually get that value for money and the e-procurement regime has no answer to that problem. So again, cradle-to-grave.

The thing I really like about e-procurement, however, is that it gives me an opportunity to go back and show in reasonably graphic terms what some of the trade-offs are with an approach you might take in public procurement. For example, Knut makes an excellent case that e-procurement increases transparency and this is tremendously important for any Government. E-procurement is a wonderful way to achieve uniformity and, with that, e-procurement gives great operating efficiency as well. It does help with corruption control and it may enhance competition, but, conversely, it is almost impossible for e-procurement to help you achieve best value in trading off quality and price. It is good for getting the lowest price, it is never going to get you the best quality. Similarly, it is almost impossible for e-procurement to get you true customer satisfaction, because most customers are incapable of articulating the nuances of what they want other than price. Then, finally, this goes back to the post-award management issue, the risk avoidance issues are totally unaddressed by e-procurement.

Very briefly, I want to turn to Robert's point for just a second because the point that he makes is so important and he did a beautiful job doing this. I think it is intriguing that we may start with a premise for the UNCITRAL Model Law on Procurement that States are entitled to use public procurement to distribute wealth, while at the same time acknowledging that

wealth distribution policies are antithetical to maximizing free trade. As long as we keep that in mind and we understand that we are making a trade-off, that is fine, but I often hear people talk about this and fail to bring together these two key points. I think ultimately you cannot have it both ways, but the single most significant social policy that most Governments will attempt to effectuate through their public procurement regime is domestic preferences.

*Michael E. Schneider*  
*Lalive Avocats, Switzerland*

The aspect that I found missing in the discussion is control and verification, procedures, persons and institutions, because you are talking about all the regulations you are imposing on the persons, individuals and organizations awarding and implementing contracts. What I see in practice is the stifling that many of these regulations, especially in the anti-corruption decisions, impose on those handling the contracts. You get a shying away wherever you have decisions that imply judgement. You have a stifling of the decisions by incompetent people overlooking the procurement decisions. You have some auditors. I have sat as an arbitrator overlooking award decisions. You have a stifling at the level of contract drafting, what kind of provisions you write in the contract at the time of awarding the contract and at the time of settlement of disputes. Nobody has the guts to make reasonable decisions because there is some auditor sitting behind him and checking according to criteria that are removed from the actual contract implementation. So I think that, if you regulate, you have to look at who is implementing the regulations and how you avoid economically and business-wise wrong decisions or restricted decisions by over-regulating.

*Don Wallace, Jr.*  
*Chairman, International Law Institute, United States of America*

I have some observations, and then a question. With respect, I do not believe that the analogy with the contrast between soccer and American football is a sound one. Indeed there are differences in soccer itself. You say it is free-flowing. It depends. The Brazilian is more free-flowing than the German or the British.

Secondly, with respect to defence procurement, we dealt with it interestingly enough in the first model procurement law and as the United States delegate I consulted with the then General Counsel of the Department of Defense, Walter Carrington, later our Ambassador to Nigeria, and he said you can go for it, which was startling. Now if you look at the UNCITRAL Model Law on Procurement that we drafted, it allows this, but in a way that is quite circumlocutious. But we deliberately thought about it; one delegation said that we could never deal with national security, but the Model Law said you can if you wish.

Thirdly, contract administration, post-award. I agree with you totally. We should deal with it. The world of the actual administration is in effect defined by the International Federation of Consulting Engineers (FIDIC) red book, by taking each of its provisions and thinking out how you would give guidance to Governments on how to apply those provisions.

The socio-economic issue, the one that Robert Hunja talked about, is on our current agenda. I understand the issue was proposed initially by the then Chief Counsel for

Procurement of the World Bank, Françoise Bentchikou, who would like to narrow those possibilities, in other words fewer trade-offs, less discretion, and we will presumably be dealing with these issues.

My next observation concerns the question of lists. I think lists are very problematic. We are going to be dealing with them, with registration, certification and so on. Their operation can be very protectionist. One point: the Model Law in this respect did not distinguish between big ticket items, on the one hand, and commodities and bulk items on the other. Of course, we were thinking of the big tickets when we proscribed, anathematized, if that is the word, lists. We do not even mention them. And I think we have to be very careful, as, again, Françoise Bentchikou said.

Now my question. It is about the implementation of reform. Michael Schneider really touches on this when he says if you over-implement you crush the spirit, but I want to raise the question of meta-implementation, if I can use the expression. I have a colleague who once spoke of the implementation of reform in the Soviet Union when it became Russia, not in the field of procurement as such but in everything. How could you get the existing bureaucrats, the ministers, to change? You had to make it worth their while. And in Russia, you did it by special privatization. Ministers suddenly became entrepreneurs and became even richer. How do you really effect real reform in countries with which all of you and Robert and others are familiar? How do you get the Government—I do not have a particular Government in mind—the ministers, the deputy ministers, the provincial governors, the deputy governors, the mayors of the municipalities, many of whom benefit quite frankly enormously from corrupt procurement, how do you, realistically speaking, get them to change? That is my question.

*Yuejiao Zhang*  
*Shantou University, China*

We all know that procurement is increasingly important for achieving economy and efficiency as well as in providing more business opportunities. So what we are talking about today is quite relevant to commerce, but the problem is that the procurement procedure is burdensome and the costs of preparing a bidding document are increasingly more expensive and also the cost of corruption. After this short remark, I have four questions.

Firstly, the scope or definition of “public”. Does it refer to the Government—central government—local government and state-owned companies? What is the scope of goods, services and constructions? Scope is also very important.

The second question is how to evaluate the qualification of tenderers and how to set up objective, transparent and fair criteria to evaluate the bids.

Thirdly, how to deal with various political and social issues such as business restrictions provisions, tie-in policies, international procurement or bidding or local bidding, and also social and political requirements?

And the last question concerns the coordination of the many international organizations that work on government procurement. As we know, WTO has an Agreement on Government Procurement. It is not mandatory in the WTO package, but more countries will join.

Secondly, the OECD Development Assistance Committee is monitoring the harmonization of procurement procedures of all multilateral development financial institutions. And the most important element is the UNCITRAL procurement review.

To avoid overlap among the agencies and to reduce bureaucracy, how can we coordinate the different organizations' work on procurement and how can we adapt to new situations such as e-procurement?

*Arie Reich*

*Vice-Dean, Bar Ilan University, Israel*

I have two questions for Professor Schooner.

First of all, I notice that your list of objectives is presently missing the objective of equality, which is coming in many countries from the area of administrative law. So if I take your objectives, they would seem to fit in equally if we took a private body that is procuring. But once you have a Government, the Government under administrative law is expected to treat its citizens even-handedly, equally, even if sometimes this does not result in the best value for money. And I find that that is the main problem in our system, the main competing value with the values of efficiency and best value and so on. So I was wondering if you would comment on that.

The other question is how you see the relationship between the work of UNCITRAL in this area of public procurement and that of WTO. Nobody has mentioned today the Agreement on Government Procurement, the existing and revised text, and I am wondering whether you think that maybe the efforts of WTO and incentives and pressures in this area would eventually help to push more developing States to abide by procurement regimes.

*Tore Wiwen-Nilsson, Chair*

I am not going to try to answer any of the other questions, but maybe I can give you some brief response to the question about how to coordinate the work of different international organizations in this field.

The work of UNCITRAL is helped, if I may put it like this, first by notes from the secretariat providing information on what is going on in other organizations; there is very valuable information, presented to the Working Group, also by experts, and there are representatives of organizations present at some of the meetings to tell what the views of those organizations are, WTO and so forth. Whether that is enough, that is a different story, but there is an input, a fairly substantial input.

Then we had a number of other questions and if I may try to group them, there was one about implementation control and verification, which I think is one question actually and I will leave that to my speakers.

*Knut Leipold*

*Senior Procurement Specialist, Procurement Policy and Services Group, World Bank*

Let me briefly comment on the implementation issue and Don's question on how to make Governments change. We have also been faced with this issue in the context

of electronic government procurement adoption. As I mentioned, it is not only about this technological part, it is all about change management and, to be frank, from my experience, I can only say where there is a will, there is a way. In other words, if there is no will, there is no way. I have experienced this not only since having been at the World Bank for more than six years now, but also when I was in the private sector. After an initial temporary assignment at the World Bank, I went back to the private sector and I was responsible for business development in several countries in the public sector. So I went to one country director and I talked to him and I said, well, we have got a good relationship with the World Bank. There is a lot of e-government, including e-government procurement programmes, why do we not together build a partnership and we can do some marketing for our company in the country, talk to the ministries and take part in World Bank-funded operations and so on and so forth. And I told him that all this helps in order to address the issue of corruption to ensure more transparency and things like that. So the country director looked at me and he smiled and I did not understand at first because I was very much on the track of e-government, including procurement and the potential to increase transparency and corruption. He kept on smiling. And he said: "Do you really believe that the Government in this country wants to be transparent and wants to fight corruption? You are on the wrong track." So I had to learn at that time that it is not always easy to walk into a country and to think, well, yes, we have a good tool here in order to address these issues, let us just implement them. It is really a challenge.

Again, I want to repeat where there is a will, there is a way, and it takes a lot of time, specifically in this preparatory work, to convince Governments to talk about the objectives of a good public procurement system not only for the Government itself, but for the whole society. That is really a challenge that must not be underestimated.

Another question, from China, had to do with coordination among international organizations in the area of public procurement. I agree absolutely. It is very important to look into this issue. A lot of initiatives are going on. We, ourselves, in the area of procurement, we are part of the heads of procurement initiative, which tries to harmonize the approach to public procurement, and I think our contribution in this area is, rather than having several multilateral development banks walking into a country and telling them their own view of public procurement, which might be different in some cases, to harmonize first and then go into these countries and speak the same language.

From my perspective in the area of electronic government procurement, all I can say is that we have a harmonized working group in this area, so, in other words, whenever we walk into an Asian country, together with the Asian Development Bank, we are talking the same language there. We are also in contact with other international organizations and we are also happy to see UNCITRAL on board in order simply to avoid there being different opinions and no communication. It is very important also to communicate on that level and to convey the message into the countries in a harmonized way.

Now, I already mentioned because you were asking specifically how to adopt these new issues, new public procurement techniques, including e-procurement, again, I wanted to point out and I always will point it out again and again, e-procurement primarily is not about the "e", it is still about procurement. The "e" is just a tool to improve public procurement. Let me formulate it in another way: if you have bad public procurement

procedures and you automate those procedures, you will end up with even worse public procurement. So, first of all, it is the procedures that need to be addressed and then the “e” is a good tool to automate them. But, again, the political will needs to be there.

*Steven L. Schooner*

*George Washington University School of Law, United States of America*

I think I want to start with Professor Reich. The question as I heard it was, in this particular rubric that I have put up, why do we not see the word “equality”.

In terms of equality, one thing that has happened over time is that the term “integrity” has been used to mean a number of different things and corruption control is the term of old, which is frequently used, for example, by OECD. Ultimately, however, in terms of level playing field, access to the markets and the like, generally that is the portion that I am trying to get to with integrity, fairness. Equality can mean a number of different things, but from one standpoint it means everyone being treated fairly rather than everyone being treated equally. This is an important aspect of the system, but I would group it under integrity.

The second question that I heard was in terms of harmonization and I think you posed the issue of UNCITRAL versus WTO. China, I think, posed the same question a little bit differently. It seems to me that harmonization would be wonderful, but I think we are quite far away from it and I think it is rather optimistic to think that we might see it in our lifetime. I think that one of the reasons that this is particularly important and critical is because the aims are so different. For example, if we look at WTO and the Agreement on Government Procurement, it seems that the vehicle serves to create minimum procurement standards as a price of admission to greater market access among the club members. And that is really the selling point. It would be nice to say that that is an optimal procurement system, but the actual vehicle is, if you play by these rules, you get greater market access. That is what WTO is selling. It seems to me that the UNCITRAL Model Law initiative has a broader aim, to achieve something such as optimal minimal standards or at least optimal procurement systems, but I think that we are very far away from actually getting those harmonized.

I want to go back to Michael Schneider’s point about the stifling. If I could just go back for a second, I think that the point you make here is the reason why the change is constant because at the end of the day, no matter what we see with the procurement system, the cycle is almost always the same, that is, we attempt to inject greater flexibility into the system so that procurement officials have the discretion to make good business decisions. As flexibility and discretion expand, mistakes increase and often corruption tends to occur and then what happens is, the media react, the political officials take away the discretion and the flexibility, stifle the system with rules, the system then becomes inefficient again. We then get a backlash. So we see the cycle over and over again.

At the end of the day, though, I think the answer to your question is a simple one: procurement requires business acumen, flexibility and the exercise of discretion by business managers. When the rules take away that discretion, you have a failure of government not a failure of procurement, and that is why I think your question is such a good one.

Finally, wrapping up on Don’s question, it seems to me that the issue of investment in the workforce is really the key issue with regard to implementation and I am familiar with

no country on this planet that has properly invested in the implementation of the procurement system through appropriate support of the acquisition workforce. Maybe the most dramatic example in the last 20 years has been the United States' evisceration of its procurement or acquisition workforce. It is very easy to reduce the acquisition workforce or not put enough money into it because people do not make the economic calculation to figure out that more money for more training and more people who are qualified to make good business decisions get you value for money. At the end of the day, the argument that needs to be made here is not a legal argument but an economic one. So someone like Simon Evenett in Oxford or Bernard Becq at the World Bank can show you the value of investing in a good procurement regime to get you good results, which is really how you make the argument for investing in implementation.

The last point I wanted to make concerned Professor Zhang's question. One of the questions that I heard you ask was how you evaluate the quality of tenders and how to make that more objective. I would like to say that you should not make it more objective. You should do exactly the opposite, because the best value outcomes are given when the procurement professionals are empowered to trade off whether you should spend more money for higher quality or save money by buying something with minimum standards. And you have to customize the valuation factors in each procurement. You have to have maximum flexibility to marry up the valuation factors with the ultimate outcome you want for the procurement.

*Tore Wiwen-Nilsson, Chair*

I did not want to say anything, but I cannot resist. I think that this is a matter of flexibility at different levels when it comes to the procurement procedures themselves. I think certainly there has to be an objective standard if at all possible.

*Robert Hunja*

*Interim Director-General, Public Procurement Oversight Authority, Kenya*

I will be very quick, as most of the questions have actually been dealt with. I just want to deal with an issue I have been struggling with at home in Kenya, which relates to the question by Mr. Schneider and Professor Wallace, that is, the question of the whole emphasis on control in the process of auditors and other people. What are the drivers of reform? And I just want to add one thing to what my colleagues have already mentioned, something we are working very hard on, which is to create alliances with people outside the procurement function. You see, we procurement people have always been very good at talking to each other. I think what we have to do is talk to the auditors so the auditors understand when discretion is exercised and what that means, so that we do not fear audit queries because we can explain them.

In relation to the last question, for example, how do you convince the politicians? In the procurement system in Kenya that existed for a long time, the politicians used procurement to finance politics and to create their relationships. What we did was, we said, we as procurement people can make the procurement argument and could even probably bring in economists, but until the people and the non-governmental organizations and the women's groups request changes in procurement practice, only then will the politicians begin to say, well, maybe this is something important because it is not just a technical

subject, it is a subject that is being pushed by other people and, therefore, we are working very hard and spending a lot of time in creating alliances. So I just wanted to say that is probably a solution to some of the issues.

Finally, on the question of equality, I think this is extremely important, but I think Professor Schooner has really answered it well, which is what I think most people are really looking for. It is not so much to be treated equally but to be treated fairly. As long as there is some evidence that the treatment is fair and there is some transparency as to what that fairness is, I think people all need that.

## **B. Long-term government contracts and private investment**

*Chair: Gerold Herrmann  
Secretary of UNCITRAL, 1991-2001*

It was particularly wise on the part of the organizers of this Congress not to put me on any panel dealing with arbitration, despite the fact that I am President of the International Council for Commercial Arbitration. They might have been afraid that I would use up most of the time myself. So they put me on a topic about which I do not have the faintest idea, but they balanced it fortunately by the fact that they gave me and you three superb experts and that is why I will immediately shut up and let them speak. The first speaker works for an organization that has tremendous experience in the kind of contracts that we are talking about here; and he has not only witnessed but also shaped that experience and he will convey it to you. He is Senior Counsel at the European Bank for Reconstruction and Development (EBRD), Alexei Zverev. He is willing to share that experience with you, and I immediately ask him to do so and to open the treasure trove of expertise of EBRD.

### *1. Key issues on creating a legal framework for infrastructure concessions*

*Alexei Zverev  
Senior Counsel, European Bank for Reconstruction and Development*

This paper is based on the results of various evaluations that EBRD has conducted in the past few years, complements the slide presentation by the author at the Congress and addresses the following points:

- (a) Core elements of an effective public-private partnership (PPP) framework;
- (b) To what extent the legal and policy environment facilitates PPPs in some European emerging markets: EBRD evaluations and surveys;
- (c) Legislative trends in EBRD countries of operation and challenges they face.

Further information is available from [www.ebrd.com/law/concess](http://www.ebrd.com/law/concess).

*Foreword*

Among the numerous ways in which the private sector may invest in public infrastructure, arguably the most interesting and sophisticated arrangements lie in the area somewhere between procurement and privatization. Such options are generally considered to be more effective than those at the extremes of the spectrum.

For over a decade the volume and number of PPPs has increased significantly worldwide. When regulated effectively, PPPs allow for flexible risk-sharing between the public and private sectors, with the aim of carrying out infrastructure projects or providing services for the public in areas including transport, waste management, water distribution and public health and safety.

The EBRD Legal Transition Programme focuses on a particular category of PPPs—concession-type and build-operate-transfer (BOT)/design-build-finance-operate (DBFO)-type arrangements—and does not address privatization or procurement contracts. The selected category is regarded as the most complex since it involves more sophisticated legal and financial arrangements as well as risk-sharing. The legal environment for concessions is vital to the implementation of many types of PPP. For a number of years, EBRD has been evaluating both the quality of national concessions laws and their workability throughout its countries of operation. Recent evaluations were devoted to concessions legislation and practices.

*Results of the European Bank for Reconstruction and Development 2005 concessions laws assessment*

In 2004/05, EBRD undertook an assessment of concessions laws (the 2005 Assessment) in transition countries. This involved a detailed analysis of concessions laws in selected core areas: (a) the general policy framework; (b) the general legal concessions framework; (c) definitions and scope of the concessions law; (d) selection of the concessionaire (the entity to which a concession has been awarded); (e) the project agreement; (f) availability of security instruments and state support; and (g) settlement of disputes and applicable law.

The core areas and the questionnaire used in the 2005 Assessment were based on international standards developed in the concessions field by UNCITRAL and other organizations and on the experience of EBRD in implementing PPP projects. It is against such internationally accepted standards that the laws were assessed.

In the course of developing the rating methodology it was thought appropriate to develop a separate list of questions for countries where rules governing concessions are contained in various contract laws and/or sector-specific legislation. Rules in these countries were benchmarked against internationally accepted principles only. Using the answers provided by lawyers in the transition countries, the relevant laws were assigned a rating of their compliance with internationally accepted standards (or principles, as applicable), ranging from very high to very low. As illustrated in the table below, only one country, Lithuania, achieved a “very high” rating. Three countries were rated “very low”, while the majority achieved the “medium” category. This illustrates the need for reform of concessions legislation in virtually every transition country.

### Compliance/conformity with international concessions standards and principles

<i>Very high compliance/ fully conforms</i>	<i>High compliance/ largely conforms</i>	<i>Medium compliance/ generally conforms</i>	<i>Low compliance/ partly conforms</i>	<i>Very low compliance/ does not conform</i>
Lithuania	Bulgaria	Bosnia and Herzegovina	Albania	Belarus
	Czech Republic	Moldova	Croatia	Georgia
	Slovenia <sup>a</sup>	Romania	Hungary	Tajikistan
		Russian Federation	Kyrgyzstan	
		Serbia and Montenegro	Latvia	
		Slovakia	Poland	
		The former Yugoslav Republic of Macedonia	Turkmenistan	
		Ukraine	Uzbekistan	
		Armenia <sup>a</sup>		
		Azerbaijan <sup>a</sup>		
		Estonia <sup>a</sup>		
		Kazakhstan <sup>a</sup>		

Source: European Bank for Reconstruction and Development, Assessment of Concessions Laws 2005.

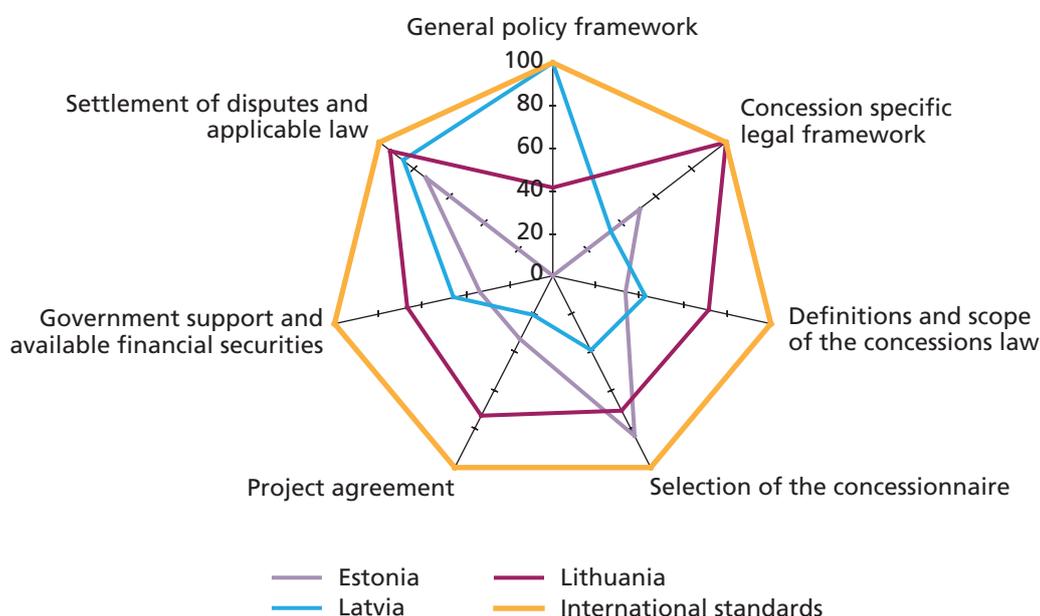
<sup>a</sup> Country did not have a law on general concessions when the assessment was undertaken in 2005. For these countries, the assessment rated the level of conformity of other relevant laws—such as contract law or sector-specific legislation—with internationally accepted principles.

Policy framework plays an essential role in a PPP-enabling regime. A clear, well spelled out policy will usually be found in the form of a government resolution or endorsement. It will typically state the Government's vision of PPP development in the country, its objectives, the principle that it will promote, including the legal and regulatory regime, institutional framework and possibly training policy and educational campaign. In setting out the institutional framework, a policy paper will be expected to set forth the delineation of policy formulation from regulatory responsibilities and operational functions.

In many transition countries a general policy framework for PPPs has not been defined. The results of the evaluation revealed that the existence of such a framework was not necessarily linked to a good quality law. For example, Latvia scored strongly for policy framework, but did poorly in the overall assessment. Conversely, Lithuania did not have an extensive general policy framework, but its concessions law was very close to best international standards (see figure I below). Figure I pinpoints strengths and weaknesses in the legal concessions regime using the example of some of the Central European States. For example, while rules governing dispute settlement in Latvia approximated to international standards, project agreement rules were not adequately regulated.

Estonian laws were reasonably strong in terms of the selection of a concessionaire and dispute resolution, but rather weak in all other core areas. Estonia, generally, represented a rare case of a country where concessions were regulated by a combination of sector laws and general laws; the Estonian authorities did not envisage the wide use of PPPs.

**Figure I. Quality of concessions laws: levels of compliance with international standards in core areas of concessions legislation in Estonia, Latvia and Lithuania, 2005**



Source: European Bank for Reconstruction and Development, Assessment of Concessions Laws 2005.

Note: The extremity of each axis represents an ideal score in line with international standards such as the *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects*. The fuller the “web”, the more closely the concessions laws of the country approximate to those standards.

Most countries scored well on settlement of disputes and applicable law, owing, in part, to the ratification by many countries of the relevant international treaties on enforcement of arbitral awards and protection of foreign investments. However, few countries scored well on the availability of reliable security instruments for lenders regarding the assets and cash flow of the concessionaire. This includes lenders’ rights to step in, that is, to select a new concessionaire to perform under the existing project agreement, in case of a breach of contract by the initial concessionaire.

The survey also found that state financial support or security and guarantees rules were generally entirely omitted from the law or contained unnecessary restrictions. Among the few exceptions were the laws of Albania and Lithuania, which contained specific reference to a concessionaire’s entitlement to create security and to obtain government support.

Croatia, Hungary, Latvia and Poland, contrary to general perceptions regarding the relatively good quality of their investment climate and private sector development legislation, were rated as having a low level of compliance. However, in most of these countries there has been progress in the reform of legal concessions and/or policy frameworks since the completion of the 2005 Assessment, and the EBRD team is working in Hungary on a number of elements aiming to improve further its PPP-allowing regime. A number of other countries in the region have undertaken similar efforts, upgrading elements of their respective framework, be it policy, institutional or legal/regulatory.

*Results of the European Bank for Reconstruction and Development's 2006 Legal Indicator Survey*

The EBRD 2006 Legal Indicator Survey (2006 LIS) measured the effectiveness of concessions laws in the transition countries and complements the 2005 Assessment. The 2006 LIS is based on a case study and assesses how a country's legal and institutional framework for concessions works in practice. Lawyers in each country were presented with a typical scenario for the award and implementation of a concession and were asked a series of questions about how the legal and institutional framework in their country would operate in such a situation (for a full case study and detailed results of the survey, see [www.ebrd.com/pages/sector/legal.shtml](http://www.ebrd.com/pages/sector/legal.shtml)). Scores for effectiveness were based on four core dimensions of the concessions legal and institutional framework:

(a) *Presence/potential*, whether concessions have been implemented successfully and/or whether there is a potential for such implementation;

(b) *Process*, whether there is a fair and transparent selection process, measured by the possibility of challenging a concession award effectively;

(c) *Implementation*, whether there is a fair and transparent implementation of concessions, measured by how effectively the contracting authority adheres to the project agreement terms and by the efficiency of remedial action in cases of non-compliance;

(d) *Termination*, whether an investment can be recovered in cases of early termination, measured by the capacity to enforce arbitral awards and counter obstruction by the contracting authority.

Each of the four areas was rated out of 10 points and a total of 40 points represented a score of 100 per cent. Effectiveness for all areas was graded as follows: very low (less than 30 per cent of the maximum total score), low (from 30 to 49 per cent), satisfactory (from 50 to 69 per cent), high (from 70 to 89 per cent) and very high (90 per cent and above).

Most of the transition countries fell into a middle category. As demonstrated by figure II, four countries with experience of concessions were rated as highly effective: Bulgaria, Lithuania, Romania and Slovenia. In each of these countries concessions have been awarded generally following a transparent selection process and without major difficulties in implementation, although in some cases the awards have led to criticism and complaints. Bulgaria and Romania, for example, have each successfully implemented a number of concessions since the late 1990s on the basis of their concessions laws. Recent reforms of the legal framework in these two countries are expected to have a further positive impact. In Lithuania, concessions implementation started only recently and no major difficulties have been encountered to date.

For countries that had only implemented one concession project or none at all by July 2006 (Belarus, Czech Republic, Kyrgyzstan, Mongolia, Slovakia, Tajikistan and Uzbekistan) the potential for an effective regime and any recent developments towards establishing one were assessed. The Czech Republic was rated potentially highly effective as its survey was based on a hypothetical implementation rather than any actual experience of concessions. Even though many public services were carried out in that country by private entities, such exercises were not based on concessions, but rather on licences.

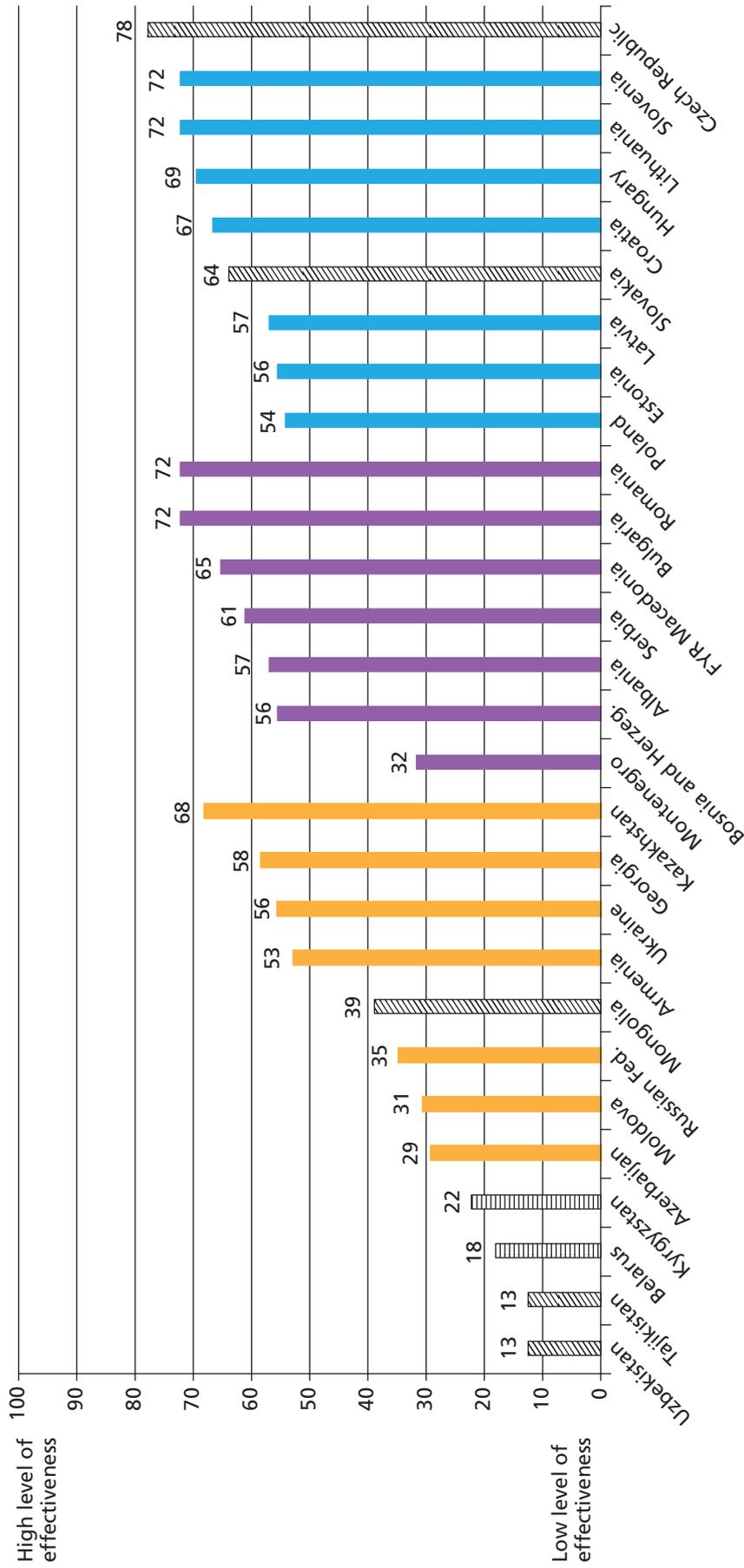
After the creation of a PPP centre in 2004, a new concessions law was adopted in 2006 and several concession-based pilot projects have been launched by various ministries, including for prisons, hospitals and motorways. The Czech Republic scored highly owing to the following: concessions under discussion currently benefit from strong political support; concession awards can be challenged before the contracting authority, the office for the protection of competition, as well as before administrative courts; public authorities generally adhere to the agreements to which they are party; and arbitration is widely recognized and generally not obstructed.

The five countries that received a “very low” effectiveness rating were: Azerbaijan, Belarus, Kyrgyzstan, Tajikistan and Uzbekistan. In Azerbaijan, even though several concessions had been implemented, in particular in the electricity sector, their implementation had generally not been successful (for instance, there were early terminations and disputes). The other four countries mentioned had had little or no concessions experience and the general legal, institutional and/or political environments in those countries were not supportive of concession-type arrangements.

Although the findings of this survey give an indication of how effective concessions regimes are in the transition countries, the results must be treated with caution. This is because, firstly, they are based on the analysis of only one law firm in each country. Secondly, they relate to a specific set of circumstances and may not apply to all types of concession. Thirdly, even though the focus of the survey was limited to concession arrangements, it involved projects of different sizes and scales in different sectors. Lastly, as mentioned above, not all countries have had experience with the types of concessions described in the chosen scenario and, therefore, answers from those countries were speculative.

The results give a surprisingly positive picture of the overall level of adherence by contracting authorities to contractual terms. Respondents in 16 out of 26 countries have indicated that the contracting authority would abide by the terms of the project agreement or provide adequate compensation despite social and political pressures. Effective enforcement of arbitral awards is regarded as especially difficult in Kyrgyzstan, Moldova, the Russian Federation, Tajikistan, Ukraine and Uzbekistan.

**Figure II. Effectiveness of concessions laws in transition countries**



Source: European Bank for Reconstruction and Development, Legal Indicator Survey 2006.

Note: Effectiveness is measured on the following scale: very high (90 per cent and above); high (70-89 per cent); satisfactory (50-69 per cent); low (30-49 per cent); and very low (less than 30 per cent). Data on effectiveness for Turkmenistan were not available. Countries with hatched lines had only implemented one concession project or none at all by July 2006.

### *Conclusion*

Overall, the 2005 Assessment of the quality of concessions legislation and the 2006 LIS on how these laws work in practice produced generally consistent results in that most countries with a sound legal framework for concessions had effective mechanisms in place for enforcing the law, although with some exceptions.

There are, however, some countries where legal concessions frameworks generally conform to relevant international standards, but policy, institutional framework and the general rule of law climate do not permit projects to be implemented effectively. The reasons for this include the inefficient court system and poorly trained public officials and a negative attitude towards international arbitration. In some countries, in spite of significant restrictions in the legal concessions framework, projects can still be implemented fairly successfully (e.g. in Croatia and Hungary). The explanation for this is the existence of several good precedents and a generally efficient institutional framework, which is essential for day-to-day implementation and enforcement.

Generally, the concessions legal environment in transition countries has much scope for improvement. Ideally, any reform aimed at enhancing PPP opportunities should start with a well thought out policy. This should then be complemented by further legal and institutional efforts to allow PPPs to work effectively. The majority of countries still need to implement further legal and institutional reforms if they wish to allow complex PPPs to work effectively.

\* \* \*

*Gerold Herrmann, Chair*

Now we come to our next speaker, Mr. Hector Mairal, from Argentina. While chairpersons are provided with long CVs of the speakers, I am certainly not going to use up the valuable time by reading everything. I only mention one thing: the CV is full of fellowships, awards, visiting scholarships, Harvard, Cambridge and places I have heard before in some contacts, but one piece of advice I want to give you. Read his written paper carefully. Do not just look at the conclusion: the paper is full of green apples, of practical examples, of realities, and you will hear that in a moment from himself.

#### *2. The impact of public procurement and rules of government contracting on public spending and attracting private infrastructure investment*

*Hector A. Mairal*

*Partner, Marval, O'Farrell & Mairal, Argentina*

Rules on public procurement and government contracting can have a significant impact on the capacity of a country to attract private infrastructure investment. However, those rules are often influenced by certain attitudes or sectoral interests that generally escape detection. It may come as a surprise to some that such types of investment are not seen as a panacea for a country's development problems or as an uncontroversial means to speed up investments in more developed countries. It may be useful, therefore, to identify the reasons for the opposition to private infrastructure investment.

This paper is based mainly on the work done by the author in 2000 in the drafting of the rules and model agreements for an Argentine public-private partnership (PPP) system, finally embodied in Executive Decree 1299 of 2000. However, presentation of those ideas in Latin American forums has showed that the issues that arose in Argentina may be present in a wider geographical context.

(a) *Non-legal factors*

Let us address first, then, some non-legal factors that have considerable influence both on the text of the public procurement rules that are applied to public infrastructure projects, as well as on the manner in which those rules are applied.

The first question is whether a country's Government sincerely wants private investors (which in some countries means foreign investors) in the infrastructure sector. The Government may so declare, sometimes at the urging of multilateral institutions, but when it realizes what private investment actually entails for the Government, or for some of its sectors, it may not be too keen to pursue this alternative.

This is because private investment in the infrastructure sector forces the Government to abandon certain powers that it enjoys when resorting, instead, to loans to finance public investment in the sector. Among these we can mention the power to award the different contracts that are needed to build and operate the project throughout its life (instead of awarding a one-time all-encompassing contract such as a concession); the power to appoint persons to the board of directors and executive functions of the operating company; the power to overstaff the operating company and thus use it as a means to combat regional unemployment; and the power to set the rates according to political, and not economic, criteria.

Of course, the Government can retain some of these powers when it sets the conditions of the main contract. It can keep a part of the shares in the operating company and thus some board seats. It can decide to pay a consideration itself for the services rendered by the operating company and thus keep its hands free to charge the public rates set on political grounds, but it can never enjoy the full powers of the operator of the project. Seldom will "authentic" private investors allow the Government to keep a controlling stockholding, as they will fear that their natural expectation of profits will be sacrificed to the natural wish of the Government to defend public interests, whether long- or short-term, as construed by the same Government. By "authentic" I mean investors who contribute important amounts of equity without relying on government loans or guarantees, and without expecting to recover most of such equity by being awarded the construction of the project.

Project finance depends greatly on firm contracts being respected by the Government. This may clash in certain countries with the traditional attitude of the public works authority of interfering with the contract to keep it attuned at all times to the perceived public needs. In a public works contract, in which the contractor is paid as the work progresses, this interference does not pose major problems for the contractor and may even be a source of profit for it, as the contractor can charge the cost increases resulting from the changes required by the authority. The situation is radically different in a project finance scenario, since the amount of finance is limited and changes during construction can both impose costs that go beyond such limit as well as delay the start-up of the project and the related commencement of the stream of payments that will reimburse the lenders.

Firm contracts are as good as the parties that sign them. In a country with a domestic construction industry that is not fully developed, there may be few, if any, construction companies that can offer firm bids that the banks will find reliable. Therefore, resorting to project finance mechanisms to build public works may exclude most of the local construction companies to the benefit of a few major ones and, especially, of contractors from more developed countries. The choice of project finance mechanisms may therefore be resented by local industry and may not be seen with sympathy by those sectors of the Government dedicated to the promotion of domestic companies.

In certain countries, in a public works contract most of the risks are assumed by the Government. This is especially true with the risk of delays caused by unforeseeable situations, such as unexpected subsoil conditions, archaeological findings, the need to respect “first nation” rights or, in federal countries, a lack of coordination between the zoning authorities of the different jurisdictions. In a project-financed work, these risks, which, at the very least, delay start-up and thus affect the expected repayment schedule, inevitably have to be distributed among the constructors, the banks and the investors. While the host Government may assume some of them according to the terms of the contract, this may change a commercial risk into a sovereign risk, an outcome that may be welcomed in some countries but not in others depending on the creditworthiness of the host Government. Moreover, the whole PPP mechanism is based on the concept of passing to the private investors the risks that they are more qualified to assume or to control.

It should come as no surprise, therefore, that in certain countries the domestic construction industry will favour public works contracts over project finance mechanisms that limit or exclude its participation or impose on the industry risks that it is not accustomed to facing.

We should now look at the way these non-legal factors may influence the text of public procurement and government contract rules and their application.

(b) *Legal rules*

(i) *Public procurement rules*

We will first consider public procurement rules, restricting our analysis in this section to the procedures on competitive bidding, to deal later with the rules that apply to the substantive aspects of government contracts.

The first issue is whether public works carried out by means of a project finance system can be awarded through competitive bidding. In France, the traditional rule was that a concession—which historically had been the French contract used to channel project finance operations—could not be the object of competitive bidding, since the choice of the concessionaire was based on the special characteristics of the contractor and not on a monetary comparison. However, new legislation has forced French state entities to apply a special kind of competitive bidding in this case also.<sup>318</sup>

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<sup>318</sup> See Laurent Richer, *Droit des contrats administratifs*, 4th ed. (Paris, Librairie générale de droit et de jurisprudence, 2004), pp. 512-513.

In a country where the honesty of government officers is doubted, with or without reason, contracting authorities may not like to use mechanisms such as PPPs that allow great latitude to bidders to tailor their proposals to stated public needs. This makes monetary comparison very difficult, or even impossible, so contracting authorities may fear accusations of favouritism in the negotiations that necessarily must precede the award of the contract.

Two types of competitive bidding mechanism that rely on a purely monetary consideration may be thought of as compatible with public works that are to be project-financed. The first is to award the contract to the bidder who offers to charge the lowest price (e.g. tolls, rates, etc.) for the output or services rendered by the project. Another is to fix the price of the output at the outset and award the contract to the bidder who offers to pay the highest price to the Government, either up front or in instalments throughout the life of the operation of the works. Both systems present problems.

Awarding the contract to the bidder who offers lower rates, or higher payments to be made after start-up, risks rewarding the “biggest liar” unless the Government has the discipline and political strength to refuse to renegotiate during construction and thus risk the delays and political criticisms resulting from a change of contractor mid-stream. Charging a price to award the concession may be illegal in some countries. Assuming it is legally possible, if the price is to be paid up front, the aforementioned problem disappears, but domestic companies may be excluded from the competition owing to the higher access of investors from the most developed countries to the international capital markets.

Awarding project-financed works on the basis of monetary comparison alone often requires a prior stage of selection on bidders based on certain required qualifications. The choice of such qualifications is discretionary, but if the discretion is abused perfectly acceptable bidders may be excluded. Thus, having financial statements audited by one of the major international firms, which would appear on its face a reasonable standard, may put those state companies from the most developed countries which are audited by an agency of the Government out of the running.

“Buy national” rules in the applicable procurement regulations, to the extent they are allowed by the treaties that bind the host country, are an obvious mechanism to exclude foreign bidders, but the exclusion may be more devious. Thus, allowing a short time to present the qualification documents and the bid, and requiring cumbersome formalities to be fulfilled (e.g. translation and legalization of by-laws) effectively excludes all those companies which had not been made aware of the competition beforehand. Also, a cultural gap exists between companies from certain countries accustomed to returning with their comments the official draft of the contract attached to the bidding specifications and the rules that require that the bid conform strictly to the specifications, including any draft of contractual documents to be used. Delays in deciding the award, with the consequent need for bidders to extend the term of their offers, is another deterrent for foreign contractors, especially when the local economic conditions are subject to sudden changes.

Finally, a caveat with respect to unclear drafting: Governments are often not monolithic nor may all their agencies have the same perception of the advantages or disadvantages of private infrastructure investments. Treasury officials may welcome firm contracts, as they know the cost of mid-stream changes; project finance also allows them to postpone expenditures for budget purposes and avoid increased borrowings. Other sectors of the Government, on the other hand, may find that project finance limits their powers, as has

already been explained. Unless strict discipline is exercised by the executive branch, different sectors of the Government may be working at cross purposes with respect to a given project. As “ambiguity breeds consent”, such conflict often gives rise to obscure, contradictory or ambiguous contracting rules. Bidders should beware that in some countries the rule *contra proferentem* does not apply to the Government and thus doubts will be resolved against the contractor on the theory that it is only entitled to that which is clearly and expressly granted.

(ii) *Government contract rules*

The French doctrine of *contrats administratifs* is followed in many Latin American countries and in some European ones as well.<sup>319</sup> According to this doctrine, as applied in Latin America, the government contracting party enjoys certain powers over the contractor, which is itself subject to limitations on its rights compared with those of a party to a purely private contract. Some European countries that follow this doctrine have recently put certain limits on these rules.<sup>320</sup> These powers and limitations can be spelled out in the bidding regulations and specifications or may be sprung upon the contractor after the award.

The most important of these powers are the right to change the contract to cater to perceived changes in public needs and to terminate the contract for reasons of public interest. Compensation must be paid in both cases to cover the increased cost of the performance or the damages caused by early termination, as the case may be. However, this last rule may not give full protection to contractors for two reasons. Firstly, loss of profits may not be recognized, but, more importantly, compensation often requires a lengthy lawsuit that may take 10 or more years.

An important limitation on the rights of the contractor is the very restricted role that the *exceptio non adimpleti contractus* plays in contracts that are deemed to be of an “administrative” nature. In Argentina, this defence against an action for breach of contract, which is based on the plaintiff’s own breach, is not admitted, in principle, in administrative contracts unless the Government’s default is such that it makes performance by the contractor impossible.

The main consequence of the existence of the theory of the administrative contract, however, is to “administrativize” all the contractual relationship, thus turning into “administrative acts” all government decisions relating to the contract. This, in turn, means that such decisions enjoy the presumption of validity that extends to all government decisions and forces the contractor to challenge them in a matter of days as otherwise they would be considered final and valid. Not too many contractors wish to antagonize their government counterpart by filing such a challenge, so in practice these rules force the contractor to accept as valid many government decisions that affect the contract even if they are not fully in accordance with its terms.

The impact of the theory of the administrative contract upon project finance for public works can be considerable. If the legal rules are spelled out in the bidding specifications, or incorporated by reference by citing regulations that include such rules, foreign contractors, especially those coming from countries that do not apply this theory, may refuse to participate.

<sup>319</sup>On the Argentine theory of administrative contracts, see Hector A. Mairal, “Government contracts under Argentine law: a comparative law overview”, *Fordham International Law Journal*, vol. 26, 2003, p. 1716.

<sup>320</sup>See the Government Contracts Law of Spain (1995), as amended.

Domestic contractors, who know how those rules are applied and can count on some tolerance from the Government, are not similarly dissuaded. Thus, the theory of the administrative contract can act as a non-tariff barrier to foreign investment in the infrastructure sector.

Of course, not all countries that apply this theory suffer similar consequences. If a country has a tradition of respect for its contracts, a professional civil service and a reliable and independent court system, the impact of the theory may be minimal. Therefore, to determine the “bankability” of a project, analysis should not be limited only to the rules applicable to public procurement and government contracts, but should take into account the broader institutional features of the host country.

Another attitude that can dissuade private infrastructure investment is the excessive zeal of government officers who draft the contract terms, even without applying the theory of the administrative contract. High penalties for delays or minor breaches, and limited rights for the contractor in case of government default or of early termination for reasons of public convenience, are a common feature. The price increase and the restriction on competition brought about by these rules are seldom perceived, but the peace of mind of the drafting officer in being seen to defend the national interest, as well as the position of power such rules grant to the government contracting officers, are deeply appreciated by the bureaucracy.

Some countries have tried to overcome perceived deficiencies in their internal judicial and administrative structures by resorting to bilateral investment protection treaties. The case of Argentina, which has more than 40 arbitrations currently pending that invoke such treaties, shows that their mere existence may not constitute a sufficient deterrent to allegedly infringing conduct by the host country. Time will tell whether the remedies afforded by these treaties are effective and also whether they are here to stay, as criticism of them and of the way they are being applied by arbitration panels is growing in certain less developed countries.

Chile has been very successful in using project finance for its infrastructure works. Over \$6 billion have been channelled into its road network by private investors. One of the features that may have contributed more significantly to this success is the setting up, simultaneously with the signing of the contract, of an arbitration panel to resolve disputes between the Government and the concessionaire. This has been perceived by the investment community as a guarantee of the fair and quick resolution of such controversies. The inability of the Government to amend the contract unilaterally or to terminate it for reasons of public convenience is another important feature for investors.<sup>321</sup>

### (c) *Conclusions*

*Pacta sunt servanda.* This is the main rule needed to allow project finance in infrastructure to develop. Other legal rules may be helpful, as, for example, a law exempting lenders who step-in from the tax and labour liabilities of their initial counterpart, as otherwise it is difficult to imagine that step-in rights may be effectively used. Most problems can be solved by contract drafting, however. Therefore, if lenders can trust that the contract terms will not be changed mid-stream, the bankability of the project may pose no legal problems, but if the

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<sup>321</sup> Information taken from a presentation by Marcos Rios at the 2007 spring meeting of the American Bar Association in Washington, D.C., 1-5 May 2007.

legal regime in force or the legal culture of the host country allows the Government to exercise the traditional power of the administrative contract without providing a fast dispute-resolution mechanism, some projects will find no bidders, while others will only be carried out at an increased cost.

If the Government wishes to retain its special powers vis-à-vis the contractor, it should advise so clearly in the bidding specifications. Surprising the contractor with powers based on legal theories not spelled out in the bidding documents can only provoke surprise and probable litigation. This is sometimes the case in countries whose successive Governments have different political views on private infrastructure finance, as the contractual safeguards that are accepted by one administration may be overruled by the following one. In the long run, fair terms work to the benefit of the Government. Not all projects can be financed through a PPP or similar mechanism. In some cases, such as hydroelectric dams, given the importance of the construction risks, resorting to a public works contract, with the Government assuming most of the risks, may be the cheapest—or the only—available alternative, but project finance properly and fairly used allows a country to tap more widely the resources of the international capital markets. It would be a pity if this mechanism were not fully exploited as a result of certain legal theories or the overly protective attitude of government officers.

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*Gerold Herrmann, Chair*

I think I did not promise too much when I said we are in for a treat, green apples of practice, with so many interesting points. I, of course, picked up the one concerning something I once recommended as a “standby arbitrator”, to have someone in place, which I think is finally used here.

We now come to our third speaker, Professor Don Wallace. I think he fits the cliché used by chairmen all over the world: “This man does not need any introduction”. If anyone has practised in the field for the last 20 years and has not heard of Don Wallace or read one of his many publications, he must have practised on another planet!

*3. Public procurement, long-term government contracts and dispute settlement: the need for national systems to prevent and resolve disputes between regulators and private operators of infrastructure and providers of public services*

*Don Wallace, Jr.*

*Chairman, International Law Institute, United States of America*

In its breadth the subject of this paper extends to many economic sectors, including power, water, transportation’s many aspects and telecommunications, and to matters of privatization, competition policy, capital markets, investment and permits, tariff rates, safety, environmental and other standards, and contract performance. In its depth, it extends to prophylactic measures: the conditions for rule-making, the conduct of ongoing relations between regulators and operators (whether they have concessions or not, and whether domestic or foreign), ensuring compliance with laws and regulations and contracts; and the mechanisms in place for the

resolution of disputes. Within these regulated areas, many disputes arise between operators themselves (e.g. over connectivity issues) and with consumers of services, as well as disputes involving lenders and many others. My focus however will not be on these, but rather exclusively on disputes between the government regulator and concessionaires and other operators. The subject may possibly also cover disputes between the Government as market participant and private parties (the operators) in such regulated areas.

One or two preliminary points are in order. Private participation in the provision of public services, also called, inter alia, build-operate-transfer (BOT), privately financed infrastructure projects (PFIPs)<sup>322</sup> and public-private partnerships (PPPs) in its various forms, is here to stay. I have elsewhere called it “inevitable and difficult”.<sup>323</sup> There is an obvious problem for Governments. By and large they increasingly realize that they do not have the skills to manage industries, factories and the like well. On the other hand, they feel responsibility to see that basic services are delivered. The evolving solution: privatization of what have been public services and regulation. The imperatives of economic development, and the limited sources of capital for Governments in many countries, seem to leave little alternative; and these realities trump resistance to privatization and nationalism in many countries.

Does the inability of a country to properly handle the disputes arising from regulation of increasingly privatized sectors of the economy, once thought to be core responsibilities of government, discourage private investment in those sectors? Studies in fact suggest this to be the case.<sup>324</sup>

### *An international prism*

The next two panels deal with the subject of international arbitration, including in one case investment arbitration. UNCITRAL is currently undertaking a revision of its arbitration rules, and there is some controversy as to whether investment arbitrations deserve special treatment, that is, greater transparency, because of their effect on issues of “public policy”.<sup>325</sup> It is that growing<sup>326</sup> phenomenon of international investment arbitration through which we may initially examine our subject. Most of you will know something about international investment arbitration, have heard of the growth of the case load of the International Centre for Settlement of Investment Disputes (ICSID),<sup>327</sup> possibly have witnessed the raft of claims brought against Argentina in recent years, or been bemused by the contradictory arbitral awards in the matter of Ronald Lauder’s investment in Czech media, at the end of which the Czech Republic was ordered to pay Mr. Lauder more than 300 million euros. In one way or another all these proceedings reflect on the inner workings of the respondent Governments.

<sup>322</sup> *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects* (United Nations publication, Sales No. E.01.V.4).

<sup>323</sup> Don Wallace, Jr., “Private participation in infrastructure and the provision of public services—inevitable and difficult”, *Transnational Lawyer*, vol. 18, No. 1 (2004), p. 117.

<sup>324</sup> See Robert R. Bruce and others, *Dispute Resolution in the Telecommunications Sector: Current Practices and Future Directions* (Geneva, International Telecommunication Union and World Bank, 2004).

<sup>325</sup> Note by the Secretariat entitled “Settlement of commercial disputes: revision of the UNCITRAL Arbitration Rules” (A/CN.9/WG.II/WP.145), available from [www.uncitral.org](http://www.uncitral.org).

<sup>326</sup> Luiz Fernando Guilherme da Silva, Jr., “Arbitration and the international trade field”, paper submitted for the Dr. Thomas Marx Award of Consulegis, 2006, available from [www.consulegis.com/fileadmin/downloads/Dr\\_T\\_M\\_Award-Luiz\\_F\\_G\\_da\\_Silva.pdf](http://www.consulegis.com/fileadmin/downloads/Dr_T_M_Award-Luiz_F_G_da_Silva.pdf).

<sup>327</sup> The total number of conciliation and arbitration proceedings registered with ICSID rose to 236 in 2006, and the number of pending cases in the same year reached 118 according to the *ICSID Annual Report 2006*, available from <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDPublicationsRH&actionVal=ViewAnnualReports#>.

In many cases the claims are grounded in allegations of improper administration, and indeed improper handling of disputes by the Governments.<sup>328</sup> Possibly the clearest window into these phenomena is the rapid growth of the jurisprudence of the denial of “fair and equitable” treatment (FET).<sup>329</sup> Possibly the most sweeping statement of the concept can be found in the award in *Tecmed v. Mexico*,<sup>330</sup> where in paragraph 154 it is stated:

“The Arbitral Tribunal considers that this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation. In fact, failure by the host State to comply with such pattern of conduct with respect to the foreign investor or its investments affects the investor’s ability to measure the treatment and protection awarded by the host State and to determine whether the actions of the host State conform to the fair and equitable treatment principle. Therefore, compliance by the host State with such pattern of conduct is closely related to the above-mentioned principle, to the actual chances of enforcing such principle, and to excluding the possibility that State action be characterized as arbitrary; i.e. as presenting insufficiencies that would be recognized ‘... by any reasonable and impartial man,’ or, although not in violation of specific regulations, as being contrary to the law because ‘... [it] shocks, or at least surprises, a sense of juridical propriety.’”

The quoted language posits an almost flawless administration of a country’s laws. Unhappily, the instances of Governments contravening their own laws, and failing their administrative and constitutional norms, are legion.<sup>331</sup> Against this test, I would submit

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<sup>328</sup>The Argentine cases typically arose from another cause, namely, the consequence of de-linking the Argentine peso and the United States dollar, the latter provided for in many affected concession agreements (e.g. see *Gas Natural SDG, S.A. v. Argentine Republic* (ICSID Case No. ARB/03/10), Decision of the Tribunal on Preliminary Questions on Jurisdiction, 17 June 2005; and *El Paso Energy International Company v. Argentine Republic* (ICSID Case No. ARB/03/15), Decision on Jurisdiction (2006)). However, such cases as *Compañía de Aguas del Aconquija S.A. & Vivendi Universal v. Argentine Republic* (ICSID Case No. ARB/97/3) clearly arose from allegations of the inadequate administration of regulations and/or the inadequate resolution of disputes.

<sup>329</sup>This development is not without controversy. For a detailed discussion of this issue, see Noah Rubins, “*Loewen v. United States*: the burial of an investor-State claim”, *Arbitration International*, vol. 21, No. 1 (2005), p. 1.

<sup>330</sup>*Técnicas Medioambientales Tecmed S.A. v. United Mexican States* (ICSID Case No. ARB (AF)/00/2) Award, 29 May 2003, para. 154.

<sup>331</sup>E.g. Philip Gray and Timothy Irwin, “Exchange rate risk: reviewing the record for private infrastructure contracts”, *Viewpoint*, note No. 262, June 2003, available from World Bank, *Public Policy Journal*, <http://rru.worldbank.org/documents/publicpolicyjournal/262Gray-062703.pdf>.

that no country is immune from failing to satisfy international judgement; and Tecmed is by no means unique.<sup>332</sup> Some have celebrated this fact, announcing that these international arbitration cases are the means to ensure “good governance” in the delinquent respondent countries.<sup>333</sup> It is not clear that this is the principal, or indeed any, purpose of such arbitrations.<sup>334</sup> But even if it were, it strikes me that it would be quite futile, for a number of reasons: Governments will not see the awards in such a way,<sup>335</sup> and then there is the sheer vastness of government regulation and administration. The relatively few international investment arbitrations touch only the tips of vast icebergs. Of course, what is really needed is domestic reform, preventative of international disputes, in the case of each, indeed of every, country. In my view, “a ton of prevention is worth an ounce of cure”, that is to say the sort of cure prescribed by my friend Thomas Walde.<sup>336</sup>

A bit more discussion of the international level. A lawyer, Professor Benedict Kingsbury, suggests that the evolution of administrative regularity at the municipal level is now so great that an international administrative law to govern international organizations, based on general principles, may be developing.<sup>337</sup> If this were the case it might be expected to loop back through Professor Walde’s prescriptions to provide international legal discipline to nations—of this I am a sceptic at this time. Indeed, Professor Louis Wells, of the Harvard Business School, not a lawyer, is very critical of the ability of the usual international legal efforts, embodied, for example, in bilateral investment treaties (BITs) and international investment arbitrations, to manage effectively disputes of the kind we are dealing with here.<sup>338</sup> Of course, many Governments are undertaking extensive reforms; again the point is the vastness of Governments, and of their many component elements, good and bad.

An interesting study, *Dispute Resolution in the Telecommunications Sector: Current Practices and Future Directions*,<sup>339</sup> tells the story of one sector of Government and specifically the handling of disputes. (Most, although not all, of the disputes discussed are between two or more operators, rather than between regulator and operator, and the adoption of domestic alternative dispute resolution (ADR) seems to be the principal prescription.)

<sup>332</sup> *Saluka Investments B.V. v. The Czech Republic*, Permanent Court of Arbitration, arbitration under the UNCITRAL Arbitration Rules (Partial Award, 17 March 2006), available from [www.pca-cpa.org/showpage.asp?pag\\_id=1149](http://www.pca-cpa.org/showpage.asp?pag_id=1149).

<sup>333</sup> Thomas Walde, “Current issues in investment disputes: comments”, available from [www.dundee.ac.uk/cepmlp/journal/html/forum\\_8.html](http://www.dundee.ac.uk/cepmlp/journal/html/forum_8.html): “The reference in modern treaties to ‘fair and equitable treatment’ and to international law (as now evidenced by modern State practice of economic regulation in domestic law and multilateral/bilateral treaties) are the gateway for defining what good governance in economic regulation is.” There are many weak, indeed even “failed” States, see Christopher J. Coyne, “Reconstructing weak and failed States: insights from Tocqueville”, *Journal of Social, Political and Economic Studies*, vol. 31, No. 2 (2006), pp. 143-162.

<sup>334</sup> Christoph Schreuer, “Arbitration is the preferred method for the settlement of disputes arising from investments”, available from [http://public.univie.ac.at/fileadmin/user\\_upload/legal\\_studies/courses/Schreuer\\_Investment\\_Arbitration\\_SS2010.pdf](http://public.univie.ac.at/fileadmin/user_upload/legal_studies/courses/Schreuer_Investment_Arbitration_SS2010.pdf).

<sup>335</sup> See Thomas Walde, “Current issues in investment disputes”.

“I recently discussed these matters in a large Latin American country. The Minister, an old Latin American, very educated nationalist said: ‘That is not possible here. Our Constitution forbids these things, our courts would intervene. We cannot have a private group of people sitting in judgement over a sovereign nation.’ I then looked on the Internet that evening and found a bilateral investment treaty signed by this country which says: ‘We hereby submit irrevocably to investment arbitration for a number of enumerated disciplines.’ The next day, when I told him this, the Minister was shocked. He had never heard about the treaty because government agencies often do not collaborate well. He could not stomach this and said: ‘No, no, but that is all invalid. Our Constitution is against it, and that is much more important than international law.’”

<sup>336</sup> See footnote 333 above.

<sup>337</sup> Benedict Kingsbury, “The administrative law frontier in global governance”, Proceeding of the 99th Annual Meeting of the American Society of International Law Proceedings, Washington D.C., 2005.

<sup>338</sup> Louis T. Wells and Rafiq Ahmed, *Making Foreign Investment Safe: Property Rights and National Sovereignty* (New York, Oxford University Press, 2006).

<sup>339</sup> Bruce and others, *Dispute Resolution in the Telecommunications Sector* (see footnote 324 above).

There are the beginnings of specific attention, at the international level, to the relation of regulator and operator. Possibly the most extensive is a requirement found in article VI of the WTO General Agreement on Trade in Services to have independent regulatory agencies or their equivalent, in the covered sectors, whose function extends to the resolution of regulator-operator disputes.<sup>340</sup> The United States and others, in their bilateral negotiations, have begun to extract and give commitments, to regularize the process of administrative rule-making and regulatory proceedings generally<sup>341</sup> and in particular areas.<sup>342</sup>

<sup>340</sup>General Agreement on Trade in Services (GATS), article VI; currently specific Government commitments are rather limited; Joel P. Trachtman, "Lessons for GATS article VI from the SPS, TBT and GATT treatment of domestic regulation", SSRN working paper, 29 January 2002, available from <http://ssrn.com/abstract=298760>.

<sup>341</sup>See United States-Colombia Trade Promotion Agreement (2006) ([www.ustr.gov/trade-agreements/free-trade-agreements/colombia-fta](http://www.ustr.gov/trade-agreements/free-trade-agreements/colombia-fta)):

"Article 19.2: Publication

"1. Each Party shall ensure that its laws, regulations, procedures, and administrative rulings of general application respecting any matter covered by this Agreement are promptly published or otherwise made available in such a manner as to enable interested persons and Parties to become acquainted with them.

"2. To the extent possible, each Party shall:

"(a) publish in advance any such measure that it proposes to adopt; and

"(b) provide interested persons and Parties a reasonable opportunity to comment on such proposed measures.

"Article 19.4: Administrative Proceedings

"With a view to administering in a consistent, impartial, and reasonable manner all measures of general application affecting matters covered by this Agreement, each Party shall ensure that in its administrative proceedings applying measures referred to in Article 19.2 to particular persons, goods, or services of another Party in specific cases that:

"(a) wherever possible, persons of another Party that are directly affected by a proceeding are provided reasonable notice, in accordance with domestic procedures, when a proceeding is initiated, including a description of the nature of the proceeding, a statement of the legal authority under which the proceeding is initiated, and a general description of any issues in controversy;

"(b) such persons are afforded a reasonable opportunity to present facts and arguments in support of their positions prior to any final administrative action, when time, the nature of the proceeding, and the public interest permit; and

"(c) its procedures are in accordance with domestic law."

<sup>342</sup>United States-Panama Trade Promotion Agreement (2007) ([www.ustr.gov/trade-agreements/free-trade-agreements/panama-tpa/final-text](http://www.ustr.gov/trade-agreements/free-trade-agreements/panama-tpa/final-text)), chapter seventeen (Environment), e.g. article 17.4:

"1. Each Party shall ensure that judicial, quasi-judicial, or administrative proceedings, in accordance with its law, are available to sanction or remedy violations of its environmental laws.

"(a) Such proceedings shall be fair, equitable, and transparent and, to this end, shall comply with due process of law and be open to the public, except where the administration of justice otherwise requires.

"(b) The parties to such proceedings shall be entitled to support or defend their respective positions, including by presenting information or evidence.

"(c) Each Party shall provide appropriate and effective remedies or sanctions for a violation of its environmental laws that:

"(i) take into consideration, as appropriate, the nature and gravity of the violation, any economic benefit the violator has derived from the violation, the economic condition of the violator, and other relevant factors; and

"(ii) may include criminal and civil remedies and sanctions such as compliance agreements, penalties, fines, injunctions, suspension of activities, and requirements to take remedial action or pay for damage to the environment.

"2. Each Party shall ensure that interested persons may request the Party's competent authorities to investigate alleged violations of its environmental laws, and that each Party's competent authorities shall give such requests due consideration in accordance with its law.

"3. Each Party shall ensure that persons with a legally recognized interest under its law in a particular matter have appropriate access to proceedings referred to in paragraph 1.

"4. Each Party shall provide ... appropriate and effective access to remedies, in accordance with its law, ... which may include rights such as:

"(a) to sue another person under that Party's jurisdiction for damages under that Party's laws;

"(b) to seek sanctions or remedies such as monetary penalties, emergency closures or temporary suspension of activities, or orders to mitigate the consequences of violations of its environmental laws;

"(c) to request that Party's competent authorities to take appropriate action to enforce its environmental laws in order to protect the environment or to avoid environmental harm; or

"(d) to seek injunctions where a person suffers, or may suffer, loss, damage, or injury as a result of conduct by another person subject to that Party's jurisdiction.

"5. Each Party shall ensure that tribunals that conduct or review proceedings referred to in paragraph 1 are impartial and independent and do not have any substantial interest in the outcome of the matter.

"6. For greater certainty, decisions or pending decisions by each Party's tribunals, as well as related proceedings, shall not be subject to revision or be reopened under this Chapter."

*National provisions for resolution of disputes*

UNCITRAL, in its *Legislative Guide on Privately Financed Infrastructure Projects* (2001), and its accompanying Model Legislative Provisions on Privately Financed Infrastructure Projects<sup>343</sup> (2003) (that is to say a model for national laws), deals in several places with disputes and their resolution. The *Guide* adverts to disputes at various phases of the concessioning process: competitive selection/formation, the construction phase, operations, termination. Most of the disputes between regulator and operator (whether under a concession or not) will arise during the operations phase. In terms of prophylaxis, it is apparent that a sound selection process and attendant negotiations can serve to anticipate and possibly minimize future disputes.

The *Guide* contemplates both the concession agreement and regulations as dealing with the machinery to deal with disputes. It is possible we underplayed the role of regulations.<sup>344</sup> In any event, in the case of merchant power plants or other infrastructure providers not operating under a concession agreement, regulations will be paramount. Incidentally, the *Guide* also may not emphasize sufficiently that the formulation of such regulations should involve consultation with operators and others in the sector to be regulated. The *Guide* deals with machinery, whether for arbitration or conciliation, or review boards, somewhat in the abstract and may not be keyed enough to our regulator-operator relations. As it deals with law and legislation, it does touch on a matter of particular relevance to our subject: the consignment by most civil law countries of the disputes we are discussing to the exclusive jurisdiction of *conseils d'état* and lower administrative tribunals, the application of administrative (often giving the Government unilateral powers to alter projects) rather than commercial or private law, and the prohibition of arbitration in these cases. This regime has rendered projects “unbankable” in some cases.<sup>345</sup>

Some countries have created special commissions to deal with regulator-operator disputes, whether of rates, market standards, safety or other matters,<sup>346</sup> but these commissions frequently become part of the problem, rather than the solution.<sup>347</sup> The reasons are many: commissions that are part of the ministry or agency that is the regulator or a competitor of the disputing operators, or commissions not sufficiently independent of government and government policy.<sup>348</sup>

<sup>343</sup> United Nations publication, Sales No. E.04.V.11.

<sup>344</sup> Thus model provision 49 reads: “Any disputes between the contracting authority and the concessionaire shall be settled through the dispute settlement mechanisms agreed by the parties in the concession contract.” Note that the “contracting authority” may be different from a later regulator.

<sup>345</sup> Amnesty International, “Turkey: constitutional amendments—still a long way to go”, 1 January 2002, available from <http://web.amnesty.org/library/Index/ENGEUR440072002>. This situation required Turkey to amend its Constitution (Constitution of the Republic of Turkey, published in the *Official Gazette*, No. 17863, dated 9 November 1982, and amended in 2001, available from [www.legislationline.org/documents/section/constitutions/country/50](http://www.legislationline.org/documents/section/constitutions/country/50) and points up the required reform in national regimes that is the thesis of this paper.

<sup>346</sup> For instance, in Mexico, the Federal Telecommunications Commission, in the Dominican Republic, the Instituto Dominicano de las Telecomunicaciones (INDOTEL), and in India, the Telecom Regulatory Authority of India (TRAI).

<sup>347</sup> See Mark Kantor, “Arbitration award may alter Dabhol debate”, *Transnational Dispute Management*, vol. I, No. 2 (May 2004), available from [www.transnational-dispute-management.com/samples/freearticles/atv1-2-article179b.htm](http://www.transnational-dispute-management.com/samples/freearticles/atv1-2-article179b.htm), on the *Dabhol* case in India.

<sup>348</sup> See Bruce and others, *Dispute Resolution in the Telecommunications Sector*, section 2, pp. 19-22 (see footnote 324 above).

*Some innovations in the resolution of disputes involving regulators*

It is not apparent that the “ton of prevention” needed at the national level is taking place. To be sure, Governments in most countries, developing and developed, are constantly evolving and seeking to “reinvent” and improve themselves. In this respect, movement towards e-government is surely a flavour of the year. Another is the promotion of arbitration for Governments,<sup>349</sup> although rarely involving regulator-operator disputes; operator-operator disputes may sometimes be covered. The ITU-World Bank report<sup>350</sup> on the telecommunications sector details some of this. Arbitration is beginning to impinge on regulation, if not the regulator itself; thus the European Union now prescribes arbitration between private parties affected by European Union merger review orders. (Although the European Union Commission is not a party, it does reserve the right to be informed and file amicus briefs!)<sup>351</sup> So too the United States in its bilateral tax treaties<sup>352</sup> contemplates arbitration between government “competent [tax] authorities” to resolve clashes between Governments that affect private taxpayers—but again there is not resolution of direct disputes between regulator (tax authorities) and operator (taxpayers).

There are examples of regulator-operator dispute resolution by arbitration, but they are rare. One example from the United States: the laws of the State of Florida provide for arbitration of disputes between the state insurance regulator and insurance companies, over the rate of return on investment for insurance companies.<sup>353</sup>

It is not that countries do not have reasonable arrangements in place; the economically successful Nigerian telecommunications sector, in part X of its Communications Act of 2003, provides for administrative and judicial procedures that might well be emulated; a description is included in annex II to these *Proceedings*.

*What should be done?*

Not all problems have complete solutions, but surely a situation that may, as I have said, call for a “ton of prevention”, has parts that need addressing. I believe that this is a problem that UNCITRAL itself can address; we have worked on infrastructure problems, and we have worked on many aspects of dispute settlement, through arbitration and other means.

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<sup>349</sup> See, for example, for the United States, Jeffrey M. Senger, *Federal Dispute Resolution: Using ADR with the United States Government* (San Francisco, Jossey-Bass, 2004).

<sup>350</sup> See footnote 324 above.

<sup>351</sup> Gordon Blanke, *The Use and Utility of International Arbitration in EC Commission Merger Remedies* (Groningen, Europa Law Publishing, 2006).

<sup>352</sup> For example, the Convention between the Government of the United States of America and the Government of the Republic of Bulgaria for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed in Washington, D.C., on 23 February 2007. These examples of arbitration involving regulation and other public measures suggest that earlier concerns about “arbitrability”, that is to say what subjects may be arbitrated, may sometimes have been exaggerated. See, for example, William W. Park, “The arbitrability dicta in *First Options v. Kaplan*: what sort of Kompetenz-Kompetenz has crossed the Atlantic?”, *Arbitration International*, vol. 12, No. 2 (1996), p. 137.

<sup>353</sup> Florida Administrative Code Annotated, Title 69. Financial Services, Subtitle 690. Office of Insurance Regulation, chapter 690-170. Property and Casualty Insurance Rating, Part IV. The Rate Filing Arbitration Rules of Procedure. See *Nationwide Insurance Company of Florida v. Florida Office of Insurance Regulation*, American Arbitration Association, case no. 33 195 Y 00453 06. By contrast the elaborate regulatory regime managed by the United States Federal Energy Regulatory Commission over gas and power seems to immunize the Commission from judicial attack (and presumably has no provision whatsoever for arbitration or anything comparable) under the so-called “filed rate doctrine”, see *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.* (341 US 246).

What form the work might take needs reflection. Legislative guide? Model law? Other? The aim is to develop solutions for administrative aspects of national regulatory regimes that run from alpha to omega: an open and proper system for developing rules and administration; provision in agreements and regulations for regular information exchange between regulator and operator; “early warning” systems as problems arise,<sup>354</sup> possibly standing machinery (analogous to contract review boards, or other standing provision for the application of independent expertise)<sup>355</sup> to tackle problems in their incipiency by assuring legitimate implementation of regulations by the regulator and good faith compliance by the operator; of course good and competent administration overall; some dispute-settlement machinery, whether commission or arbitrator, that is and is seen to be independent of politics and short-term government policy; judicial review presumably (although pure judicial solutions will probably not be expert or expeditious enough, and at least foreign investors would be sceptical) and surely effective and honest enforcement of the result; detailed consideration of questions such as the selection and composition of the dispute-settling bodies and the means to ensure their competence and independence (some of this will be in the nature of public, rather than private, law); and some political science and public administration, rather than law (some will deal with technical and economic expertise, not the mere application of existing rules to given facts). To be sure, this is a tall order, but UNCITRAL and others have done this kind of work before.<sup>356</sup>

In terms of the form of any work to be undertaken, I would probably at this point opt for a legislative guide to consider the best practice as to the necessary elements of a sound national regime for the prevention and resolution of disputes between regulator and operator, but a model legislative provision, a “module” to be inserted into relevant national statutes, might also be in order, and doable.

A legislative guide might also, optionally, build on existing programmes of cooperation between regulators of different countries, and propose an international organization of national regulators (an organization in which operator groups would also participate in some open and transparent fashion), along the lines of cooperation among central banks (see the several Basel accords), or by capital market regulators in the International Organization of Securities Commissions.

#### 4. *Comments, evaluation and discussion*

*Anthony Colman*

*Royal Courts of Justice, United Kingdom of Great Britain and Northern Ireland*

I was up to recently a judge in a commercial court in London, but among the various things I did in my professional capacity was to try to help countries in transition in Eastern Europe to develop modern judicial systems responsive to the needs of modern commerce in a free enterprise society.

<sup>354</sup> *UNCITRAL Legislative Guide*, p. 176 (see footnote 322 above).

<sup>355</sup> *Ibid.*, p. 181.

<sup>356</sup> For example, the UNCITRAL Model Law on International Commercial Arbitration (1985), the UNCITRAL Model Law on Electronic Commerce (1996), the EBRD Concession Assessment Project (2005), available from [www.ebrd.com/country/sector/law/etc/cetc.pdf](http://www.ebrd.com/country/sector/law/etc/cetc.pdf), and the OECD Guidelines for Multinational Enterprises, available from [www.oecd.org/daf/investment/guidelines](http://www.oecd.org/daf/investment/guidelines).

In 1991, I attended an international conference called by EBRD in Moscow and the purpose of the conference was to ascertain what could best be done by the developed countries to assist the legal systems in transition economies. And the outcome of the conference was that EBRD would attempt to coordinate the assistance that was being provided by the developed countries and provide by way of distribution of information an account of what the different countries were doing and the assistance that they were giving. Since then, I have spent a very great deal of my time trying to assist both the Czech Republic and Romania, particularly the Czech Republic, in the development of their judicial systems. So I would like to ask Mr. Zverev whether, in fact, EBRD ever did produce an account of what the different developed countries were trying to do in the less well-developed countries about the improvement of their legal systems and their judicial systems, because I discovered in 2000, when I got to Prague, that as far as the British Government was concerned, it had not the faintest idea what other countries, even in Western Europe, were doing, much less the United States, to provide judicial assistance to the Czech Republic and other countries in Central Europe. Perhaps Mr. Zverev could provide some sort of enlightenment there.

*Alexei Zverev*

*Senior Counsel, European Bank for Reconstruction and Development*

Over the past 15 years that EBRD has been in existence, the Bank has implemented a number of technical assistance and technical cooperation projects in various countries, and in particular in the Czech Republic and in Romania. One particular aspect of this that I wanted to mention, which is very much related to your question, is within the framework of this series of technical assistance projects. A couple of years ago, one particular direction was identified, judicial capacity-building, and we have developed this direction into a separate focused area of the Bank's Legal Transition Team. And since then, since 2005, we have been developing this area by assisting various countries in enhancing their judicial capacity. We started in Kyrgyzstan and then in Serbia and slowly but surely will develop it further to cover other countries. We do this on a demand-driven basis: it is not that we come to a certain country and say, look, you need to listen to us and you need to do what we tell you to do. This would be a very bad, unacceptable approach. You would appreciate that.

So whenever we offer our assistance we seek both local commitment and demand for our assistance, subject to which and to our normal procedures, we are there to provide this assistance.

*Dmitry Davydenko*

*Director, Institute of Private International and Comparative Law, Russian Federation*

As a practising lawyer, I have had various opportunities to see that the attitude of public officials to individuals and legal entities is one of the most important issues in creating good conditions for both national and international trade. Unfortunately, sometimes state officials show an insensitive or excessively formalistic approach in application of law. This is a real obstacle for commerce, even if formal rules of law are quite effective. For example, they are creating obstacles to national and international trade such as unjustified delays in making decisions, introduction of unexpected prohibitions, refusals for purely formal reasons, loose interpretation of legal provisions or invention of

formal procedures that, in fact, are nothing more than purely unjustified obstacles. In my opinion, some international solutions to this problem should be found. Maybe there should be some international standards for public officials' conduct, including state reports, an international system of evaluation and monitoring. This would be a great contribution to the stability and development of world trade.

*Don Wallace, Jr.*

*Chairman, International Law Institute, United States of America*

Before I speak to that, I just wanted to say something to Sir Anthony.

The United States has been very active in this field of judicial assistance, or assistance to judges. We have an institute in Prague. It is a creature of the American Bar Association, of the so-called Central European and Eurasian Law Initiative (CEELI), now called the Rule of Law Initiative (ROLI), and CEELI has developed magnificent assessment tools for judges. Its first draft was going to assess each judge individually and my own observation was that that would not be smart. In fact, the final product is more for use by entire judiciaries, and it is excellent.

Going to the gentleman from Moscow, in a way you are talking about taking on human sin, as was mentioned the other day, because we are talking about the entire operation and mentality of public administration. In my view, one should focus on something specific, and in this case it would be regulatory regimes and rules, their implementation and disputes within these regulatory regimes. I think there should be an international effort to develop national standards. In other words, there should be national laws. I think the last thing in the world we need is one more international convention proclaiming that people can be perfect, and then have lots of non-governmental organizations going around the world having a good time, bringing perfection. I think that is unfair to the citizens, the people of the countries who are the principal victims of the maladministration of laws, as Mr. Mairal suggested. An effort should be made and it has to be demand-driven, or requested, as it was suggested. That, I think, might be interesting in this defined area because we have already done work in this area. The *UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects* deals with these issues of disputes but they need to be further dealt with.

*Chair: Jeffrey Chan Wah-Teck*

*Principal Senior State Counsel, Head, Civil Division, Attorney-General's Chambers, Singapore*

We have heard the comments made about the role of public officials in the procurement process and the sense is that public officials do present certain problems, both in the procurement as well as in the administration of contracts and dealing with the Government. I am sure that the comments that have been made reflect the experiences of the speakers. However, there appears to be a conundrum here because, and this is a proposition I would like to advance, the more transparent and accountable a Government is, the more inflexible the public officials tend to be. Who does the public official ultimately answer to? He answers to his minister, and who does the minister answer to? The minister answers the elected representatives of the people in a public forum. Therefore, if you have a procurement process where there is a tremendous amount of discretion built in,

which is, of course, something that is very favourable to commercial parties, then should an issue be made public, what does a minister say? Because every time there is a decision taken, which is an exercise of discretion, there can be different views expressed as to how that decision could be exercised. So the public official must, therefore, take the course of action that will allow his minister to be able to defend that particular decision publicly with the least controversy. That often means sticking to the rules and making the rules as clear as possible.

Now UNCITRAL is all about removing uncertainty in the legal rules applicable to international trade. Likewise, public officials, in formulating and calling for government contracts and in administering government contracts, those who are in accountable and transparent Governments, try to make it as clear as possible that they operate by very certain rules that minimize the exercise of discretion.

I appreciate the point made by Professor Wallace that this may increase the cost; minimization of risk does carry increased costs. This is something that many public officials may not realize. So the solution is actually not so much to educate public officials, at least not the public officials in transparent and accountable government. The solution is to educate the public of these countries, to allow the ministers and the public officials who work for them to be able to exercise their duties in a more commercially realistic manner, which, in that case, would enable the same goods and services to be procured at hopefully a lesser cost.

*Yuejiao Zhang*  
*Shantou University, China*

I want to quickly comment on this issue, based on my last 10 years' experience dealing with the Asian Development Bank (ADB) and the Western African Development Bank.

I think the infrastructure issue becomes more and more important than before. Now we have water scarcity, like in the six West African countries. They have no drinking water so they have to invest in 10 years one per cent of their GDP to improve this situation. And transportation in Central Asian countries, like Kyrgyzstan and Turkmenistan. I think we are talking about PPPs. We should also deal with public institutions. The World Bank, ADB and EBRD should play a more important role. If they do not step-in, private investors are reluctant to invest in a huge infrastructure project, even if the law is perfect, because of the high risk involved. Therefore, in concession agreements, we should also define the role of the institutions in case of disputes. If they get out, but private investors stay, then the risk is for the private investors.

Another point is that international development institutions can help those countries. I led the ADB team that drafted the cross-border agreement between Kazakhstan and Kyrgyzstan. The cross-border agreement provided a legal framework for cross-border transportation and customs cooperation. Now some other countries have followed this. So that is the legal assistance project's positive effect.

We are talking about concessions. In regional development projects, there is not a single country concession but a group of countries' concessions at the same time. They may involve many complex issues, including joint and separate liabilities, nationalization

in one country and currency remittance risks. The key problem of road construction is maintenance, road charges and fees, lender security and tariffs. If the tariff regulations are not good, the private sector will not be prepared to invest.

I hope that we can consider these issues.

*Jernej Sekolec*  
*Secretary of UNCITRAL*

Professor Wallace, you mentioned disputes about rates and prices for delivering services, which are among the most vexing ones. You also told us that the regulators that are in dispute with the private suppliers about these prices do not like arbitration and that they do not like courts. But you did not give us your opinion. In which direction should we be looking for a solution? I think you have been unusually non-committal.

*Don Wallace, Jr.*  
*Chairman, International Law Institute, United States of America*

A word for Mr. Chan. We should always be polite and exclude present company, but we can never generalize from Singapore, which we know is a remarkably administered place. And by the way, I do not mean anything invidious, or a reflection on anybody, but this is information about Singapore that we get continuously. But your point is really to Professor Schooner. He and other academics of procurement believe in discretion. You say it is dangerous. I tend to share your view and I certainly try endlessly to make that point at UNCITRAL Working Group I (Procurement). For example, I am very nervous about new-fangled innovations that we see coming on, electronic reverse auctions or framework agreements and so on.

Going now to Mr. Sekolec's challenge: yes, I think we should work on this and it should be done by UNCITRAL, but it has to do the studies, it has to survey the existing situation and what has been done, because more and more is happening. In my paper, I mentioned some of this. And the United States is insisting in its free trade agreements in Central America and elsewhere that the Governments have a public rule-making procedure somewhat like the Administrative Procedure Act of the United States, notice and comment in this area and every other area of regulation whether it is environmental or tax and so on.

The Nigerians have a good system in telecommunications. This is a successful area of regulation apparently where the industry and the regulators, the Nigerian Communications Commission, know each other, respect each other. We should see what arrangements have been made in various countries to promote that.

Dispute settlement, of course, is the key, that is the tough one, and there Mr. Mairal suggested something like a contract review board. I am not saying that I necessarily endorse that particular form. I do not want to be as academic as Mr. Schooner but I do not want to be as practical as a lawyer representing one person. That is a possibility. Some countries have commissions. Some Latin American countries have commissions, say in the power sector, but the trouble is that the commissions are often *parti pris*. The commission may

have a stake in the ministry with whom the private operators are competing. In the *Dabhol* case, if you know that, and I am sorry to be invidious with the Indian ladies and gentlemen here, the commissions were half of the problem.

Arbitration is what many people have suggested. I think it will be a mixture. Who knows? I do not think that we should just be taking the UNCITRAL Arbitration Rules because, for one thing, what I am suggesting is that we work on promoting national institutions and solutions. I could see multisector or single-sector bodies, but who would they be staffed by? It could be retired judges, if they swear like Sir Anthony to remain impervious to the desire to be retained in the next case, which is a real problem. The General Agreement on Trade in Services calls for independent regulatory bodies, including dispute settlement. We should work on this. We should make a study, investigate and so forth. It would be very interesting, putting together construction types, procurement types, infrastructure types, arbitration types. It will be a huge job, but it should be done in my view.

### **C. Steps to ensure a stable framework for the settlement of commercial disputes**

*Chair: Michael E. Schneider*  
*Lalive Avocats, Switzerland*

We are now moving to an area of UNCITRAL work that is one of its major success stories. The field of dispute resolution and arbitration has made UNCITRAL known in many circles of international commercial practice. As major texts, we could cite the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, the UNCITRAL Model Law on International Commercial Arbitration, the UNCITRAL Model Law on International Commercial Conciliation, the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules. And now after the “buildings” have been erected and have weathered the first storms, we are moving, to some extent, to maintenance and refurbishing. There have been revisions to the UNCITRAL Model Law on International Commercial Arbitration, adopted by the Commission in 2006, and UNCITRAL Working Group II (Arbitration and Conciliation) has now undertaken a revision of the UNCITRAL Arbitration Rules.

The first of our speakers is Mr. Cecil Abraham, one of the leading figures in the arbitration world in South-East Asia. He is a practitioner as counsel and, as I have experienced myself, a formidable opponent. He also sits on many arbitration tribunals and has a wide practice as arbitrator. He is a fellow and chartered arbitrator of the Chartered Institute and has important functions in the arbitration community in South-East Asia. He is the Deputy President of the Malaysian Institute of Arbitrators, the Vice-President for the Asia-Pacific Regional Arbitration Group and the Chairman of the Arbitration Committee for ICC in Malaysia.

And now Cecil will talk to us about an issue that is particularly problematic in arbitration practice, the interpretation of public policy.

## 1. *How to promote a uniform interpretation of public policy*

*Cecil Abraham*

*Managing Partner, Shearn Delamore & Co., Malaysia*

### *Introduction*

There has been an increase in the number of jurisdictions around the world that have enacted the UNCITRAL Model Law on International Commercial Arbitration and replaced older legislation on arbitration. New challenges have since emerged, notably with regard to the way in which the courts recognize and enforce awards rendered in both domestic and international arbitrations under the new emerging arbitration framework.

The emerging jurisdictions that have adopted the Model Law appear to have developed the law on “public policy” in ways that, perhaps, had not been anticipated. The concept of public policy has been playing an increasingly important (and unexpected) role under the new arbitration framework in those jurisdictions, particularly with respect to setting aside applications.

This is the topic of my presentation. I shall be speaking specifically on how the courts of developing countries such as India, Malaysia and the Philippines have dealt (or will be expected to deal) with this subject. As far as India is concerned, new arbitration legislation was introduced in 1996<sup>357</sup> incorporating the Model Law. In a new act, in 2005, Malaysia also accepted the Model Law framework. While there are no decisions of note in Malaysia as the Act of 2005 is relatively new, there have been a number of decisions that I shall deal with. I shall also touch on various decisions in Canada, New Zealand, Singapore and the United Kingdom on the treatment of public policy.

### *What does the Model Law mean by the use of the words “public policy”?*

The Model Law refers to “public policy” in two places:

(a) Article 34 (which deals with applications to set aside an award) in subparagraph (2) (b) (ii) provides that an award may be set aside only if “the court finds that the award is in conflict with the public policy of this State”;

(b) Later, in article 36, subparagraph (1) (b) (ii) (which deals with the grounds for refusing recognition or enforcement of an award), the Model Law provides:

“Recognition or enforcement of an arbitration award, irrespective of the country in which it was made, may be refused only if the court finds that the recognition or enforcement of the award would be contrary to the public policy of this State.”

The Model Law does not define what it means by “public policy”. I would, however, like to point out that the United Nations publication of the Model Law in 1994 provides an explanatory note,<sup>358</sup> which provides some guidance.

<sup>357</sup> India, Arbitration and Conciliation Act, 1996.

<sup>358</sup> Explanatory note by the UNCITRAL secretariat on the Model Law on International Commercial Arbitration (United Nations publication, Sales No. E.95.V.18, pp. 23-24).

Paragraph 42 of the explanatory note (on grounds for setting aside an award) provides that the Model Law allows for an award to be set aside for “violation of public policy, which would include serious departures from fundamental notions of procedural justice”.

Paragraph 44 of the explanatory note goes a little further. It states:

“Although the grounds for setting aside are almost identical to those for refusing recognition or enforcement, two practical differences should be noted. Firstly, the grounds relating to public policy ... may be different in substance, depending on the State in question (i.e. State of setting aside or State of enforcement).”

It would therefore appear that the Model Law envisages differing public policy standards that would apply from State to State and that this may not be restricted to “serious departures from fundamental notions of procedural justice”, which, arguably, would be consistent between most, if not all, States.

I need to reproduce a provision of the New Zealand Arbitration Act of 1996 (on which the Malaysian Act of 2005 is modelled) because of certain additions it has included over and above the Model Law. The Act of New Zealand provides an example of what may constitute “fundamental notions of procedural justice” (as used in the explanatory note to the Model Law).

Section 34 (2) (b) (ii) of the New Zealand Arbitration Act is in the following terms: “An arbitral award may be set aside by the High Court only if the High Court finds that the award is in conflict with the public policy of New Zealand”. Section 34 (6) of the New Zealand Arbitration Act (which has no equivalent in the Model Law) goes on to provide:

“For the avoidance of doubt, and without limiting the generality of paragraph (2) (b) (ii), it is hereby declared that an award is in conflict with the public policy of New Zealand if—

“(a) The making of the award was induced or affected by fraud or corruption; or

“(b) A breach of the rules of natural justice occurred—

“(i) During the arbitral proceedings; or

“(ii) In connection with the making of the award.”

What is therefore clear is that where fraud or corruption induced or affected the award, or where the award was reached in a breach of the rules of natural justice and procedural fairness, the registration, recognition or enforcement of that award would be against the public policy of New Zealand (and Malaysia).

The question that arises is what has been the judicial experience on “public policy” and enforcement of awards.

### *Malaysia*

The Act of 2005 has not been the subject of any judicial decisions regarding what would constitute a breach of the nation’s “public policy”. We can, however, look at the

decisions on the New York Convention and, to a limited extent, to decisions on the reciprocal enforcement of judgements on how the courts have dealt with public policy.

In 1991,<sup>359</sup> our High Court registered a United Kingdom judgement on a gaming debt under the reciprocal enforcement of judgements statute. It was argued that Malaysian public policy militated against enforcing foreign judgements on gaming debts. The High Court held that since the gaming took place in England, and it was not unlawful under English law, the enforcement of that judgement could not be against Malaysian public policy.

In 1994,<sup>360</sup> our High Court was asked to enforce an international award. The respondent had not appeared at the arbitration despite having been given notice. At the enforcement proceedings, the respondent argued that it was contrary to Malaysian public policy to enforce the award since the applicant was an Israeli company. In 1994, Israel was one of three countries with which Malaysia had no diplomatic relations. The applicant, in fact, was an American company which held a 68 per cent stake in an Israeli company. The Malaysian court enforced the award. It would appear, however, from the reasons given by the court that if the respondent had been able to show that the applicant was an “Israeli-based company”, the award would not have been enforced for being against Malaysian public policy as trade with Israel was prohibited.

In 1999,<sup>361</sup> in another High Court decision involving the registration of a judgement, this time from Singapore, the High Court refused registration. The High Court held that since a Malaysian plaintiff had to comply with the laws of service of a foreign country in which a foreign defendant was situated, similarly, Malaysian public policy would dictate that a Singapore writ had to be served in compliance with Malaysian law. The High Court held that both Malaysian and Singaporean law on service had not been complied with and, as such, the Singaporean judgement would not be registered in Malaysia for being against Malaysian public policy.

A year later, in 2000,<sup>362</sup> the High Court allowed the registration of a Singapore judgement in Malaysia. The High Court held that, on the facts, there was no breach of the Banking and Financial Institution Act of 1989, in that the applicant was not conducting banking business in Malaysia by offering the respondent a banking facility. The High Court opined:

“When a Malaysian court is considering the issue of public policy in Malaysia, it should look at Malaysian law, Malaysian Government policy, Malaysian moral values and all other relevant factors then prevailing in Malaysia.”

In summary, therefore, of the four decisions discussed, three decisions advocate a reference to Malaysian statutory law in deciding whether an award or a foreign judgement is consistent with Malaysian public policy. Where there is a breach of a Malaysian statutory provision, it would appear that the Malaysian court would hold there to be a breach of Malaysian public policy.

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<sup>359</sup> *Aspinall Curzon Ltd. v. Khoo Teng Hock* [1991] 2 MLJ 484, [HC].

<sup>360</sup> *Harris Adacom Corporation v. Perkom Sdn Bhd* [1994] 3 MLJ 504, [HC].

<sup>361</sup> *United Overseas Bank Ltd. v. Wong Hai Hong* [1999] 1 MLJ 474, [HC].

<sup>362</sup> *Banque Nationale De Paris v. Wuan Swee May & Anor* [2000] 3 MLJ 587, [HC].

In the one exception (the 1994 decision), there was no breach of a statute. The High Court noted, however, that since the Government of Malaysia did not have diplomatic relations with Israel, an award obtained by an Israeli company would not be enforced in Malaysia as being against Malaysian public policy.

### *Philippines*

The Court of Appeal of the Republic of the Philippines in a decision dated 29 November 2006 in *Luzon Hydro Corporation v Hon. Rommel O. Baybay* dealt with an application to set aside a foreign arbitral award on the basis that the award was null and void having been rendered contrary to the public policy of the Philippines.

This is an important decision as the Court of Appeal (unlike its counterpart in Malaysia) noted the obligations attendant to signing and ratifying the New York Convention (at p. 36 of the judgement):

“This Court recognizes that the Philippines is a signatory to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards. As a general rule, the courts are aware of the encouragement given to the parties to resort to arbitration as a mode of dispute resolution. As such, foreign arbitral awards issued in accordance with the rules of the United Nations convention are entitled to great respect and recognition by the international community. However, this Court recognizes that there are exceptions to this rule. Compelling reasons exist to justify the action to be taken by this Court in regard to the validity of the arbitral award.”

The Court of Appeal referred to the public policy of the country and held that the award could not be given effect to because, if it were, it would result in the “supplanting of our own laws and public policies”. It appears from the judgement that the substantive law of the Philippines applied to the dispute, but the arbitrator appeared not to have appreciated that law in coming up with the award.

The Court of Appeal held that the petitioner’s failure to recover liquidated damages for delay and it being compelled to grant an extension of time to the respondent was wrongly refused as a matter of law. Further, the award of substantial costs to the respondent was a further error. Philippine law and public policy did not allow for the award of costs except where proceedings were initiated with bad faith, and there was no finding of bad faith here.

A read of the judgement demonstrates the serious extent to which the Court of Appeal disagreed with the various conclusions of Philippine law reached by the arbitrator. The Court of Appeal concluded:

“It must be stressed in no uncertain terms that parties who enter into an arbitration agreement are bound by the provisions contained therein. In effect, the parties repose their trust and confidence in the arbitration tribunal, as they would in a court, to fairly and faithfully enforce their contractual stipulations as the law between such parties. However, when an arbitral tribunal grossly fails in its task to resolve disputes between parties in accordance with their agreements consistent with Philippine law and public policy, as the arbitral tribunal has glaringly done in this case and as apparent on the

face of its Final Award and its other awards, the Court cannot abdicate on its supreme responsibility to serve the ends of justice. More so in this instant case when the lower court called upon to enforce the Final Award acts with obvious bias and manifest partiality, this Court is constrained to step in to prevent a miscarriage of justice and to avoid multiplicity of suits or circuitous appeals.”

### India

There are two decisions of note in India. Both are Supreme Court decisions. Each, however, was delivered under different statutes.

The first decision is that of *Renusagar Power Co. Ltd. v General Electric Co.*<sup>363</sup> This was a decision delivered before India adopted the Model Law. The Supreme Court in *Renusagar* held that a foreign award could not be enforced (under the old Act) if the award was contrary to the public policy of India. The Supreme Court held that the use of the words “public policy” was in its narrow sense. The Supreme Court held that, in order to attract a bar on the ground of being against Indian public policy, there must be something more than just a violation of the law of India. The Supreme Court went on to hold that public policy should be defined in the sense in which it was applied in the arena of private international law. The Supreme Court in *Renusagar* held that a foreign award would not be enforced (under the Foreign Awards (Recognition and Enforcement) Act of 1961) by reason of breach of public policy if it was contrary to:

- (a) The fundamental policy of Indian law; or
- (b) The interests of India; or
- (c) Justice or morality.

India adopted the Model Law in 1996 with the passage of the Arbitration and Conciliation Act of 1996. In 2003 the Supreme Court was called upon to decide the ambit of the court’s jurisdiction where an award was challenged in a decision called *Oil and Natural Gas Corporation Ltd. v SAW Pipes Ltd.*<sup>364</sup> The Supreme Court framed the issue like this: whether the court had jurisdiction to set aside an award that was patently illegal or in contravention of the provisions of the Arbitration and Conciliation Act of 1996 or any other substantive law governing the parties or was against the terms of the contract.

The Supreme Court in *Oil and Natural Gas* first considered whether the award was against the public policy of India. It referred to earlier decisions of the Indian Supreme Court where it was held that public policy was not the policy of the Government and that it connoted:

“... some matter which concerns the public good and the public interest. The concept of what is for the public good or in the public interest or what would be injurious or harmful to the public good or the public interest has varied from time to time.”

The Supreme Court in *Oil and Natural Gas* then noted the traditional or narrow view that the courts would not invent new heads of public policy. The court referred to the

<sup>363</sup> 1994 Supp (1) SCC 644.

<sup>364</sup> AIR 2003 Supreme Court 2629.

traditional decisions on public policy<sup>365</sup> that it was “an unruly horse” and contrasted this with the approach of Lord Denning in 1971 who said that “with a good man in the saddle, the unruly horse can be kept in control”.<sup>366</sup>

The Supreme Court opined that it preferred the modern approach: the principles that governed public policy could, on the proper occasion, be expanded and modified in keeping with the public good. The Supreme Court then dealt with its earlier decision in *Renusagar* and decided not to follow it in the light of the different legislative framework under which that decision had been taken.

The Supreme Court then referred to section 68 of the English Arbitration Act of 1996 and noted how that Act allowed awards to be challenged on the grounds of serious irregularities. The Supreme Court then held that a wider meaning needed to be given to the term “public policy of India” within the meaning of the Arbitration and Conciliation Act of 1996.

My reading of the Oil and Natural Gas decision therefore is that the Supreme Court was moved by the fact that under the previous statutory framework (and even in England), an award could be challenged on more grounds than under the Model Law statutory framework. The Supreme Court therefore found it necessary to adopt a wider definition of the term “public policy of India” and included in that definition an award that on its face patently violated statutory provisions as such an award could not be in the public interest. The Supreme Court held that in addition to what was laid down in *Renusagar* as being against the public policy of India, an award would be against the public policy if it was contrary to:

- (a) The fundamental policy of Indian law; or
- (b) The interests of India; or
- (c) Justice or morality; or
- (d) In addition, if it is patently illegal (in that it goes to the root of the matter. The illegality cannot be trivial.)

The Supreme Court in *Oil and Natural Gas* further held that an award could be set aside if it was so unfair and unreasonable that it shocked the conscience of the court.

The decision of *Oil and Natural Gas*, therefore, clearly takes the matter a step further than the courts of the Philippines and Malaysia. It sets a precedent, which, thus far, has not been followed in Malaysia, New Zealand or Singapore.<sup>367</sup>

#### *Other decisions*

In *Amaltal Corporation v. Maruha*,<sup>368</sup> the New Zealand Court of Appeal opined that public policy “concerned fundamental principles of law where enforcement would violate

<sup>365</sup> For instance, Lord Davey in *Janson v. Driefontein Consolidated Gold Mines* [1902] AC 484 at 500; *Richardson v. Mellish* [1824] 2 Bing. 229 at 252.

<sup>366</sup> *Enderby Town Football Club Ltd. v. Football Association Ltd.* [1971] Ch 591 at 606.

<sup>367</sup> In the decision of *Downer-Hill Joint Venture v. Government of Fiji* [2005] 1 NZLR 554 HC.

<sup>368</sup> [2004] 2 NZLR 614 CA.

basic notions of morality or justice or be clearly injurious to the public good”, citing the report of UNICTRAL of 21 August 1985:<sup>369</sup>

“It was understood that the term ‘public policy’, which was used in the 1958 New York Convention and many other treaties, covered fundamental principles of law and justice in substantive as well as procedural respects.”

The Court of Appeal held that, even if the arbitrator had misappreciated the law on penalties, that did not render the award as being against the public policy of New Zealand.

The United States in the Court of Appeals from the Second Circuit in *Parsons & Whittemore Overseas Co. Inc. v. Société Générale de l’Industrie du Papier (RAKTA)*<sup>370</sup> held that the enforcement of a foreign award might be denied on the basis that its enforcement “would violate the forum State’s most basic notions of morality and justice”.

The Court of Appeal for Ontario said in *Boardwalk Regency Corp. v. Maalouf*<sup>371</sup> that it was common ground that the reason for imposing public policy was “essential morality” and that it was “more than the morality of some persons and it must run through the fabric of society to the extent that it is not consonant with our system of justice and general moral outlook to countenance the conduct, no matter how legal it may have been where it occurred”.

### *Conclusion*

The above decisions show a marked distinction in the treatment of awards and the definition of public policy between the developed and developing jurisdictions.

The adoption of a broad interpretation of “public policy” will increase instances where courts interfere and set aside awards rendered in arbitrations under the Model Law framework. The need for the education of judges and counsel alike on instances where awards can be challenged under the Model Law framework therefore gains an added dimension of importance.

In an increasingly economically interdependent world, there is certainly a need, as also expressed by the international arbitration community, for an international public policy shared by all States (which would include only the narrow, basic fundamental safeguards that every arbitration proceeding should observe). That might be a suggested topic of future work for UNCITRAL.

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*Michael E. Schneider, Chair*

Now I think one of the subjects for our discussion could be on the manner to deal with that diversity in which the concept of public policy is used. Now, is the solution to strive towards a similar concept of public policy, or do we need to preserve this difference, the

<sup>369</sup> A/40/17, para. 297.

<sup>370</sup> 508 F 2d 969 (1974) at 974.

<sup>371</sup> (1999) 6 OR (3d) 737 at 743.

different cultural values in different countries and different political and economic systems? And then, there is another question, if we strive towards uniformity of a concept of public policy, should there be an institutional underpinning? At a previous UNCITRAL congress, there was a proposal to have a single unit enforcement court for the entire world, to which some critical observations were made.

The next speech will focus on an institutional aspect, the question of appeal in international arbitration. Sir Anthony Colman is a judge, or was until very recently, in a very prestigious jurisdiction, the High Court in London, where he had a wide range of matters to deal with, including innumerable cases involving arbitration.

## 2. *The question of appeals in international arbitration*

*Anthony Colman*

*Royal Courts of Justice, United Kingdom of Great Britain and Northern Ireland*

In the context of this question, I am going to treat the idea of an appeal as referring primarily to a reinvestigation of the substantive merits of the issue between the parties. We are not talking here of such issues as defects in the constitution or jurisdiction of the tribunal or in the procedure adopted by the tribunal or going to the disqualification of the members of the tribunal. Our concern is with whether the original tribunal arrived at the correct decision on the evidence as to the facts and on the legal analysis of those facts.

There is obviously a fundamental difference between the former kind of defect, which goes to the adequacy and fairness of the proceedings, and the latter kind of defect, which goes to the intrinsic quality of the tribunal's conclusions. The former involves a direct or indirect mis-performance or non-performance of the parties' arbitration agreement in as much as there is said to have been a failure to comply, for example because an arbitrator has been appointed who lacks required qualifications or is biased or because, having been appointed, the tribunal has mis-conducted the hearing. The latter involves the making, by a properly appointed tribunal, acting in an entirely fair and unobjectionable manner in its conduct of the hearing, of an error of fact or law in reaching its conclusions.

As I shall explain, there is at least one important instance where there is sometimes an overlap between the tribunal's conclusions on a matter going to implementation of the arbitration agreement and its conclusions on the merits of the underlying dispute. This most frequently arises where there is an issue as to jurisdiction of the tribunal that is inextricably linked with an issue as to the merits. The classic case is where the respondent alleges that it was not a party to the agreement upon breach of which the claimant founds its claim but which also contained the arbitration clause.

Approaching this question with regard to the supervisory jurisdiction of domestic courts from the viewpoint of an English commercial judge, which was my position until I retired a few weeks ago, there emerges a pronounced distinction between the readiness of domestic courts and other supervisory bodies to interfere with awards on the grounds of error of fact or law on the one hand and readiness to interfere on grounds going to the implementation of the arbitration agreement, including jurisdiction of the tribunal and procedural fairness. Broadly, the factual or legal error area or, as I shall call it, the merits

area is treated in most modern legal systems as off-limits, whereas the arbitration agreement implementation area is treated as much more readily open to supervisory intervention by the courts or other relevant bodies.

In English law the provisions of the Arbitration Act of 1996 neatly illustrate this dichotomy, but they also exemplify quite a significant supervisory invasion of the merits area. Let me explain.

We start from the basis that the 1996 Act makes no distinction relevant for present purposes between domestic arbitrations and international arbitrations subject to the New York Convention that have their seat in England.

The key provisions of the 1996 Act that invade the merits area are to be found in sections 69 and 70, which provide as follows:

**“69. Appeal on point of law**

“(1) Unless otherwise agreed by the parties, a party to arbitral proceedings may (upon notice to the other parties and to the tribunal) appeal to the court on a question of law arising out of an award made in the proceedings.

“An agreement to dispense with reasons for the tribunal’s award shall be considered an agreement to exclude the court’s jurisdiction under this section.

“(2) An appeal shall not be brought under this section except—

“(a) with the agreement of all the other parties to the proceedings, or

“(b) with the leave of the court.

“The right to appeal is also subject to the restrictions in section 70 (2) and (3).

“(3) Leave to appeal shall be given only if the court is satisfied—

“(a) that the determination of the question will substantially affect the rights of one or more of the parties,

“(b) that the question is one which the tribunal was asked to determine,

“(c) that, on the basis of the findings of fact in the award—

“(i) the decision of the tribunal on the question is obviously wrong, or

“(ii) the question is one of general public importance and the decision of the tribunal is at least open to serious doubt, and

“(d) that, despite the agreement of the parties to resolve the matter by arbitration, it is just and proper in all the circumstances for the court to determine the question.

“(4) An application for leave to appeal under this section shall identify the question of law to be determined and state the grounds on which it is alleged that leave to appeal should be granted.

“(5) The court shall determine an application for leave to appeal under this section without a hearing unless it appears to the court that a hearing is required.

“(6) The leave of the court is required for any appeal from a decision of the court under this section to grant or refuse leave to appeal.

- “(7) On an appeal under this section the court may by order—
- “(a) confirm the award,
  - “(b) vary the award,
  - “(c) remit the award to the tribunal, in whole or in part, for reconsideration in the light of the court’s determination, or
  - “(d) set aside the award in whole or in part.

“The court shall not exercise its power to set aside an award, in whole or in part, unless it is satisfied that it would be inappropriate to remit the matters in question to the tribunal for reconsideration.

“... ”

**“70. Challenge or appeal: supplementary provisions**

- “(1) The following provisions apply to an application or appeal under section 67, 68 or 69.
- “(2) An application or appeal may not be brought if the applicant or appellant has not first exhausted—
- “(a) any available arbitral process of appeal or review, and
  - “(b) any available recourse under section 57 (correction of award or additional award).
- “(3) Any application or appeal must be brought within 28 days of the date of the award or, if there has been any arbitral process of appeal or review, of the date when the applicant or appellant was notified of the result of that process.”

One’s immediate reaction is that at first sight these provisions represent a significant invasion of the merits area and detract from the purpose of the finality of awards. However, the reality is somewhat different.

The origin of these provisions exemplifies a typical English compromise, namely, an attempt to preserve some method of the courts deploying the consideration of arbitration awards to achieve the further development of English commercial law at the same time as establishing a barrier protective as far as consistent with that attempt of the autonomy and independence of the arbitral tribunal in the merits area.

Thus, the appeal must be on a question of law and not fact. In the result, the only permissible reference materials are the award itself. It is impermissible for the purposes of the court’s decision whether to grant leave to appeal to investigate the underlying evidence or the manner in which the arbitration or the hearing were conducted.

Further, and most importantly, section 69 (2) provides that there can only be an appeal if either all parties agree or the court gives leave and section 69 (3) imposes four requirements for the giving of leave, the most significant of which for present purposes is (3) (c). The court seized of an application for leave to appeal is therefore required to examine the strength and quality of the applicant’s criticism of the award so as to decide whether it is obviously wrong as a matter of law or whether the criticism raises a question of general public importance and the decision is open to serious doubt.

Also under section 70 the would-be appellant must first exhaust any available arbitral process of appeal and must apply to the court within 28 days of the date of the award. The availability of an arbitral process of appeal is a reference to two-tier institutional structures, which are most commonly found in the arbitration rules of the commodity trades. One of the most radical is that of the Grain and Feed Trade Association (GAFTA), where Arbitration Rules provide for each party to appoint its own arbitrator and for the third arbitrator to be appointed by the Association. An appeal can be made as of right, within 30 days of the award, to a board of appeal of three members of GAFTA or five members, dependent on whether the parties had agreed to an original sole arbitrator or to a three-arbitrator tribunal. The permitted appeal is much more far-reaching than that allowed under section 69 of the 1996 Act. It is in fact a complete re-arbitration at which all original issues of fact and law can be reopened or added to. Fresh evidence can be adduced regardless of whether it was both known to the party relying on it and available at the time of the original hearing. There is no filter system. Appeals are there for the asking. The position, therefore, is that when parties enter into a GAFTA standard agreement, incorporating such an arbitration agreement, they do so with full knowledge that the first-tier arbitrators will not necessarily achieve finality over anything. It is only at the second-tier stage that relative finality can be achieved. I say “relative finality” because there is always the possibility of an appeal application under section 69 in respect of an award by an appeal board.

The International Cotton Association, based in Liverpool, has a similar appeal regime under which new evidence may be adduced at the appeal stage regardless of its availability at the time of the original hearing.

The major problem with these particular appeal structures is the opportunity they afford to a losing party at the original arbitration for causing delay in the achievement of finality of an award.

What is the effect of section 69? When this provision first became law there were quite a number of applications for leave to appeal against awards. However, the judges gave leave in very few cases. In the interests of achieving early finality, they took a strict line on the meaning of the decision being “obviously wrong” and in identifying what was a “question of general public importance”—a provision that was intended to leave open a gateway for further judicial development of English commercial law. As word got round among the lawyers that it was so difficult to obtain leave to appeal, there were fewer and fewer applications because they were seen as a waste of costs. There were so few in fact that the narrow gateway left open for appeals has by now effectively been virtually closed by lack of use. In 2006 there were 42 applications in the Commercial Court under section 69. Out of those, 16 cases were refused, 3 transferred out of the Commercial Court to other courts and 13 settled or were discontinued. Ten cases were granted leave to appeal. Of those eight are still to be heard and the two applications that have had a full hearing were both dismissed.

The 1996 Act deals with issues of jurisdiction in what many commentators consider to be an eccentric way. The preservation of party autonomy and *Kompetenz-Kompetenz* was very much in the mind of the draftsmen of the Act. So, also, however, was the belief that the English courts should retain ultimate responsibility for the determination of issues going to the substantive jurisdiction of the tribunal. The result is a cluster of provisions the

effect of which is to give the parties the opportunity of a decision by the tribunal on an issue of substantive jurisdiction and then to superimpose on it the court's power to reinvestigate the same issue if one of the parties invokes that additional jurisdiction without delay. Thus one finds the following provisions:

**“31. Competence of tribunal to rule on its own jurisdiction**

“(1) An objection that the arbitral tribunal lacks substantive jurisdiction at the outset of the proceedings must be raised by a party not later than the time he takes the first step in the proceedings to contest the merits of any matter in relation to which he challenges the tribunal's jurisdiction. A party is not precluded from raising such an objection by the fact that he has appointed or participated in the appointment of an arbitrator.

“...

“(4) Where an objection is duly taken to the tribunal's substantive jurisdiction and the tribunal has power to rule on its own jurisdiction, it may —

“(a) rule on the matter in an award as to jurisdiction, or

“(b) deal with the objection in its award on the merits.

If the parties agree which of these courses the tribunal should take, the tribunal shall proceed accordingly.

“(5) The tribunal may in any case, and shall if the parties so agree, stay proceedings whilst an application is made to the court under section 32 (determination of preliminary point of jurisdiction).

“...

**“32. Determination of preliminary point of jurisdiction**

“(1) The court may, on the application of a party to arbitral proceedings (upon notice to the other parties), determine any question as to the substantive jurisdiction of the tribunal.

A party may lose the right to object (see section 73).

“(2) An application under this section shall not be considered unless—

“(a) it is made with the agreement in writing of all the other parties to the proceedings, or

“(b) it is made with the permission of the tribunal and the court is satisfied—

“(i) that the determination of the question is likely to produce substantial savings in costs,

“(ii) that the application was made without delay, and

“(iii) that there is good reason why the matter should be decided by the court.

“(3) An application under this section, unless made with the agreement of all the other parties to the proceedings, shall state the grounds on which it is said that the matter should be decided by the court.

“...

**“67. Challenging the award: substantive jurisdiction**

“(1) A party to arbitral proceedings may (upon notice to the other parties and to the tribunal) apply to the court—

- “(a) challenging any award of the arbitral tribunal as to its substantive jurisdiction; or
- “(b) for an order declaring an award made by the tribunal on the merits to be of no effect, in whole or in part, because the tribunal did not have substantive jurisdiction.

A party may lose the right to object (see section 73) and the right to apply is subject to the restrictions in section 70 (2) and (3).

“... ”

“(3) On an application under this section challenging an award of the arbitral tribunal as to its substantive jurisdiction, the court may by order—

- “(a) confirm the award,
- “(b) vary the award, or
- “(c) set aside the award in whole or in part.”

This provision involves a rehearing of the jurisdiction issue and not merely a review of the correctness of the arbitrators’ decision on their own jurisdiction before the arbitrators. It is thus open to either or both parties to introduce fresh evidence, even if it was available at the time of the original hearing on jurisdiction. Of course, it is always open to the parties to agree to avoid this potential source of additional expense and delay by dispensing with the arbitral tribunal’s decision on jurisdiction and going straight to the court under section 32, but obstructive respondents are unlikely to agree to that.

Most jurisdictions do not permit an appeal from an arbitrator’s award on the merits. Thus, in Switzerland there is no such appeal and indeed on issues relating to the jurisdiction of arbitrators it is an open question whether, although the hearing is *one de novo*, the arbitrators’ findings of fact that are relevant to the issue of jurisdiction can be ignored altogether or should, at least in part, be respected. In Hong Kong SAR, the UNCITRAL Arbitration Rules have been adopted almost without variation. Consequently, no appeals on the merits are allowed in international arbitrations, although in domestic arbitrations appeals on issues of law only are permitted. In France there are no appeals in the merits area: article 1502 of the New Code of Civil Procedure sets out the only grounds for annulment of awards; for example, that there was no arbitration agreement or that the agreement was void or had expired or that due process had been ignored or that the award was contrary to public policy.

Finally, in the United States there is no general right of appeal in the merits area. However, manifest disregard of the law can form the basis of an appeal. This, however, appears to involve the deliberate refusal to apply established principles of law rather than a mere error in application of the law. Commentators express the view that this may simply be a facet of the arbitrators exceeding their jurisdiction rather than a genuine appeal in the merits area.

So far I have been describing the appeals structures, such as they are, that are found to exist in major domestic procedural regimes designed to supervise and control international

arbitrations such as would be covered by the New York Convention that have their seat in the relevant jurisdiction. Such regimes obviously have the facilities in the shape of the existence of the civil court structure to entertain supervisory jurisdiction, including jurisdiction in the merits area, in the exceptional cases where that is permitted.

A very different picture emerges when one comes to seatless arbitrations. In this context I am referring to arbitrations such as those conducted under the ICSID Rules of Procedure for Arbitration Proceedings or under bilateral investment treaties (“BITs”). These arbitrations differ fundamentally in origin from those to which I have already been referring. In particular, the jurisdiction of the arbitrators arises from the fact that it has been invoked under international treaty rules. There is normally no contractual arbitration agreement as such. Rather, multilateral or bilateral treaty regimes are triggered by the conduct of one party to the dispute initiating the prescribed procedures. With regard to ICSID, the procedural regime and arbitration awards emanating from it are insulated from the supervisory jurisdiction of the courts of any particular State. It is the Administrative Council of ICSID that is the medium of operation of supervisory procedures.

One consequence of this particular characteristic of insulation from all domestic courts is that any supervisory jurisdiction and, if there ever were one, any appellate jurisdiction with regard to the merits area would necessarily have to be supplied either by the very organization that itself is insulated from domestic jurisdiction or by some other organization of an international character that is equally detached.

The position in relation to ICSID arbitrations is that a power of annulment exists under article 52 (1) of the Rules of Procedure. Matters giving rise to annulment include: the tribunal is not properly constituted; the tribunal has manifestly exceeded its powers; there has been corruption on the part of a member of the tribunal; there has been a serious departure from a fundamental rule of procedure; and the award has failed to state the reasons on which it was based.

There is also provision in article 51 (1) for the revision of an award by the original arbitral tribunal if new evidence has come to light since it was made. This is not the time or place to investigate the niceties attaching to the provisions relating to annulment. They have given rise to acute difficulties, particularly in view of the power to annul an award in part, alternatively to annulling it in whole, coupled with the facility that either party may request the resubmission of the dispute to a new tribunal, whereupon the whole arbitration starts again in relation to the whole or that part of the award which has been annulled. For present purposes, however, it is important to note that the administration of the annulment procedure is conducted by the Administrative Council of ICSID, which appoints an ad hoc committee under article 52 (3) of the Rules. The remarkable situation may therefore arise where there is an original arbitration, then the proceedings before an ad hoc committee relating to annulment, then the annulment of part of the original award, the reference of the annulled part of the original award to a new arbitral tribunal followed by proceedings before that tribunal in which findings of the original tribunal relevant both to the surviving part of the original award and to issues before the new tribunal are not necessarily binding on the parties and can be reopened. To those outsiders such as myself who are more accustomed to a developed domestic regime for the exercise of supervisory jurisdiction, this appears to represent a recipe for no little procedural chaos, not to mention the opportunity for some wonderful points on issue estoppel under the applicable conflicts rules.

Is it possible in any practical sense, as distinct from the fantasies of an international arbitration conference, to splice into such a free-standing international regime an appellate jurisdiction directed to the merits area rather than to the area of the ICSID annulment regime?

The first thing to be said is that it is extremely dangerous, in my view, to attempt to proceed by way of analogy with the kind of appeal structure in the merits area that one finds, for example, in England. For one thing, there is not any analogous purpose for the introduction of such a regime. One is not concerned with the organic growth of an area of domestic commercial law such as motivated the provisions of the Arbitration Act of 1996 in England. In the case of arbitrations of international investment disputes, a multiplicity of bodies of law may be in play. Indeed, it may be open to the arbitrators to develop rules of fairness and common practice in the commercial field that have more to do with a developing *lex mercatoria* than with the identifiable commercial legal regime of any particular country, even the countries involved directly in the dispute in question. A merits area appeals system may therefore give rise to considerable dispute as to the appropriate operation of rules of conflicts of laws as distinct from rules of any particular domestic body of commercial law and indeed may become concerned with highly debateable *lex mercatoria* principles that do not necessarily directly reflect or coincide with the bodies of law of the countries of the participants in the arbitration in question. Against this background the concept of error of law as a justification for the introduction of an appellate regime may well be flawed. What may really matter in this kind of international arbitration is not so much the importance of ensuring that purity of legal principle is being adhered to but rather whether the hearing is in fact seen to have been fairly conducted in the interests of both parties. That throws us back into the field of procedural regulation already catered for by the annulment procedure operated by ICSID.

If, however, the position is adopted that a merits area appeal structure really is needed, the next question is: how wide ought the appeal facility to range? Should it, for example, cover all matters in dispute in the original arbitration, including issues of fact? Or should it be confined to questions of law? Should it involve the radical approach of GAFTA of catering for a complete rehearing of the arbitration? Or should it be concerned only with reviewing the decisions of the original tribunal on the issues then before it? To what extent should it allow new issues to be introduced at the appeal stage?

In my view, it is very hard to justify the concept of a complete rehearing in the context of international commercial arbitration. It is less hard to justify but still problematical to contemplate the introduction of a review of decisions on the facts. That would involve the investigation of the question whether the original tribunal had improperly attached weight to particular evidence or had indeed decided issues of fact without any evidence to support its conclusions. On the face of it this involves a very serious inroad into the concept of the autonomy of the original tribunal and is hardly likely to attract much international support unless glaring errors of evidential analysis are extremely commonplace. So let us assume that the scope of appeals is confined to errors of law.

The next question is whether there is to be any filter system whereby only if the arbitral tribunal has made an obvious error of law, should there be an appeal, by analogy with the regime of section 69 of the English Arbitration Act of 1996? This in itself produces further problems. Who is to determine whether the error of law is obvious or not obvious? In a domestic regime the civil courts are there and available to determine whether this filter system should operate in favour of an appellant. However, where there is no substitute for a domestic court

operating as a filter agency, there are more difficult problems. For example, is the filtering to be done by the very same body that sits for the purpose of determining a substantive appeal?

The question that next arises is whether the members of the appellate body should be a standing court or tribunal, having a published list of members, or whether the members of the appellate body should be appointed ad hoc by an administrative machinery such as the Chairman of the Administrative Council of ICSID. That in turn raises the question as to how the appellate body should be composed by whoever is responsible for appointing it. All sorts of delicate issues as to cultural and juristic balancing are likely to arise. Further, should the members of the appellate body be unconnected with any interested State or the State of the claimant party? The advantage of the establishment of a permanent body with published names is that it can develop a coherent body of jurisprudence and can thereby gradually establish consistency of approach to the kind of issues likely to arise on appeal. However, I am very much aware that our friends from civil law jurisdictions are likely to find the concept of anything approaching a doctrine of *stare decisis* distinctly indigestible.

Whereas in relation to ICSID arbitrations the establishment of a permanent appellate body could be made to fit in with the existing procedural regime, this would be much more difficult in relation to BITs. There might only be a minute number of disputes arising for arbitration under a particular BIT over a very large number of years, such that the appellate body would be virtually unemployed for most of the time. It may be that all investment disputes could be referred to a global appellate body, perhaps set up under the permanent Court of International Arbitration, which is, of course, equipped with a standing body of experienced personnel able to deal with the sort of issue that might arise for decision on appeal in an investment dispute. Here, however, one runs into an unsatisfactory dichotomy. On the one hand, under ICSID one has a system of ad hoc annulment committees that may be called upon to deal with issues of fact arising before the original tribunal for the purpose, for example, of deciding whether the tribunal is properly constituted or has manifestly exceeded its powers or has departed from a fundamental rule of procedure. On the other hand one would run perhaps an unacceptable risk of jurisdictional overlap between such a committee looking at a claim to annulment, and an appellate body considering whether the original tribunal had erred in relation to a question of law on an issue before it. For that reason, there is perhaps much to be said for combining the functions of an appellate tribunal on questions of law with the functions of the ad hoc annulment committee just in the same way as, for example, an English court could be seized both of issues of jurisdiction, which in turn raised questions of fact and law and, following an award on the merits, issues of law arising on the face of the award.

These are not easy problems and before embarking on any serious attempt to create a procedural regime capable of accommodating merits area appeals in relation to investment disputes, the starting point, to which I return, has to be, do we really need to have appeals against decisions of tribunals that, in the interests of fairness and justice, are already subject to the supervisory regime of an annulment system, such as under article 51 of the Rules of Procedure? Are things going so badly wrong that putting in place an appellate regime, which, by its very nature, is likely to be fraught with problems of jurisdiction and to provide obstructive losing parties with a blueprint for delay, is a remedy really called for in a world where arbitral autonomy and finality still count for something?

*Michael E. Schneider, Chair*

Before having heard Sir Anthony's intervention, I thought the subject could give rise to a lively debate, but he has been so persuasive in his conclusions that it would take a daring challenger to challenge his views. We should reserve our thoughts on this question, perhaps not in as radical a form as it is sometimes suggested or heavily debated with respect to investment disputes, where appeal procedures are even promoted or supported by certain Governments. In the discussion, we should limit ourselves to such procedures or forms of correction of awards in the context of commercial arbitration, leaving aside the investment arbitration aspect.

Now, there may be various institutional supports to arbitration, either at the end of the proceedings when the arbitration has gone wrong or somewhere in the course of the arbitration proceedings and that leads us to the next subject on our agenda, which will be presented by Georgios Petrochilos, whose name means "outstanding orator, lips of stone". And from these lips of stone sound the words of a great orator, one of the lawyers in one of the leading arbitration firms, Freshfields, where he practices both arbitration and public international law.

### 3. *Does ad hoc arbitration require more support?*

*Jan Paulsson*

*Freshfields Bruckhaus Deringer, France; and President, London Court of International Arbitration*

*(Presented by Georgios Petrochilos*

*Freshfields Bruckhaus Deringer, France)*

Our fellow panellists have addressed the far more intellectually demanding topics of public policy and reviewability of awards in international arbitration. It falls to us to consider an entirely practical matter, namely the extent to which it might be useful or indeed necessary to enhance the support available to buttress ad hoc arbitration.

Although this subject will lead us to deal with, inter alia, certain rather mundane aspects of the arbitral process, these may be of very great interest to the parties. Indeed, there are some matters that appear to be ones of pure routine, but in reality bring into question the very legitimacy of the process. Hence the concept of "support" that is relevant for our purposes today covers both of the two principal etymological definitions of the term:<sup>372</sup> assistance and backing to the ad hoc arbitral process; and upholding or sustaining ad hoc arbitration as an institution, to ensure its continuing vitality.

Before turning to those matters, a few words are in order by way of introduction.

#### (a) *"You never had it better"*

Writing in 1967, less than a year after the creation of UNCITRAL, René David penned a contribution to the *Liber Amicorum for Martin Domke* entitled "*L'avenir de l'arbitrage*".<sup>373</sup>

<sup>372</sup> According to the *Shorter Oxford English Dictionary*, 5th ed. (Oxford, Oxford University Press, 2002).

<sup>373</sup> See Pieter Sanders, ed., *International Arbitration: Liber Amicorum for Martin Domke* (The Hague, Martinus Nijhoff, 1967), p. 57.

Critically taking stock of developments, Professor David noted that much progress had been made since the 1923 and 1927 Geneva instruments,<sup>374</sup> but fundamental questions remained, notably as to the requirements for the validity of an arbitration agreement, the question of the law to be applied by arbitrators (including in particular *lex mercatoria*), the law governing the arbitration (the *lex arbitri*),<sup>375</sup> and the legal nature of an arbitral award (contractual or judicial?). Today we recognize that many of those questions have been conceptually explored, and there is a substantial amount of uniformity in the way that they have been resolved in practice, in international conventions, arbitration statutes and arbitration rules. Much of this progress is doubtless due to the work of UNCITRAL, whose fortieth annual session we honour today.

In the paper cited above, Professor David went on to say that there was a “*différence de grande portée*” between ad hoc and institutional arbitration: only institutional arbitration could be subject to some measure of supervision. If that difference were recognized, international arbitration could be “improved”. States should be prepared to vouch (“*se porter garant*”) for the quality of select arbitral institutions and publish official lists of such institutions. A measure of “international control”, or at least the creation of some international norms, should be further considered.<sup>376</sup> Professor David could not envisage that what we today call “control assurance” would ever be feasible in ad hoc arbitration. He perceived ad hoc arbitration as a diffuse, unsupervised and casuistic process, and harboured no hope that it could foster the development of international arbitration as a discipline. As he put it, in ad hoc arbitration “*tant vaut l’arbitre, tant vaut l’arbitrage*”.

Professor David had a point, of course. Resorting to ad hoc arbitration in a satisfactory way required the expenditure of considerable resources to set out the charter of the arbitral process. It was appropriate for very large matters, typically between States and large foreign investors<sup>377</sup> or between States only<sup>378</sup> (or for very small matters, to be resolved informally, without much attention to procedural arrangements). For the vast majority of cases in between, parties had to rely on the provisions on arbitration to be found in statutes or procedural codes, which were much too often antiquated. As ICC put it in 1974:<sup>379</sup>

“The difficulties to which ad hoc arbitration gives rise at the international level [are due to] the inadaptability of national rules of civil procedure that are applicable in the absence of, or in opposition to, special stipulations by the parties.”

<sup>374</sup>The Protocol on Arbitration Clauses, signed at Geneva on 24 September 1923 (League of Nations, *Treaty Series*, vol. XXVII, No. 678); and the Convention on the Execution of Foreign Arbitral Awards, signed at Geneva on 26 September 1927 (League of Nations, *Treaty Series*, vol. XCII, No. 2096).

<sup>375</sup>F. A. Mann, “Lex facit arbitrum”, in Sanders, *International Arbitration: Liber Amicorum*, p. 157.

<sup>376</sup>René David in Sanders, *International Arbitration: Liber Amicorum*, p. 63.

<sup>377</sup>See, for example, the *compromis* in *Saudi Arabia v. Aramco*, which is quoted by Hambro (1962-I) 105 RdC 1, 43. (Award: *International Law Review*, vol. 27, 1958, p. 117).

<sup>378</sup>See for example the Agreement between the Government of the United States of America and the Government of Canada concerning the establishment of an International Arbitral Tribunal to dispose of United States claims relating to Gut Dam, signed at Ottawa on 25 March 1965 (United Nations, *Treaty Series*, vol. 607, No. 8802); and the Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Greek Government regarding the submission to arbitration of the *Ambatielos* claim, signed at London on 24 February 1955. (United Nations, *Treaty Series*, vol. 209, No. 2827). Alternatively, States could draw up a *compromis* setting out the basic parameters of the arbitration (principally, the composition of the tribunal and the number and sequence of submissions) and leave more detailed procedural matters to the tribunal, and organizational and logistical matters to the Permanent Court of Arbitration; see, for example, the agreement between the United Kingdom and France regarding the *Muscat Dhows* case (1904), Scott, *The Hague Arbitration Cases* (1915), p. 65. (Award: *ibid.*, p. 69 (1905).)

<sup>379</sup>Observations to the preliminary draft UNCITRAL Arbitration Rules (A/CN.9/97/Add.1) (1975), annex II, reproduced in *Yearbook of the United Nations Commission on International Trade Law, Volume VI: 1975* (United Nations publication, Sales No. E.76.V.5, vol. VI, p. 181).

The *Société européenne d'études et d'entreprises v. Yugoslavia* saga illustrates the observation by ICC well. The facts are recounted elsewhere.<sup>380</sup> For present purposes, the point to note is that the parties' arbitration agreement called for an umpire procedure.<sup>381</sup> Yugoslavia defaulted, and the courts of the Canton of Vaud (the place of the arbitration) made the necessary appointment. The two-arbitrator formation, as constituted, was able to reach consensus, and rendered an award.<sup>382</sup> Litigation in three countries (France, the Netherlands and Switzerland) then ensued. Thirty years, and much judicial time and learned argument, were spent in that litigation, much of which was devoted to the question whether the parties' ad hoc agreement, calling for an umpire process, was valid under the law of the Canton of Vaud (if that law was relevant at all, which was in dispute).<sup>383</sup>

Not only was ad hoc arbitration cumbersome to design, it was also bereft of practical support on the international plane. If the parties failed to constitute the tribunal (say, because the respondent defaulted in the arbitration and refused to cooperate), the only reliably available *autorité d'appui* was a national judiciary.<sup>384</sup> Clauses calling for appointments to be made by the President of the International Court of Justice had no statutory foothold in the Statute of the Court, and were not always effective in practice.<sup>385</sup>

The adoption of the UNCITRAL Arbitration Rules by the General Assembly in its resolution 31/98 of 15 December 1976 must be seen in the light of the void in which ad hoc arbitration existed—or, rather, floated—until that time. (A similar attempt had been made in respect of State-to-State ad hoc arbitration in the 1950s by the International Law Commission—with very limited success in practice.)<sup>386</sup> Professor Sanders, who was the UNCITRAL consultant in the preparation of the Rules, initially proposed a set of rules

<sup>380</sup> See Jan Paulsson, "The extent of independence of international arbitration from the law of the *situs*", in *Contemporary Problems in International Arbitration*, Julian D. M. Lew, ed. (Dordrecht, Martinus Nijhoff, 1987), pp. 141-143.

<sup>381</sup> The arbitration clause is at *Revue critique de droit international privé*, vol. 37, 1958, p. 359. For a contemporaneous similar clause involving Yugoslavia, see Permanent Court of International Justice, *Losinger & Co. Case*, Series C., Pleadings, Oral Statements and Documents, No. 78, Judicial year 1936 (Leiden, A. W. Sijthoff, 1937), pp. 52-53.

<sup>382</sup> See *Journal du droit international*, vol. 86, 1959, p. 1074.

<sup>383</sup> See Georgios Petrochilos, *Procedural Law in International Arbitration* (Oxford, Oxford University Press, 2004), paras. 8.90-8.97 and the references.

<sup>384</sup> The European Convention on International Commercial Arbitration, done at Geneva on 21 April 1961 (United Nations, *Treaty Series*, vol. 484, No. 7041), provided for support in the constitution of the tribunal to be given by national chambers of commerce (officially notified by the contracting States) or a three-member Special Committee to be constituted by nominees of such chambers; see articles IV and X (6), and the annex to the Convention. The European Convention attracted few ratifications.

<sup>385</sup> For the difficulties encountered by the eponymous claimant in the *Anglo-Iranian* case, see Johnson, *British Yearbook of International Law*, vol. 30, 1953, p. 152. And for a clause that, failing agreement of the parties, called for the appointment of the presiding arbitrator by the Secretary-General, see *Peace Treaties* (Advisory Opinion), *International Court of Justice Reports* (1950), p. 221: no such appointment could be made if one of the parties had failed to appoint an arbitrator. For happier outcomes, see the appointments reported at [1968-1969] *International Court of Justice Yearbook*, pp. 112-113 and [1969-1970] *International Court of Justice Yearbook*, pp. 117-118, in disputes relating to Algerian hydrocarbons and claims brought by French parties.

<sup>386</sup> A memorandum submitted by the Secretary-General in 1949 entitled "Survey of international law in relation to the work of codification of the International Law Commission: preparatory work within the purview of article 18, paragraph 1, of the International Law Commission" (A/CN.4/1/Rev.1) noted that arbitral practice raised the question of an authoritative formulation of some of the principles of arbitral procedure, in particular excess of jurisdiction, the doctrine of "essential error", and the revision and interpretation of arbitral awards (p. 58). Professor Georges Scelle, who was appointed Special Rapporteur, prepared a report in 1950 on arbitral procedures (document A/CN.4/18, reproduced in *Yearbook of the International Law Commission*, 1950, vol. II (United Nations publication, Sales No. 1957.V.3, vol. II), p. 114)) focusing on the "technical framework" of the arbitral process (p. 117). A draft convention on arbitral procedure was proposed, and the Secretariat prepared a detailed study in support, entitled "Commentary on the draft convention on arbitral procedure adopted by the International Law Commission at its fifth session" (A/CN.4/92), but ultimately there was little support for such a convention and the text that resulted from the process took the form of model rules on arbitral procedure (*Yearbook of the International Law Commission*, 1958, vol. II (United Nations publication, Sales No. 58.V.1, vol. II), p. 83).

that, in some respects (such as the constitution of the tribunal), contained separate rules for ad hoc and “administered” arbitration.<sup>387</sup> It was noted that the ad hoc procedures were necessarily more complex than they would be under administered arbitration.

There was considerable opprobrium generated by the idea that some sort of institutional arbitration, however—until that time (and now) a service offered by national/official chambers of commerce, specialized institutions, and ICC—would be regulated by a United Nations instrument.<sup>388</sup> UNCITRAL decided to focus on ad hoc arbitration, and a revised draft of the UNCITRAL Rules was prepared on that basis.<sup>389</sup> A year later the UNCITRAL Rules were endorsed by the General Assembly. They purported to set forth a comprehensive code of the arbitral process. Parties that had a preference for ad hoc arbitration (say, to avoid the confines of rosters of arbitrators maintained by national chambers of commerce, or fees calculated on an *ad valorem* basis) no longer had to reinvent the wheel or experiment: there was a reliable text, with a United Nations imprimatur, which they could adopt by reference in their contract.

Thirty-one years after the adoption of the UNCITRAL Rules, it is useful to bear in mind that the basic architecture of ad hoc arbitration was codified in those Rules. That was the most significant support that ad hoc international commercial arbitration had ever received.

Today we start with the UNCITRAL Rules as an *acquis*. We are able to focus on matters subordinate, of refinement and adaptation. But those matters do merit our attention. It is still the case—and in the nature of things it will always be the case—that the lack of institutional support in ad hoc arbitration poses special challenges. Ad hoc arbitration is still perceived as a mechanism best left to experienced users.<sup>390</sup> Only 25 per cent of the known investment-treaty cases are resolved under the UNCITRAL Rules,<sup>391</sup> and investment-treaty cases typically attract more resources and more experienced counsel than ordinary commercial cases. The importance of having a codification that is adapted to the broad range of contemporary needs cannot be overstated. *Tant valent les règles, tant vaut l'arbitrage*.

It is clear that the most important measures of support in ad hoc arbitration relate to the constitution of the tribunal.<sup>392</sup> In this paper, we propose not to deal with that matter, focusing instead on more discrete aspects of the arbitral process. Here we confine ourselves to two observations only.

Firstly, it is difficult to overstate the importance of article 6 (4) of the UNCITRAL Rules, which requires the appointing authority to “have regard [inter alia] to ... the advisability of appointing an arbitrator of a nationality other than the nationalities of the

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<sup>387</sup> See document A/CN.9/97 (1974), reproduced in *Yearbook of the United Nations Commission on International Trade Law, Volume VI: 1975* (United Nations publication, Sales No. E.76.V.5), p. 163.

<sup>388</sup> See Observations to the preliminary draft UNCITRAL Arbitration Rules (see footnote 379 above).

<sup>389</sup> See document A/CN.9/112, reproduced in *Yearbook of the United Nations Commission on International Trade Law, Volume VII: 1976* (United Nations publication, Sales No. E.77.V.1), p. 157.

<sup>390</sup> A recent research by the School of International Arbitration of the University of London, showed that only 24 per cent of the corporations interviewed opted for ad hoc arbitration, which was perceived as appropriate for primarily larger corporations with more experience of international arbitration (*International Arbitration: Corporate Attitudes and Practices 2006*, p. 12, available from [www.arbitrationonline.org/docs/IAstudy\\_2006.pdf](http://www.arbitrationonline.org/docs/IAstudy_2006.pdf)).

<sup>391</sup> United Nations Conference on Trade and Development, “Latest developments in investor-State dispute settlement”, *IIA Monitor*, No. 4, 2006, p. 3 (figures as at November 2006).

<sup>392</sup> See footnotes 384–385 above and the accompanying text.

parties”. That provision must be seen against the background of arbitration rules of national chambers of commerce that, at the time of the adoption of the UNCITRAL Rules, called for the appointment of nationals of the State of the chamber concerned.<sup>393</sup>

Secondly, there is today some discussion about the idea of a universal body or institution assuming the functions of a default appointing authority under the UNCITRAL Rules. A similar idea was mooted in 1975, in the revised draft UNCITRAL Rules.<sup>394</sup> Article 7 (b) of that draft suggested that “an appropriate organ or body to be established under United Nations auspices” should be the designating authority (as an alternative to the Permanent Court of Arbitration (PCA)). Something different is being discussed today in the context of the revision of the UNCITRAL Rules. The idea is that the PCA could be the default appointing authority (rather than the designating authority, as is now the case), subject to: (a) the parties’ right to ask the PCA to designate another appointing authority; and (b) the PCA’s discretion to designate another appointing authority. The suggestion has met with initial scepticism: it is asked whether a single body (rather than several regional bodies) would be an appropriate appointing authority in all cases; and, if there is to be a universal appointing authority, whether the PCA should be that body.<sup>395</sup> We would in principle answer both questions in the affirmative.

(b) *Quis custodiet the tribunal in fixing its fees?*

We started by noting that mundane matters can be of cardinal importance. The fixing of fees is the paramount example of such a fundamental issue. Everyone knows that arbitration is generally different from court litigation in the sense that arbitrators must be remunerated for their one-time service in a given case. No one gets a salary for being willing to be an arbitrator; an arbitrator without a case is not in fact an arbitrator at all. So it is perfectly routine that arbitration rules establish a mechanism for the establishment of arbitrators’ fees, but this routine matter looks very different when one compares ad hoc arbitrations with those conducted under the rules of an institution. When ICC or the London Court of International Arbitration (LCIA) fixes the fees of a tribunal, it does so in a purely objective manner. When ad hoc arbitrators fix their own fees, they are in effect acting as judges in their own cause. The UNCITRAL Rules say in article 39 (1) that “the fees of the arbitral tribunal shall be reasonable in amount”, taking all relevant circumstances into account. That is fine as far as it goes, but there must be some way to control excessive demands, otherwise parties are at the mercy of arbitrators. They may be hesitant to challenge the arbitrators on this subject. After all, the arbitrators’ fees are but a small fraction of the amount in dispute, but when parties have the sense that arbitrators have abused their position of authority, it leaves them with a bad taste, and in fact diminishes their confidence in the process as a whole. That this is not a theoretical problem may be proved by reference to a simple fact: arbitrators often complain when ICC or LCIA restrict their fees. So if they were unchecked, they would be in a position to impose their own ideas of what they deserve. This is not in the interest of good and well-accepted governance.

<sup>393</sup> See Professor David’s criticism and suggestions (footnote 373 above), p. 63. Today, those arbitral institutions that maintain a roster of arbitrators take care to include foreign nationals.

<sup>394</sup> See footnote 389 above.

<sup>395</sup> See A/CN.9/619, paras. 71-74. For the Permanent Court of Arbitration’s track record, see the document cited at footnote 403 below.

Most experienced arbitrators who have a steady flow of cases, and good reputations to protect, act responsibly. There is no problem. There are still cases where this is not true, however, and they create ripples of discontent and mistrust. When the ad hoc system is not combined with a good system of controls, applied effectively and at an early stage of the process, huge embarrassments may ensue as parties go to court to remove arbitrators or to challenge their awards,<sup>396</sup> indeed demanding that they appear as defendants in court to justify their conduct. This is harmful for the system.

The UNCITRAL Rules have no system of controls. Article 39 (2) provides that if an appointing authority has been agreed upon by the parties or designated by PCA and “if that authority has issued a schedule of fees for arbitrators in international cases which it administers”, the arbitral tribunal “shall” take that schedule into account “to the extent it considers appropriate in the circumstances of the case”.<sup>397</sup> That, we submit, is little comfort, for two reasons.

Firstly, there is a question mark as to what kind of schedule of fees is appropriate. It is true that institutions like ICC and the Stockholm Chamber of Commerce (SCC), both of which administer UNCITRAL arbitrations, have schedules of fees.<sup>398</sup> At least one court in Switzerland has adopted the schedule of fees under the Swiss Rules, for cases in which the court is asked to function as an appointing authority,<sup>399</sup> but those schedules are *ad valorem*, linked to the amount in dispute. No such schedule (or any schedule for that matter) was thought appropriate for inclusion in the UNCITRAL Rules in 1976.<sup>400</sup>

Secondly, and most importantly, article 39 (2) is a *lex imperfecta*: it has no teeth. The duty of consultation with the appointing authority (if one is in place and has issued a schedule of fees for international cases), under article 39 (4) of the UNCITRAL Rules, will not deter those determined to abuse the process. (Professor Sanders has recommended doing away with that provision.<sup>401</sup> There is no recorded instance of its use in practice, nor are we aware of any.)

In our report to the UNCITRAL secretariat on the revision of the UNCITRAL Arbitration Rules,<sup>402</sup> we suggested that article 39 (2) should be prescriptive. If any party disagrees with the tribunal’s determination of its fees, the fees “shall be fixed by the

<sup>396</sup>For a specific right of recourse against an award in respect of fees, see section 41 of the Swedish Arbitration Act of 1999 (SFS 1999:116).

<sup>397</sup>See also article 39, paragraph 4 of the UNCITRAL Arbitration Rules, which sets forth a duty for the tribunal (if an article 39 (2) request has been made and accepted) to “consult” with the appointing authority before fixing its fees.

<sup>398</sup>The American Arbitration Association Procedures for Cases under the UNCITRAL Arbitration Rules (1996, revised in 2005), provide in article 5: “The AAA has no schedule of fees for arbitrators, but it will furnish a statement concerning customary fees based on its experience in administering large numbers of cases.”

<sup>399</sup>This of course raises the question whether that schedule may be said to have been “issued” by the court as the appointing authority in the sense of article 39 (2) of the UNCITRAL Rules.

<sup>400</sup>The legislative history is set out in David D. Caron, Matti Pellonpää and Lee M. Caplan, *The UNCITRAL Arbitration Rules: A Commentary* (Oxford, Oxford University Press, 2006), pp. 942-943. The UNCITRAL commentary to the revised draft of the UNCITRAL Arbitration Rules (quoted in Caron, *The UNCITRAL Arbitration Rules*, p. 943) states that “it was not believed possible to develop a uniform schedule of fees for arbitrators”.

<sup>401</sup>Pieter Sanders, “Has the moment come to revise the Arbitration Rules of UNCITRAL?”, *Arbitration International*, vol. 20, No. 3 (2004), p. 258.

<sup>402</sup>The final version of the report, dated September 2006, is available from the website of UNCITRAL. [The report was available at the time of the Congress.]

appointing authority”, and “if the appointing authority is unwilling or unable to do so, the fees shall be fixed by the [PCA] or by another institution or person selected by the [PCA] for that purpose”.<sup>403</sup>

The strength of the proposed provision would lie in its deterrent force. Taking away the tribunal’s power to fix its fees is a powerful incentive for the tribunal to be reasonable. A more elaborate (and, we respectfully submit, better) provision that would achieve the same result is now under consideration in UNCITRAL Working Group II.<sup>404</sup>

(c) *Administrative support*

There are other ways in which support for ad hoc arbitration is useful and perhaps indispensable to make up for deficiencies in the applicable rules. As rules of arbitration are revised and improved, this need will diminish.

That leaves a category of support that is not the product of any particular deficiencies in the rules, but purely and simply useful practical adjuncts to the process. LCIA, for example, has found over the past decade that there is a steady demand for its services, even in ad hoc cases having no connection with LCIA or its Rules, with respect to the administration of funds. Ad hoc tribunals are often inexperienced in such matters, or face difficulties in establishing segregated accounts, for example in the name of the presiding arbitrator. An established institution can act as a secure and independent fund holder of sums deposited by the parties, disbursing them as appropriate, and at all times being in a position to render accounts to the parties.<sup>405</sup> LCIA, for example, has developed an accounting system specifically adapted so as to maintain up-to-date balances immediately available at request without the need for any specific retrieval of information.

The full list of LCIA administrative-support services in ad hoc arbitrations is as follows:

- (a) Establishing and maintaining a computerized procedural monitor to track proceedings;
- (b) Monitoring compliance with the procedural calendar and advising the tribunal and the parties accordingly;
- (c) Maintaining a full file of correspondence and written submissions, to facilitate any enquiry arising and to prepare such copies as the parties or the tribunal may from time to time require;
- (d) Issuing procedural directions on behalf of the tribunal, most typically directions for advances on costs;

<sup>403</sup> Jan Paulsson and Georgios Petrochilos, *Revision of the UNCITRAL Arbitration Rules*, p. 153 (proposed article 39, (2)). Note that, while PCA does not fix arbitrators’ fees or establish schedules of fees, it has “assisted parties in reaching agreements with arbitrators with respect to their fees”, including fixed-fee arrangements, differential fee arrangements, and the application of the fee schedule of an arbitral institution; see the report of the Secretary-General of PCA on its activities under the UNCITRAL Arbitration Rules since 1976 (A/CN.9/634), paras. 18-19.

<sup>404</sup> See A/CN.9/WG.II/WP.145/Add.1.

<sup>405</sup> The PCA Procedures for Cases under the UNCITRAL Arbitration Rules (2000) provide that “upon request, the International Bureau [of the PCA] will hold deposits from the parties and account for the same”. AAA “upon request, ... will make all arrangements concerning the amounts of the arbitrators’ fees, and advance deposits to be made on account of such fees in consultation with the parties and the arbitrators” (see the AAA Procedures, article 6). Other institutions, such as the German Institution of Arbitration (DIS), have on occasion provided such accounting services to tribunals under the UNCITRAL Arbitration Rules.

(e) Closely monitoring the costs of the arbitration, in particular ensuring that fee notes are regularly submitted and the level of further advances on costs calculated in consultation with the tribunal and by reference to the established procedural timetable;

(f) Ensuring that lines of communication among parties, counsel and the tribunal are kept open and up to date;

(g) Making practical arrangements for any meetings and hearings, together with such support services as interpretation, translation, court reporting and telephone and videoconferencing;

(h) When required, facilitating entry visas for the purpose of hearings;

(i) Arranging accommodation for parties and arbitrators;

(j) Proofreading draft awards for typographical and clerical errors;

(k) Preparing and issuing certified copies of any award, including notarized copies where required.

Other institutions, including PCA and AAA, offer a range of the above services.<sup>406</sup>

These services are important. They ensure smooth progress of the process, professionalism and decorum that enhance the credibility of the process, and may lead to savings in time and cost.

#### (d) *Interim and conservatory measures*

Support for ad hoc arbitration need not always come from outside. Empowering the tribunal to maintain the integrity of its process is equally important. Two aspects of the arbitral process may be especially singled out for discussion in this regard: (a) an express provision permitting truncated tribunals to continue with the arbitration and render an award; and (b) express powers to issue interim and conservatory measures.

As to the former matter, we dealt with it in some detail in our September 2006 report, where we also proposed that the tribunal should have the power to police resignations, so that only authorized resignations would be effective.<sup>407</sup>

As for interim measures, the first point to make of course is that the UNCITRAL Rules do contain an express provision, article 26. In material part, this is worded as follows:

“1. At the request of either party, the arbitral tribunal may take any interim measures it deems necessary *in respect of the subject-matter of the dispute*, including measures for the conservation of the goods forming the subject-matter in dispute, such as ordering their deposit with a third person or the sale of perishable goods.” [Emphasis added.]

Article 26 (1) evolved little in the course of the preparation of the UNCITRAL Rules. An almost identically worded provision is to be found in article 22 of the 1974 preliminary

<sup>406</sup> See the documents at footnotes 398 and 405 above.

<sup>407</sup> Paulsson and Petrochilos, *Revision of the UNCITRAL Arbitration Rules*, paras. 8 and 57-62 (revised article 13). For the UNCITRAL Working Group's subsequent consideration of the matter, see A/CN.9/614, paras. 67 ff.; A/CN.9/WG.II/WP.145, paras. 19-21; and A/CN.9/619, paras. 21-22.

draft.<sup>408</sup> It was derived from the Economic Commission for Asia and the Far East Rules and the Economic Commission for Europe Rules, of 1967 and 1966 respectively.<sup>409</sup>

In 1974, article 22 was a small revolution. The 1955 ICC Rules in force at that time authorized the parties to have recourse to the courts “in cases of urgency, whether prior to or during the proceeding”. It was only in the 1975 version of the ICC Rules that it was felt that “the power of the arbitrators to order such [urgent] relief was more widely accepted” and a provision to that effect was included in those Rules (albeit in terms whose clarity left much to be desired).<sup>410</sup>

On the public international law plane, too, the area of interim and conservatory measures was one in which to tread with caution. Professor Scelle, writing in 1950, asked whether an *ad hoc tribunal épisodique* should have a power traditionally associated with standing bodies, such as the International Court of Justice.<sup>411</sup> As to the binding force (if any) of interim orders, that was an open question. As is well known, article 41 (1) of the Statute of the Court was couched—and deliberately so—in terms that lent themselves to ambiguity:<sup>412</sup>

“The Court shall have the power to *indicate*, if it considers that circumstances so require, any provisional measures which *ought to be taken* to preserve the respective rights of either party.” [Emphasis added.]

In the 1950s, the International Law Commission’s study, and Professor Scelle’s earlier study, noted the precedents supporting the need for an international tribunal to have the power to intervene to preserve the status quo, but were silent as to the binding force of such a power.<sup>413</sup> Today it is admitted in international jurisprudence that interim and conservatory measures are binding as a matter of principle and that the relevant statutory basis is to be interpreted in the light of that principle.<sup>414</sup> They are a necessary adjunct of the process, and in that sense they may be said to form part of an international tribunal’s necessary (“inherent” or “incidental”) jurisdiction.

Those were in fact the terms in which the Iran-United States Claims Tribunal pronounced itself in the landmark E-Systems case of 1983. Rather than basing itself on article 26 (1) of

<sup>408</sup> See document A/CN.9/97, reproduced in *Yearbook of the United Nations Commission on International Trade Law, Volume VI: 1975* (United Nations publication, Sales No. E.76.V.5), p. 163.

<sup>409</sup> *Ibid.*, p. 176.

<sup>410</sup> See Yves Derains and Eric A. Schwartz, *A Guide to the ICC Rules of Arbitration*, 2nd ed. (The Hague, Kluwer Law International, 2005), p. 295. See further Ali Yesilirmak, *Provisional Measures in International Commercial Arbitration* (The Hague, Kluwer Law International, 2005), chaps. 2 and 5.

<sup>411</sup> He answered that question in the affirmative, “without a doubt”; see document A/CN.4/18, reproduced in *Yearbook of the International Law Commission*, 1950, vol. II (United Nations publication, Sales No. 1957.V.3, vol. II), pp. 114 and 137).

<sup>412</sup> See further Jerome B. Elkind, *Interim Protection: A Functional Approach* (The Hague, Martinus Nijhoff, 1981), chap. 6.

<sup>413</sup> See Scelle (see footnote 411 above); and the ILC 1955 study (“Commentary on the draft convention on arbitral procedure adopted by the International Law Commission at its fifth session” (A/CN.4/92), pp. 72 ff.). The text of the 1958 model rules on arbitral procedure (*Yearbook of the International Law Commission*, 1958, vol. II (United Nations publication, Sales No. 58.V.1, vol. II), p. 83) article 20, followed closely the formulation of article 41 (1) of the Statute of the International Court of Justice.

<sup>414</sup> See notably *LaGrand (Germany v. United States of America)*, *Provisional Measures, Order of 3 March 1999*, *I.C.J. Reports 1999*, p. 9; “*Casado and President Allende Foundation v. Republic of Chile* (case No. ARB/98/2): Decision on Provisional Measures, 25 September 2001”, *ICSID Reports*, vol. 6, 2001, p. 375. See also Shabtai Rosenne, *Provisional Measures in International Law: The International Court of Justice and the International Tribunal for the Law of the Sea* (Oxford, Oxford University Press, 2005), pp. 9-12.

the UNCITRAL Rules,<sup>415</sup> the Tribunal chose to rely on a wider principle, holding that it had “an inherent power to issue such orders as may be necessary to conserve the respective rights of the Parties and to ensure that [its] jurisdiction and authority are made fully effective”.<sup>416</sup> The Tribunal left the parties in no doubt as to the binding force of its order and, notwithstanding the Tribunal’s desire to proceed on the basis of a wider jurisdictional principle, rather than article 26 (1) of the Rules,<sup>417</sup> one may wonder whether the Tribunal would have felt able to rule in such confident terms in the absence of article 26 (1).

*E-Systems* teaches that article 26 (1) of the UNCITRAL Rules is expressive of a broad rule of the customary law pertaining to international adjudication. Now the question arises whether the express terms of article 26 (1) fully give effect to that rule. A strong argument may be made that they do not.

Article 26 (1) was drafted against the basic staple of international arbitrators at the time: trade disputes. Hence the narrow formulation “interim measures ... in respect of the subject-matter of the dispute”; and the emphasis on “measures for the conservation of the goods forming the subject-matter in dispute, such as ... the sale of perishable goods”. None of the contemporary major sets of arbitration rules is formulated in such a narrow way.<sup>418</sup> Indeed, there is no compelling reason to abide by the narrow compass indicated by the wording of article 26 (1). Thus, the practice of the Iran-United States Claims Tribunal suggests that the powers conferred by article 26 (1) cover a broader range of measures than “in respect of the subject-matter of the dispute”.<sup>419</sup>

The reason is straightforward. As a practical and conceptual matter, interim and conservatory measures serve three principal functions:<sup>420</sup>

- (a) Facilitating the conduct of the arbitral proceedings (e.g. orders to preserve evidence);
- (b) Avoiding loss or damage, or preserving a certain state of affairs until the dispute is resolved (e.g. orders to continue performing a contract); and
- (c) Facilitating enforcement of a final award (e.g. freezing orders).

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<sup>415</sup>Article 26 (1) of the UNCITRAL Arbitration Rules is retained without modification in the Iran- United States Claims Tribunal Rules. See “Final tribunal rules of procedure, 3 May 1983”, *Iran-United States Claims Tribunal Reports*, vol. 2, p. 405.

<sup>416</sup>*E-Systems, Inc. v Iran*, *Iran-United States Claims Tribunal Reports*, vol. 2, pp. 51 and 57 (Interim Award, 1983). See also Sean D. Murphy, “Interim measures of relief: the continuing importance of the Iran-U.S. Claims Tribunals jurisprudence”, in *The Iran-U.S. Claims Tribunal at 25: The Cases Everyone Needs to Know for Investor-State and International Arbitration*, Christopher S. Gibson and Christopher R. Drahozal (Oxford, Oxford University Press, 2007), chapter 3.

<sup>417</sup>George H. Aldrich, *The Jurisprudence of the Iran-United States Claims Tribunal: An Analysis of the Decisions of the Tribunal* (Oxford, Clarendon Press, 1996, p. 138) notes that the Tribunal intended to emphasize in this way the integrity of its jurisdiction: the *E-systems* order was to prevent the respondent, Iran, from continuing with parallel court proceedings in Iran.

<sup>418</sup>See article 23 (1) of the ICC Rules of Arbitration; article 25.1 (c), of the LCIA Arbitration Rules; article 32 (1) of the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce; article 46 (a) of the WIPO Arbitration Rules; article 26 (1) and (2), of the Swiss Rules of International Arbitration; and article 21 (1) of the AAA International Arbitration Rules.

<sup>419</sup>See Charles N. Brower and Jason D. Brueschke, *The Iran-United States Claims Tribunal* (The Hague, Martinus Nijhoff, 1998), p. 217 and the references.

<sup>420</sup>See A/CN.9/WG.II/WP.108, para. 63, and A/CN.9/WG.II/WP.109, paras. 16 and 17. And see further the proposed revised article 17 (2) of the UNCITRAL Model Law on International Commercial Arbitration, cited at footnote 421 below. The European Court of Justice has adopted a broadly similar (though narrower) definition; see Judgment of the Court of 17 November 1998, *Van Uden Maritime BV trading as Van Uden Africa Line, v. Kommanditgesellschaft in Firma Deco Line and Another* (Case C-391/95), *European Court Reports*, 1998, vol. 1, p. 7091.

On that basis, much work has been devoted by UNCITRAL to a revised article 17 of its Model Law on International Commercial Arbitration. (The current formulation of article 17 follows closely the wording of article 26 (1) of the UNCITRAL Rules.)<sup>421</sup> It is now proposed that the salient parts of that revised article 17 (which itself consists of 11 detailed articles) be included in the revised UNCITRAL Rules.<sup>422</sup> The consensus in principle with which those proposals have been met indicates the significant progress that has been made in this area in the past 30 years.<sup>423</sup>

The cynic would ask: why is any of this important? What real power of coercion does a tribunal have? Our answer is threefold. Firstly, there is an important psychological factor at play. If the powers of the tribunal are set forth in comprehensive and clear terms in the arbitration rules, those provisions condition the parties' expectations and future conduct. Secondly, orders may (and often do) take the form of interim awards,<sup>424</sup> which may be enforced by the courts.<sup>425</sup> Finally, and at the very least, failure to abide by an order may well have (and in principle should have) cost consequences.

#### (e) *Conclusions*

Arbitration is a form of litigation. It is a process. As in litigation, the credibility and efficiency of arbitration as an institution depends in great measure on the soundness of the process. The principal aim of our modest contribution today was to highlight the importance of practical aspects of that process.

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#### 4. *Comments, evaluation and discussion*

*Zack A. Clement*

*Committee on International Insolvency Arbitration, International Insolvency Institute, United States of America*

Would it be a good public policy approach to define the word or the phrase "public policy" to mean procedural due process on which most people agree as opposed to substantive notions of, what I would call, legislative policy. Would that help to try to draw that line?

<sup>421</sup> The currently proposed (final) text was settled in late 2005 and is reprinted as "Revised articles of the UNCITRAL Model Law on International Commercial Arbitration" (A/61/17), annex I.

<sup>422</sup> See our September 2006 report: Paulsson and Petrochilos, *Revision of the UNCITRAL Arbitration Rules* (see footnote 402 above), paras. 108-112; and A/CN.9/WG.II/WP.145, para. 30 ff.

<sup>423</sup> See A/CN.9/614, para. 105.

<sup>424</sup> See article 26 (2) of the UNCITRAL Arbitration Rules.

<sup>425</sup> See section 42 of the Arbitration Act 1996 (England and Wales); section 593 (4) of the Austrian Code of Civil Procedure (ÖZPO); and articles 17 H and 17 I of the proposed revised UNCITRAL Model Law on International Commercial Arbitration (see footnote 421 above). In addition, UNCITRAL is currently considering whether such awards should expressly be made enforceable under the New York Convention (*Treaty Series*, vol. 330, No. 4739); see A/CN.9/592, paras. 34-39; and A/CN.9/WG.II/WP.141.

*Ibrahim Hassan al-Mulla al-Mansouri*  
*Emirates International Law Centre, United Arab Emirates*

UNCITRAL has produced an excellent Model Law on Arbitration and this is proved by the fact that most countries have used it to draft their own laws. In the last decade or so, however, we have seen that there is more and more doubt or mistrust about arbitration for several reasons. I think there is a need to review our assessment of arbitration and UNCITRAL is the appropriate international body for that.

*Eric Loquin*  
*Director, Centre for Research on Procurement Law and International Investments (CREDIMI), University of Bourgogne, France*

I should like to say something in connection with Mr. Abraham's first presentation.

In my view, he raised a very important issue regarding international arbitration law, namely, the diversity of the concepts of "public policy". It matters little whether one speaks of "international public policy" or "domestic public policy", since the purpose of the concept is to overthrow arbitral or judicial decisions that conflict with the fundamental principles of a particular country. Quite understandably, diversity is the rule; every State has values of its own that it wishes to protect.

We are dealing with international arbitration in a globalized commercial society, however, and it is reasonable to ask whether one should not, in such a society, try to bring the different concepts of "public policy" closer together. Could one not, in particular, introduce the concept of truly international public policy based on values common to all countries engaging in international trade? This doctrinal question has often been asked, and I recognize its validity. However, I am acutely aware of the difficulty of incorporating such truly international public policy into the legislation of States.

In the case of UNCITRAL, one could perhaps try to define the different areas to which such truly international public policy might relate, exercising one's imagination. I am thinking in particular of human rights, protection of the environment and protection of the cultural heritage of different nations. Should one go as far as to incorporate religious public policy into such truly international public policy? There, I admit, I have greater conceptual difficulties.

Those are my observations. I am not really asking questions, and I am certainly not providing answers. I am simply reacting to the excellent presentation by Mr. Abraham.

*Majeed H. al-Anbaki*  
*Permanent Mission of Iraq to the United Nations (Geneva)*

We have different legal interpretations of public policy. Arbitration, therefore, can succeed in countries that have somehow similar ideas, similar cultures, similar legal systems and similar economies, to a certain extent. Therefore, my idea is that in each arbitration committee, one member should be one of the citizens of the country concerned, to properly explain what public policy is.

*Cecil Abraham*

*Managing Partner, Shearn Delamore & Co., Malaysia*

I think that the concept of international public policy is something that is already accepted in some parts of the world, but certain countries will perhaps resist an attempt to introduce something called “international public policy”. It is going to take, in my view, a very long time to evolve to a standard that is acceptable to the entire arbitral community of the world.

*Anthony Colman*

*Royal Courts of Justice, United Kingdom of Great Britain and Northern Ireland*

Public policy cannot be confined to due process. If one has to go and try to define public policy internationally, the problems of definition are compounded, but I do not think that due process is the answer.

*Georgios Petrochilos*

*Freshfields Bruckhaus Deringer, France*

Just two thoughts for the plenary. There is, of course, a core of morality, good practices and substantive rules that is acknowledged and embodied in international conventions to represent international public policy. The question is whether that exhausts or covers the whole ground of international public policy in the domestic court.

Touching upon something that Cecil said earlier today, however, the whole concept of public policy is to protect a given legal system from interference from outside that would cause in that legal system some harm to its fundamental values. It is inherently a concept that is defensive and it is inherently a concept that is domestic. The problem is when the concept of public policy is used in a way that shocks us, because “public policy” applies in a wide variety of contexts that most people would find unexceptional.

*Mahmoud Ababneh*

*Ministry of Industry and Trade, Jordan*

I want just to mention my own experience in the Court of Appeal in Jordan. We used to receive arbitration awards from other countries and we were required to execute and enforce them. Article V of the New York Convention provides that enforcement of an arbitral award may be refused if it contradicts public policy. This is important and problematic as there are many different opinions on what contradicts public policy.

*Stephen Bouwhuis*

*Attorney-General's Department, Australia*

I just wanted to take up the question of whether there is an issue of serious concern with international arbitrations. I guess the concerns giving rise to ideas for an international arbitral body come more from investment law. To underline that concern, it was the United States Congress that actually added this issue into the Trade Promotion Authority, so for the United States Congress to be calling for an international arbitral body does, I think, underline the depth of the concern.

## D. Commercial dispute settlement: issues for the future

*Chair: Dobrosav Mitrović*

*Chairman of the fortieth session of UNCITRAL*

We have come to the final session of our Congress and the last topic is “Commercial dispute settlement: issues for the future”. We have four rapporteurs. We will begin by hearing Mr. Zack Clement of the International Insolvency Institute on the possible role of arbitration in insolvency.

### 1. *The possible role of arbitration in insolvency*

*Zack A. Clement*

*Committee on International Insolvency Arbitration, International Insolvency Institute, United States of America*

#### (a) *The issue presented*

Is it possible to increase the influence of the basic concepts contained in the UNCITRAL Model Law on Cross-Border Insolvency and the *UNCITRAL Legislative Guide on Insolvency Law* by providing for greater use of international arbitration in bankruptcy cases of multinational debtors?

#### (b) *Background*

The bankruptcy case of a debtor with assets and operations in many countries (a “multinational debtor” or a “debtor”) presents issues about whether creditors, lien claimants and courts in countries outside the country where a bankruptcy case is pending (“foreign countries”, “foreign courts” or “foreign creditors”) will recognize and enforce the orders of a bankruptcy court presiding over a multinational debtor’s bankruptcy case (a “bankruptcy court”).

Most nations have their own bankruptcy laws. Some of those national bankruptcy laws, including those of the United States and the United Kingdom, express worldwide jurisdiction over property of the debtor as well as claims against the debtor and its assets (“extraterritorial national laws”). Many other national bankruptcy laws express jurisdiction only over assets within the country in which the bankruptcy court sits (“non-extraterritorial national laws”).

Bankruptcy courts dealing with a multinational debtor and operating under extraterritorial bankruptcy laws need some method of enforcing their orders concerning the debtor’s assets outside their borders. Bankruptcy courts dealing with a multinational debtor operating under non-extraterritorial bankruptcy laws need some way of obtaining orders governing the debtor’s assets outside their borders.

There are relatively few multinational treaties concerning bankruptcy. There are also relatively few bilateral treaties concerning bankruptcy. Hence, enforcement of bankruptcy

court orders in other nations has traditionally been left to comity, and to other applicable international law concepts derived from custom and usage.

UNCITRAL has propounded its Model Insolvency Law, which contemplates a system of cooperation among countries in the bankruptcy case of a multinational debtor. This system contemplates a main bankruptcy case in the country with the greatest connections to the multinational debtor, that is, where such a debtor has its “centre of main interest” (a “main case”), with ancillary bankruptcy cases in other countries where the debtor has operations or assets (an “ancillary case”). These ancillary cases are intended: (a) to control the debtor’s assets located in these non-main case countries; (b) to coordinate with the main case (possibly by permitting assets from the non-main case country to be distributed to creditors through the main case); and (c) to enforce orders from the main case.<sup>426</sup> The main case and the various ancillary cases will be referred to hereafter as the “cases”, and any one such as a “case”.

The European Union has adopted a regulation reflecting many of the principles of the UNCITRAL Model Insolvency Law. Certain other countries (including the United States) have also incorporated the UNCITRAL Model Insolvency Law into their national bankruptcy laws. However, the Model Law has to date only been adopted by approximately 10 countries around the world.

UNCITRAL has also published a *Legislative Guide on Insolvency Law* describing basic principles contained in effective insolvency laws. The World Bank has adopted Principles and Guidelines for Effective Insolvency and Creditors’ Rights Systems containing similar material for consideration in insolvency reform in various nations. As more national bankruptcy laws are influenced by the *Legislative Guide* and the Principles, it will be easier to use the UNCITRAL Model Insolvency Law to coordinate between a main case and ancillary cases in other countries.

It is not clear how long it will take before substantially all nations have adopted national bankruptcy laws influenced by the *Legislative Guide* and the Principles. It is also not clear how long it will take before substantially all nations have adopted the UNCITRAL Model Insolvency Law as a basis for coordinating with and enforcing the orders of a main case in another country.

So the question presented is whether increased use of international arbitration in a bankruptcy context can hasten the spread of the concepts in the *UNCITRAL Legislative Guide* as well as in the UNCITRAL Model Insolvency Law. Increasingly, bankruptcy courts have shown a willingness to refer bankruptcy-related issues to arbitration under national arbitration statutes. For example, in the United States, two recent decisions from courts in New York and Philadelphia have held that even “core” bankruptcy questions must, in certain circumstances, be referred to arbitration pursuant to the terms of an existing arbitration agreement. In *Mintze*, 434 F. 3d 222 (3rd Cir. 2006), the Third Circuit Court of Appeals held that a bankruptcy court

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<sup>426</sup>An important limitation on this cooperation is the “public policy” exception contained in the UNCITRAL Model Law on Cross-Border Insolvency (United Nations publication, Sales No. E.99.V.3), which provides that recognition and cooperation not be granted where matters taking place in the main case are at odds with the public policy of the country where an ancillary case is sought to be opened.

proceeding to invalidate a lien on the debtor's residence allegedly obtained by the lender in violation of consumer protection laws had to be referred to arbitration based on an arbitration provision in the underlying loan documents. In *MBNA Am. Bank, N.A. v. Hill*, 436 F. 3d 104 (2d Cir. 2006), the Second Circuit Court of Appeals held that a bankruptcy court proceeding concerning a lender's violation of the automatic stay during a bankruptcy case should be referred to arbitration in the particular circumstances of that case.

The recognition by bankruptcy courts that national arbitration statutes may require that issues otherwise within the courts' jurisdiction be referred to arbitration may signal a concomitant willingness of bankruptcy courts to refer matters to international arbitration. As national bankruptcy courts gain more exposure to international arbitration, will the benefits of wider adoption of the concepts promoted by UNCITRAL become apparent? As described below, we believe that the answer is yes, and that UNCITRAL should appoint an insolvency arbitration committee to deal with these issues.

(c) *Consensual nature of arbitration/forced coercive nature of court assertion of jurisdiction*

Arbitration can aid the bankruptcy of a multinational debtor because it has an excellent enforcement mechanism. Court jurisdiction is based on the power of nations that have the coercive power of state officials. Their jurisdiction may apply broadly even to persons and assets that assert that they are not subject to jurisdiction ("coercive jurisdiction"). Because enforcement of this coercive jurisdiction is implemented only pursuant to national authorities, it can be enforced in foreign countries only pursuant to either treaties or comity given by courts of other countries.

By contrast, international arbitration is a private system that is based upon an agreement to arbitrate ("consensual jurisdiction"). Once agreed to, however, arbitration has an impressive worldwide enforcement mechanism through the New York Convention. Pursuant to the original Geneva Conventions, the New York Convention was adopted in 1958 and more than 140 nations are now signatories to it. If an entity has consented to arbitration and an arbitration is properly initiated against it, any award that is ordered may be enforced in any of the over 140 signatory States under the New York Convention.<sup>427</sup>

To determine whether a consensual jurisdiction arbitration system can be useful in the bankruptcy of a multinational debtor, it is useful to understand the essential functions of the bankruptcy process, to be able to consider on a function-by-function basis whether they are suitable to arbitration. These essential functions fall into three categories, the details of which are defined below in footnotes: (a) lawsuit-type actions (involved in (i) the claims allowance process and (ii) claim assertion causes of action); (b) debtor financing activity (involved in (i) debtor asset sales, (ii) debtor loans and (iii) debtor equity

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<sup>427</sup>UNCITRAL has also published a Model Law on International Commercial Arbitration (United Nations publication, Sales No. E.08.V.4), which has now been adopted by a number of countries providing another basis for international cooperation in arbitration matters.

investments); and (c) the plan of reorganization process (involving (i) claims treatment under a plan of reorganization, (ii) claims discharge and (iii) discharge protection).<sup>428</sup>

(d) *General discussion of the application of international arbitration to bankruptcy case functions*

(i) *Arbitration of claims allowance issues*

International arbitration could also be quite useful in the claims allowance process for a multinational debtor. The claims allowance process generally proceeds by the setting of a bar date for the filing of claims against the debtor's estate (including its assets), the filing of proofs of claim, objection to the proofs of claim (if any), and the adjudication of the claim by the bankruptcy court. When creditors file a proof of claim, they submit to bankruptcy court jurisdiction, and the debtor can object to a filed claim, defending and counterclaiming as if the claim were a lawsuit seeking money from the debtor. These counterclaims can seek, among other things, recoveries of preferential and fraudulent transfers from the debtor.

In the bankruptcy case of a multinational debtor, claimants often reside in foreign countries, remote from where the case is pending. These creditors might actually prefer to litigate any claims allowance issues in arbitral panels in countries nearer to where they live. Likewise, a multinational debtor might wish to refer certain of these claims allowance matters to arbitration, especially if it has any fear that a foreign creditor that loses a claims allowance issue before the bankruptcy court might refuse to abide by the bankruptcy court's order, and especially if the debtor wishes to assert a counterclaim and enforce a judgement that the estate might win on such a counterclaim.

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<sup>428</sup> Bankruptcy reorganization generally involves creating an estate (the "debtor's estate") against which creditors can file claims, the debtor can object to such claims (and even file counterclaims), and the bankruptcy court can then adjudicate the net allowed amount of the claim against the estate (the "claims allowance process"). Generally, this process is aided by the setting of a bar date so that claims filed after such a date are disallowed. Claims can thus be allowed (becoming an "allowed claim") or disallowed (becoming a "disallowed claim"), either because the bankruptcy court sustains the debtor's objection to a claim or because the claim was not filed before the bar date. Allowed claims receive some form of payment out of the debtor's estate at the end of the bankruptcy case.

To prohibit immediate enforcement and repossession by creditors during the bankruptcy, there is often a stay during the bankruptcy case of pre-bankruptcy claim collection activity (the "bankruptcy stay").

Debtors can generally sue non-debtor third parties to replenish/build up the debtor's estate by pursuing causes of action: (a) for preferences or fraudulent conveyances to recover assets improperly transferred out of the debtor's estate after it became insolvent ("avoidance power causes of action"); and (b) for other affirmative causes of action based upon contract, fraud, statute or other applicable law ("general lawsuit causes of action"). (Avoidance power and general lawsuit causes of action are collectively referred to as "claim assertion actions".)

To make a reorganization financially viable, it is often important to permit the debtor to refinance: (a) through the sale of assets, giving comfort to the buyer that these assets are not encumbered by claims against the former debtor owner or liens granted by the former debtor owner ("debtor asset sales"); or (b) through loans, with liens granted on the debtor's assets with a particular priority versus any other lien claimant (a "debtor loan"). Another form of investment in a bankrupt debtor is an equity investment made at the consummation of a plan of reorganization, relying on the claim allowance process and discharge protection (defined below) to invest in a restructured company as it emerges from bankruptcy ("debtor equity investment").

As a bankruptcy reorganization case nears conclusion, a plan of reorganization can be developed and approved to describe how allowed claims will be classified and treated, that is, paid (a "plan of reorganization" and "claims treatment"). As a result of a plan of reorganization, certain allowed claims will receive the proposed claims treatment (in place of their full pre-bankruptcy allowed claim amounts) and disallowed claims will be discharged for ever ("claims discharge"). A plan of reorganization thus grants protection to the debtor from creditors: (a) asserting claims after the reorganization that the creditor did not file in the bankruptcy case before the bar date; (b) asserting claims that were disallowed pursuant to a claim objection; or (c) asserting claims in their original pre-bankruptcy claim amount (collectively "discharge protection").

(ii) *Arbitration of enforcement issues relating to orders entered on central bankruptcy financial issues*

There would be substantial policy issues involved with referring to an arbitral panel the initial decision of central bankruptcy issues involved in the debtor financing and plan of reorganization process, such as a multinational debtor's: (a) sale of assets; (b) obtaining loans; (c) obtaining court approval for a plan of reorganization; and (d) obtaining exit financing for such a plan of reorganization (collectively "central bankruptcy financial issues"). However, after the bankruptcy court has decided central bankruptcy financial issues and issued orders concerning them, there may be disputes about whether a party has breached such orders and the proper remedy for such breach ("order enforcement issues"). It might be useful and appropriate to permit the parties to agree to submit such order enforcement issues to an international arbitral panel.

Under this approach, a bankruptcy court in a main case could decide central bankruptcy financial issues such as: (a) that a debtor loan should be made with certain liens subordinated; (b) that a debtor asset sale should be made free and clear of liens; or (c) that a certain plan of reorganization should be approved containing certain claims treatment for allowed claims, with all disallowed claims enjoined from further collection activity.

If a multinational debtor then alleges that a lien claimant residing in a foreign country (whose lien was either made junior in a debtor loan order, or removed from the asset being sold in a debtor asset sale order) has asserted a lien in breach of the bankruptcy court's order, then the bankruptcy court might permit the parties to agree to arbitrate this dispute. The alleged breacher might agree to such an arbitration because it might prefer to have an arbitral panel decide whether it breached a court order instead of the court that entered the order at issue. The debtor might agree to such arbitration because of better prospects of enforcement if a breach is found.

(iii) *Arbitration of claims allowance issues involving foreign investment law disputes*

Many corporations will need bankruptcy reorganization because their assets are about to be, or have been, expropriated to state ownership. In these cases there will be substantial issues under bankruptcy and non-bankruptcy law about whether this expropriation should be permitted at all and, if done, how much compensation should be paid. Often this expropriation will be in alleged violation of the foreign investment laws of a country having a significant relationship to the debtor, which contemplate that such disputes be referred to arbitration. Bankruptcy courts may be called upon to try to exercise control over these circumstances through orders staying the taking of the debtor's assets, while such arbitrations go forward. This will require coordination between the arbitration and the bankruptcy stay/bar date/claims allowance functions in the bankruptcy case. There will be significant questions about just how many of these disputes can, and should, be referred to the arbitration. For example, should the bankruptcy court exercise its powers to try to stay the taking of a debtor's assets, or should the bankruptcy stay issues be referred to the arbitration to be decided under the rubric of "interim measures".

These same issues may be presented by bilateral investment treaties, most of which contemplate arbitration of disputes.

(iv) *Arbitration of disputes between debtor's estates*

International arbitration could be quite useful in resolving disputes between a main case and the various ancillary cases that are pending at the same time for a multinational debtor. The UNCITRAL Model Insolvency Law contemplates a main case in a multinational debtor's "centre of main interest", with multiple ancillary cases concerning that same debtor in other jurisdictions where the debtor operates or has assets. Each such case will probably take the view that it has a separate estate of the debtor's assets that are subject to its jurisdiction (a multinational debtor's multiple "estates"). Disputes might arise between these multiple cases and estates (for this one multinational debtor) as to which country is, indeed, the centre of main interest and, thus, which case is, indeed, the main case. Disputes might also arise between these multiple estates over the use and disposition of the debtor's assets located in various countries. For example, the UNCITRAL Model Insolvency Law provides that a bankruptcy court in an ancillary case need not let assets go from its jurisdiction to be distributed in another case for the debtor in ways that violate its national policies or discriminate against its local creditors.

The UNCITRAL Model Insolvency Law states that bankruptcy courts presiding over the separate cases for the same multinational debtor shall cooperate by whatever methods they choose, encouraging flexibility and creativity. It would appear that this cooperation could include the various estates for one multinational debtor agreeing to arbitrate their disputes. Cooperation could also take the form of the appointment of one or more mediators to try to resolve disputes between estate representatives and/or the courts presiding over the various estates.

(v) *Agreements to arbitrate certain central financial issues*

As discussed above, a dominant issue in international insolvency law in recent years has been the development of effective and enforceable laws relating to enterprise insolvency. While the UNCITRAL Model Insolvency Law, the *UNCITRAL Legislative Guide* and the INSOL International Statement of Principles for a Global Approach to Multi-Creditor Workouts (October 2000) show much progress, there is still much divergence among local laws and in the local enforcement of insolvency legislation and security interests. Foreign investors depend not only on the existence of a bankruptcy code on paper, but on the power and willingness of courts to enforce it, sometimes to the disadvantage of local citizens. Beyond the issue of enforcement is the question of the cost and delay of any formal insolvency proceeding.

To expedite proceedings, several countries have adopted statutory alternatives to full insolvency proceedings, which in some cases resemble the United States pre-packaged plan of reorganization. The goal of such proceedings is to obtain largely consensual results between the enterprise and its largest creditors, and to limit the adjustment of debt to the largest creditors in order to achieve a needed result quickly and inexpensively.

It is possible that arbitration principles could be applied to provide a procedure that would be even more efficient, fair and less expensive than a pre-packaged plan in resolving disputes among the principal creditors of an enterprise and make that resolution more enforceable. For example, a borrower could agree with its principal institutional lenders,

major suppliers and bondholders through an indenture provision, to arbitrate certain specified issues after a default. The arbitrator could be a restructuring expert skilled in the international area, given the task of making final decisions where the parties could not agree, for example, as to the percentage of the value of the enterprise allocable to each stakeholder group based upon a determination of enterprise value. It is not contemplated that this form of arbitration would supplant a workout or an effort to achieve a consensual resolution among the parties. All bargaining, however, takes place against the backdrop of the legal principles that will be applied by a fact-finding and order-issuing authority in the event of non-agreement.

Principles that have had long success in arbitration of international commercial disputes could present many advantages in fostering a consensual resolution. For example:

(a) The parties could agree on a law to govern the substantive issues, thus standardizing international practice and procedure;

(b) Arbitrators could be chosen who would be experts in the area of restructuring and who would have the confidence of the parties;

(c) Arbitration could provide a mechanism for determining specific issues where complete creditor consent might be difficult to obtain—for instance, where a debtor proposes to obtain new or debtor-in-possession (DIP) financing, with a priority over all existing major debt;

(d) Arbitration could possibly provide a mechanism to make a generally consensual workout enforceable against an objecting minority or a silent minority;

(e) Arbitration could greatly increase the likelihood of a workout being enforceable locally, even if some of the results of the arbitration were contrary to the interests of the local owners of the enterprise. National courts are used to enforcing arbitration awards. There may be certain types of transaction that could not be enforced through arbitration, for example, a sale free and clear of liens, but most transactions should be enforceable through arbitration principles.

It is emphasized that this type of arbitration is not designed to affect the rights of those creditors and others which do not expressly agree to the arbitration process. As is the case with most pre-packaged plans of reorganization, trade creditors, “involuntary creditors” and small creditors would ordinarily be left unimpaired. Large creditors would agree to the arbitration, as they agree to a pre-packaged proceeding, because of the benefits derived from the process. Small creditors, that do not consent to arbitration, would benefit from the process, if it is faster, more efficient and less injurious to the business than a full bankruptcy proceeding.

This type of arbitration may encounter more theoretical and practical difficulties than some of the others discussed in sections (a) (i)-(iv) above; presumably, a new type of arbitration and a new arbitration panel would have to be created. Nevertheless, we believe the issue merits further study.

(e) *Request to the Commission*

We will ask UNCITRAL to form an insolvency arbitration committee, composed of persons from the insolvency practice and the arbitration practice, to study greater use of

international arbitration of certain insolvency matters, as generally described in sections (a) (i)-(v) above. We propose that this insolvency arbitration committee initially focus on the following broad issues:

(a) Are there any insolvency/bankruptcy issues that would prohibit use of international arbitration for any of the five types of matters listed in sections (a) (i)-(v) above, or other matters that the Committee thinks should be considered? If so, can these issues be resolved? Further, are there things that bankruptcy courts can do to facilitate the use of international arbitration of insolvency matters?

(b) To what extent do existing “insolvency exceptions” in arbitration conventions and practice apply to limit use of international arbitration in the types of matters listed in sections (a) (i)-(v) above? If they do create any limit, should they be changed, and how can they best be changed?

(i) Arguably, international arbitration is already able to support the bankruptcy process in many of the areas listed above. The existing “insolvency exceptions” in some arbitration conventions probably do not, or should not, apply to the discrete disputes contained in these matters, but rather may be intended to apply only to the initial decision of certain central bankruptcy financial issues;

(ii) The insolvency arbitration committee should investigate whether these “insolvency exceptions” should be clarified as to what they do, and do not, apply to, and whether they should be amended or deleted;

(c) Do any of the types of matters listed in sections (a) (i)-(iv) above involve disputes that are not arbitrable? If so, what can and should be done to establish that they are arbitrable disputes? Arguably, the matters listed in sections (a) (i)-(iv) above all present clear, distinct disputes that are not qualitatively different from disputes already regularly referred to arbitration. This might even be true of the kind of issues described in sections (a) (v) above;

(d) Finally, development of UNCITRAL procedures and guidelines to facilitate use of international arbitration of the matters listed in sections (a) (i)-(v) above, and of any other insolvency matters that are suitable to such arbitration.

## 2. *Reducing time and costs on international arbitration*

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### (a) *Introduction*

The topic of costs and time of arbitration is constantly debated. Believers in and fans of arbitration affirm in conferences, written material and business meetings that arbitration is cheaper and quicker than court litigation. On the other side, opponents of arbitration argue that arbitration is becoming akin to litigation and expensive, that arbitrators tend to split the baby and are less reliable than courts, and so on and so forth. These polemics are natural, and instead of joining in, I will limit myself to pointing out where most of the problems are and to recommending a few strategies that may be of some help in practice. That is what really matters.

What is undeniable is that the increasing sophistication, and the importation into arbitration of court litigation practices, setting aside old healthy arbitration usages, has caused arbitration to become more expensive and time-consuming.

(b) *Great expectations*

Before going into the subject, let us put things in perspective. This debate, as many others, is more founded in opinion than in facts. No wonder that, owing to the quasi-confidential nature of arbitration, there are little hard data on time incurred and costs spent in international arbitration. Regarding costs, I know only the recently issued report from the ICC Commission on Arbitration, entitled “Techniques for controlling time and costs in arbitration” (see [www.iccwbo.org](http://www.iccwbo.org)). Regarding time, some institutions, from time to time, publish averages of time spent in international arbitrations held under their rules; but averages provide no details. Other sources came from commentary in relation to certain practices that are, or may be, creating difficulties, such as the recurrent topic of interchange of information (known as “discovery” in the common law system). There are also some very useful and interesting papers dealing, directly or indirectly, with my subject on this occasion.

Dealing with costs of arbitration, only the ICC report has up-to-date, useful information. The ICC Rules of Arbitration, as others, give to the arbitrators the power to adjudicate the costs of the arbitration, and to the ICC Court the power to determine the amount of administrative and arbitrators’ fees. Thus, the practice is that before closing the instruction, the arbitrators require the parties to indicate the costs each party has incurred. The institution, before making any determination, asks the arbitrators about the time spent on the case. Thus, ICC has objective information available and the ICC report is based on hard data.

According to the ICC report, 2 per cent of the cost of arbitration is spent on administrative expenses of the ICC Court, 16 per cent on arbitrators’ fees and expenses. The rest, 82 per cent, is spent on costs borne by the parties to present their cases, including, as the case may be, lawyers’ fees and expenses, expenses related to witness and expert evidence, and other costs. What these data are telling us is that the major cause of escalation of costs and increase in time spent is not a problem particular to arbitration. Most probably it is due to litigation practices and strategies, rather than costs inherent in and peculiar to the arbitration procedure. It is a problem of international litigation that also pervades arbitration.

Any arbitration takes time and has costs in accordance with the amounts in dispute and the complexity of the case; time and costs naturally increase when the dispute is international. Why then do people complain? The answer is that apostles of arbitration stress too much the fact that arbitration is less expensive and less time-consuming than litigation, which I think is true, but in their enthusiasm they raise high expectations among inexperienced audiences. Great expectations are rarely fulfilled, and when arbitration proceedings become more expensive, and longer than expected, and if followed by post-award litigation, disillusion ensues and the whole institution becomes vulnerable to criticism.

There are three reasons that cause arbitration to reduce substantially the risks, costs and time in international litigation. Firstly, arbitration clauses eliminate forum shopping, which is one of the worst evils of international litigation; parties that agreed to arbitrate are entitled to request local courts to refer the parties to arbitration, and thus forum disputes in

different countries are avoided. Secondly, service of a request for arbitration does not require court intervention, letters rogatory or other formalities, only simple delivery. Thirdly, foreign arbitral awards are enforceable under the New York Convention,<sup>429</sup> while there is not a similar universal treaty on the enforcement of foreign judgements.

The fact is that arbitration remains less expensive and time-consuming than litigation, that there is an element of unfulfilled expectations and that, indeed, costs and time have increased by litigation practices and overlawying, but that does not mean that nothing can be done.

(c) *UNCITRAL may update its notes*

From this perspective, I am going to address the question that I was asked by the secretariat. Is there something that UNCITRAL can do on the topic of costs and time in international arbitration? If the idea is to produce more rules, codes and guidelines, my answer is no. Please do not create more regulations and guidelines; there are too many, and they help to promote overlawying and post-award litigation.

Perhaps something may be done on the side of educational efforts, and updating the UNCITRAL Notes on Organizing Arbitral Proceedings (see [www.uncitral.org](http://www.uncitral.org)) might be a good idea. Costs and time may be controlled with experience and prudence; and experience and prudence are important ingredients of the Notes. The experience gathered since their approval in 1996 may be of great value in updating the Notes. Furthermore, the use of information technologies in arbitration, under the topic of online arbitration, is a priority in the future work of UNCITRAL Working Group II (Arbitration and Conciliation) and information technologies are an important tool for reducing costs and time.

(d) *Strategies*

With or without the notes, there are other important, useful strategies. Many are well known but frequently forgotten.

Reducing costs and time starts when the parties make a wise selection of experienced counsel. Experienced counsel and experienced arbitrators do not waste time and money. Experienced counsel would advise good arbitration clauses, and it would also advise the selection of good, experienced and prudent arbitrators.

The arbitration clauses are the basis of the whole building of future arbitral proceedings. In practice, good arbitration clauses are drafted by experienced counsel and bad ones by the inexperienced. This is not a surprising statement, but let me explain it. Many times arbitration clauses are written by transactional lawyers, and this is natural because they agree and draft most relevant transactions. The problem is that transactional lawyers do not have the experience of litigators who practice arbitration, experience that is badly needed. Some transactional lawyers, acting wisely, consult on their draft conflict

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<sup>429</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards (United Nations, *Treaty Series*, vol. 330, No. 4739), articles III and V. See also the UNCITRAL Model Law on International Commercial Arbitration (United Nations publication, Sales No. E.05.V.4), articles 8, 35 and 36, and advanced national arbitration laws.

resolution clauses with their litigation partners or relationships, but many do not and this is where a lot of bad practices develop. For instance, choice by personal preferences (“I find that the ... Rules are the best”) or worse, blind acceptance of the preferences of the internal legal counsel of their client occurs. Others attach little importance to the dispute-resolution clause, and perhaps use clauses taken from some previous contract, which are imported at the last moment. Others, very dangerously, are “creative”, which in the end results in the creation of unforeseeable problems when the arbitration is set in motion.

Unfortunately, it frequently happens that the expert litigators in international arbitration who handle the cases know the dispute-resolution clause when they are required to intervene in the battle. Then they are like goalkeepers in soccer: they need to catch the ball as it comes but are not always in a very comfortable position and with good possibilities.

The UNCITRAL Arbitration Rules and the rules of most institutions, as well as experts, recommend short, uncomplicated arbitration clauses. What is needed is only to identify the legal relationship, most times a contract, that may give, or gave, cause to the dispute, and put forward the agreement to arbitrate. It is always recommended to agree also in the rules on the place of arbitration, language and applicable law, and, under the UNCITRAL Arbitration Rules or in ad hoc arbitrations, also on the appointing authority. That is enough. The experience of arbitral institutions and practitioners, however, is to confront the need to deal with pathological clauses that create all kinds of problems and delays. Among the more common mistakes are the wrong identification of the rules or the arbitral institution, arbitrators requiring to fulfil special qualifications, mandatory conciliation periods before starting the arbitration, time limits to start the arbitration, time limits to conduct the arbitration, reference to legal provisions made for court proceedings and so on.

On many occasions, the defects of pathological clauses can be cured by agreement. Those agreements may be concluded thanks to the intelligent intervention of the arbitrator. In other cases, they may be cured by negotiation and bargaining, between wise counsels, each representing an opposing party. Cure does not always bring excellent results; for instance, a friend told me that, in a recent case, in order to cure a defect of a clause, he had been forced to accept the challenge of one of the arbitrators. That is not good.

*(e) A good dialogue: prudence and common sense*

Good arbitrators are essential. Arbitration is an art that develops, mainly, through a dialogue between the arbitrators and counsel of the parties. Good arbitrators, before giving directions and making resolutions, take extreme precautions to be sure that they have fully and attentively heard the parties and understood their positions and expectations, and make the parties know that they have done so. For instance, before producing the timetable they need to clarify hidden contradictory expectations—Do the parties expect to have previous interchange of information? When and how are the parties expecting to produce written submissions? What evidence is going to be introduced, how and when? And many other questions.

Here the UNCITRAL Notes are an excellent tool. Experienced arbitrators do not need the Notes, but they have used them, very often by recommending that the parties look through them in preparation for the preliminary conference on the procedural timetable. For

instance, some arbitrators hand the Notes to the parties and invite them to try to agree on the issues relevant to the arbitration and only to refer to the arbitrators the unresolved issues.

Special mention should be made of the International Bar Association (IBA) Rules on Taking Evidence in International Commercial Arbitration, which are very helpfully as guidelines because they take a practical approach, negotiated and drafted by experienced participants in international arbitration coming from different legal systems. By consulting the IBA Rules, parties and arbitrators may avoid repetitive debate and the search for solutions that already exist. One caveat: it is risky to incorporate the IBA Rules as part of the arbitration agreement or rules; they may make rigid what must be flexible, limit the discretion of the arbitral tribunal and increase opportunities to challenge the award.

Counsel of the parties should never hesitate to consult with the arbitrators as regards what they are expecting from the parties. Counsel should ask the arbitrators to give them directions on whatever issues may be of relevance and anything they have not understood or find missing. For instance, how must foreign law be proved? By reports of legal experts or by direct submission of the law and authorities by counsel? What happens if some relevant principles of the applicable law were not debated in the hearing? And many other issues.

When there is an atmosphere of dialogue, things run smoothly. Good arbitrators constantly invite the parties to agree on procedural issues by themselves and only intervene when the ways are blocked. This is the best way to avoid unnecessary fights, waste of time and additional expenses.

Arbitrators must be fair but firm. Debates and queries that slow down the regular course of proceedings are easily prevented by clear and informed directions. Sometimes I have seen arbitrators accept unproductive motions or useless evidence, for instance, repetitive evidence or facts already agreed or accepted by the parties. The argument is always based on the need to render a valid and enforceable award and not to give the parties reasons for post-award litigation, but arbitrators who have given the parties reasonable opportunities to be heard and have let them know that they understand what the parties expect, are in a position to issue appropriate directions that could be sustained by any state court. The parties will also be well disposed to accept the arbitrators' rulings, even if these are unsatisfactory to them. In any event, too, if a party correctly objects, there is always the possibility to rectify. There is nothing wrong if arbitrators, when giving directions, inform the parties that they may consider observations of the parties when promptly made.

Another cause of delays and extra expenses are long and repetitive briefs. Information technologies are now very useful, but the availability of online databases, electronic copies of documents, and cut-and-paste techniques has caused an epidemic of overweight written submissions and exhibits. Again, prudence recommends that parties, under the guidance of the arbitrators, take care to make written submissions short, timely and to the point. Some counsel thinks that important allegations, to become true, must be repeated not less than three times. Indeed, sometimes it is necessary to insist on important issues, but the message will be more productive if made in different short and clear presentations rather than in endless briefs (that are not brief). I recently counted the same statement repeated verbatim 10 times in one submission; all the indications were that the text had been cut and pasted. This wastes the time of the arbitrators, is distracting and tedious.

Voluminous documentation is also a major problem. Its preparation, copying, organization, shipping, archiving and consulting are time-consuming and expensive. The probability that important documents may lie forgotten in their files increases with the growing number of documents filed. Often the parties send tons of documents, when they should have consulted in advance with the arbitrators and asked questions such as “My documentary evidence on issue ‘Y’ is in the documents listed in exhibit X. Shall I annex all the documents listed in ‘X’ or will it be sufficient if I attach the ones I find relevant and keep the rest at the disposition of the arbitrators and counterparty?” Some arbitrators are afraid to send documents back or to refuse to accept them, but in a recent procedural order, the arbitrators directed the parties that, before annexing voluminous documentation, they should inform and ask directions from the tribunal.

I have three recent, and very illuminating, examples. In one, the tribunal stated in the award that one of the parties had filed voluminous documentation as evidence, but with no indication of its organization and in such disarray that the tribunal could not consider it. In another, the claimant filed the request for arbitration with 25 boxes of documents, copied to each of the arbitrators, its counterpart and the institution. The respondent also sent heavy documentation. Most boxes of documents remained closed until the end of the case. Notwithstanding, the tribunal was able to decide without difficulty, because during the proceedings expert reports and memorials were submitted, with copies of the relevant documents, that were examined by the tribunal. In a third arbitration, a party informed the arbitrators that it had 3,000 drawings, and asked whether it should send them to the counterpart, the arbitrators and the institution. Two arbitrators said yes; the other recommended that the party produce the drawings it considered relevant and keep the rest available to be produced in case the other party or the tribunal required some or all of them. Again, the copies of the drawings remained asleep in their boxes, but the relevant ones were copied and attached to the experts’ reports.

Regarding witnesses and expert witnesses, there are well-known strategies to reduce time and costs, for instance, when needed, by the use of teleconferences and videoconferences. The practice whereby parties produce written witness statements is widely followed. Only a few of the witnesses who make written statements are cross-examined in the hearing. The predominant practice is that the party who will cross-examine, decides which witnesses to call, but arbitrators must prevent abuse. In a recent case, a party produced around 30 written statements. The opposing party, when it came to the time limit to designate those it proposed to cross-examine, called all the witnesses. It was evident that the agenda and duration of the hearing would not allow enough time to do so, but the arbitral tribunal denied a request from the other party to prudently reduce the number. During the hearing, gradually, the party that was to cross-examine discharged the witnesses and, in the end, did not cross-examine a single one out of the 30. The costs, and the waste of time in preparation and attendance of the witnesses, were enormous. The arbitrators should have taken measures to prevent or reduce this. It may be argued that the abusive party should pay the costs, but prevention is far better than cure.

When dealing with experts, witness conferences are a very useful tool. The experts are set to confront each other, asking questions of each other. They know very well what to ask, and the practice is very productive and the results illuminating.

Perhaps there is no better tool to reduce costs and time in arbitration than the intelligent use of information technology. When, in 1996, the UNCITRAL Notes were

finalized, information technologies were in their infancy. Thus, they are practically absent in the Notes. As we will see, important practices have developed since then.

E-mail, electronic or digital signatures, enhanced signatures, encryption and data storage have changed the world. Instant and secure filing of submissions and documents overseas is today a regular practice; I wake up every morning to see what has come from Europe during the night. Such documents may easily be stored in small memory sticks. Not only stored but backed up, so data lost by accident can be safely retrieved. Arbitrators, counsel and witnesses can now travel and read the relevant documents while on the road, without the need to be burdened with large, heavy cases filled with documents and not very easy to handle in airports, aircraft seats or hotel rooms.

For instance, I travel, even within Mexico City where I am located, with a small USB memory stick. It is so small that sometimes I have difficulty finding it in my briefcase, but it has a capacity of 15 gigabytes. When information must be copied, such as files from a case, a scanner at the speed of 36 pages a minute does it and there is no problem loading the files onto the memory stick. Then, with the use of programs such as Acrobat PDF, I can mark, write, tag and bookmark, and do all the tasks that usually are made on hard documents, and more. If I were to lose the stick, nobody could read the information, because it is stored in a 12-gigabyte, encrypted section. I would also avoid the risk of losing the information, because I have another encrypted backup that is in the safe of my room in the hotel. I regularly update the backup, and, naturally, all this information is also stored in my server in Mexico.

Today it is feasible to have secured communications, electronic rooms of documents for each party, the arbitrators and all participants, and also online hearings and chatting for arbitrators. With e-mail interchanges between arbitrators, personal meetings and long videoconferences are reduced, if not eliminated. Drafts can be rapidly distributed, received, revised and redone, and the non-online activities that are needed can be carried on with flexibility. Thus, these resources facilitate rapid proceedings, with a substantial decrease in costs.

With the UNCITRAL Model Law on Electronic Commerce now widely adopted by the countries of the world and the new United Nations Convention on the Use of Electronic Communications in International Contracts of 2005, the legal validity of these instruments is not in question.

What must be recognized is that it does not matter what age and previous training we have. As we did when we were children and learned to read, write and use and store paper information, now we must learn how to make the best use of information technologies.

Some institutions, among them the World Intellectual Property Organization (WIPO) and the American Arbitration Association (AAA), have implemented very interesting facilities for handling online arbitrations. For instance AAA has its Supplementary Procedures for Online Arbitration and a web-file section in which parties may file a new case, manage filed cases, complete conflict checklists, review and select arbitrators, view and upload documents, use the message board and make payments. This, and many other common-sense strategies, may be of great help in reducing costs and time in international arbitration.

### 3. Conciliation: enforcement of settlement agreements

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#### *Introduction*

This paper discusses problems that may arise in the enforcement of settlements resulting from conciliation. In the context of this Congress, it seems natural to discuss this topic with the UNCITRAL Model Law on International Commercial Conciliation of 2002<sup>430</sup> as a starting point. (The text of the Conciliation Model Law, its Guide to Enactment and the *travaux préparatoires* can be found at [www.uncitral.org](http://www.uncitral.org) under “Commission Texts (The Model Law on International Commercial Conciliation)”.) The Guide to Enactment and the *travaux préparatoires* contain very useful information and discussions on conciliation and on the topic of enforcement of settlements resulting from conciliation, but stop short of identifying many of the problems arising in the enforcement and in suggesting solutions to those problems.

#### *Conciliation*

The Guide to Enactment provides a definition of what shall be understood as “conciliation” (paras. 5-7), a definition that is useful and used for the purposes of this paper:

“The term ‘conciliation’ is used in the Model Law as a broad notion referring to proceedings in which a person or a panel of persons assists the parties in their attempt to reach an amicable settlement of their dispute. There are critical differences among the dispute resolution processes of negotiation, conciliation and arbitration. Once a dispute arises, the parties typically seek to resolve their dispute by negotiating without involving anyone outside the dispute. If the negotiations fail to resolve the dispute, a range of dispute settlement mechanisms is available, including arbitration and conciliation.

“An essential feature of conciliation is that it is based on a request addressed by the parties in dispute to a third party. In arbitration, the parties entrust the dispute resolution process and the outcome of the dispute to the arbitral tribunal that imposes a binding decision on the parties. Conciliation differs from party negotiations in that conciliation involves third-person assistance in an independent and impartial manner to settle the dispute. It differs from arbitration because in conciliation the parties retain full control over the process and the outcome, and the process is nonadjudicatory. In conciliation, the conciliator assists the parties in negotiating a settlement that is designed to meet the needs and interests of the parties in dispute (see A/CN.9/WG.II/WP.108, para. 11). The conciliation process is an entirely consensual one in which parties that are in dispute determine how to resolve the dispute, with the assistance of a neutral third party. The neutral third party has no authority to impose on the parties a solution to the dispute.

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<sup>430</sup>United Nations publication, Sales No. E.05.V.4.

“In practice, proceedings in which the parties are assisted by a third person to settle a dispute are referred to by expressions such as conciliation, mediation, neutral evaluation, mini-trial or similar terms. Various techniques and adaptations of procedures are used for solving disputes by conciliatory methods that can be regarded as alternatives to more traditional judicial dispute resolution.”

The Model Law uses the term “conciliation” to encompass all such non-adjudicatory procedures. So does this paper.

The increasing importance of conciliation is reflected in the Guide to Enactment (paras. 8 and 39).

“Conciliation is being increasingly used in dispute settlement practice in various parts of the world, including regions where until a decade or two ago it was not commonly used. In addition, the use of conciliation is becoming a dispute resolution option preferred and promoted by courts and government agencies, as well as in community and commercial spheres. This trend is reflected, for example, in the establishment of a number of private and public bodies offering services to interested parties designed to foster the amicable settlement of disputes. Alongside this trend, various regions of the world have actively promoted conciliation as a method of dispute settlement, and the development of national legislation on conciliation in various countries has given rise to discussions calling for internationally harmonized legal solutions designed to facilitate conciliation (see A/CN.9/WG.II/WP.108, para. 15). The greater focus on these methods of dispute settlement is justified particularly because the success rate of these methods has been high; in fact, in some countries and industrial sectors, it has been surprisingly high.

“The Commission noted that conciliation was being used with success in the case of complex, multiparty disputes. Notable examples of these include disputes arising during insolvency proceedings or disputes whose resolution is essential to avoid the commencement of insolvency proceedings. Such disputes involve issues among creditors or classes of creditors and the debtor or among creditors themselves, a situation often compounded by disputes with debtors or contracting parties of the insolvent debtor. These issues may arise, for example, in connection with the content of a reorganization plan for the insolvent company; claims for avoidance of transactions that result from allegations that a creditor or creditors were treated preferentially; and issues between the insolvency administrator and a debtor’s contracting party regarding the implementation or termination of a contract and the issue of compensation in such situations.”

### *Enforcement*

Article 14 (Enforceability of settlement agreement) of the Conciliation Model Law reads:

“If the parties conclude an agreement settling a dispute, that settlement agreement is binding and enforceable ... [*the enacting State may insert a description of the method of enforcing settlement agreements or refer to provisions governing such enforcement*].”

This wording reflects the fact that States have different solutions to the question of enforceability of settlements resulting from conciliation, and that UNCITRAL at the time of preparation of the Conciliation Model Law was not ready to suggest a universally applicable solution. Thus, in the Guide to Enactment it is stated (para. 88):

“The text of the article reflects the smallest common denominator between the various legal systems. In the preparation of the Model Law, the Commission was generally in agreement with the general policy that easy and fast enforcement of settlement agreements should be promoted. However, it was realized that methods for achieving such expedited enforcement varied greatly between legal systems and were dependent upon the technicalities of domestic procedural law, which do not easily lend themselves to harmonization by way of uniform legislation. Article 14 thus leaves issues of enforcement, defences to enforcement and designation of courts (or other authorities from whom enforcement of a settlement agreement might be sought) to applicable domestic law or to provisions to be formulated in the legislation enacting the Model Law. In finalizing this article, the Commission noted that the purpose of the Model Law was not to discourage laws of the enacting State from imposing form requirements.”

The importance of enforcement in the context of conciliation is reflected in the Guide to Enactment (paras. 87 and 89-91):

“Many practitioners have put forward the view that the attractiveness of conciliation would be increased if a settlement reached during a conciliation would enjoy a regime of expedited enforcement or would, for the purposes of enforcement, be treated as or similarly to an arbitral award (A/CN.9/514, para. 77).

“Various examples of treatment of the issue of expedited enforcement of settlement agreements in domestic legislation are outlined below, with a view to facilitating consideration of possible options by legislators enacting the Model Law.

“Some States have no special provisions on the enforceability of such settlements, with the result that they would be enforceable as any contract between the parties. This understanding that conciliation settlements were enforceable as contracts has been restated in some laws on conciliation (A/CN.9/514, para. 78).

“In the national legislation of some countries, parties who have settled a dispute through conciliation are empowered to appoint an arbitrator specifically to issue an award based on the settlement agreement of the parties. Such legislation and practice were reported, for example, in Hungary and the Republic of Korea. In China, where conciliation may be conducted by an arbitral tribunal, legislation provides that if conciliation leads to a settlement agreement, the arbitral tribunal shall make a written conciliation statement or make an arbitration award in accordance with the settlement agreement. A written conciliation statement and a written arbitration award shall have equal legal validity and effect. In some jurisdictions, the status of an agreement reached following conciliation depends on whether or not the conciliation took place within the court system and legal proceedings in relation to the dispute are on foot. For example, under Australian legislation, agreements reached in conciliation held outside the sphere of court-annexed conciliation schemes cannot be registered with

the court unless court proceedings are on foot, whereas, in court-annexed conciliation schemes, a court may make orders in accordance with the settlement agreement and the orders have legal force and are enforceable as such (A/CN.9/514, para. 79).

“Some legal systems provide for enforcement in a summary fashion if the parties and their counsel signed the settlement agreement and it contained a statement that the parties may seek summary enforcement of the agreement. Also, settlements might be the subject of expedited enforcement if, for example, the settlement agreement was notarized or formalized by a judge. For example, in Bermuda, legislation provides that if the parties to an arbitration agreement which provides for the appointment of a conciliator reach agreement in settlement of their differences and sign an agreement containing the terms of settlement, the settlement agreement shall, for the purposes of its enforcement, be treated as an award on an arbitration agreement and may, by leave of the court or a judge thereof, be enforced in the same manner as a judgement or order to the same effect, and where leave is so given, judgement may be entered in terms of the agreement. Similarly, in India, a settlement agreement that has been signed by the parties is final and binding on the parties and persons claiming under them respectively and shall have the same status and effect as if it is an arbitral award. In Germany, the Code of Civil Procedure expressly takes account of the practice that amicable settlement of a dispute is often reached during the arbitration procedure by providing that the tribunal shall record the settlement in the form of an arbitral award on agreed terms, if requested by the parties, and such an award shall have the same effect as any other award on the merits of the case. However, in some jurisdictions the enforceability of a settlement agreement reached during conciliation proceedings will only apply if the settlement agreement was reached between the parties to an arbitration or arbitration agreement. For example, in the Hong Kong Special Administrative Region of China, where conciliation proceedings succeed and the parties make a written settlement agreement (whether prior to or during arbitration proceedings), such agreement may be enforced by the Court of First Instance as if it were an award, provided that the settlement agreement has been made by the parties to an arbitration agreement. This provision is supported by Order 73, rule 10, of the Rules of the High Court, which applies the procedure for enforcing arbitral awards to the enforcement of settlement agreements so that summary application may be made to the court and judgement may be entered in terms of the agreement (A/CN.9/514, para. 80).”

### *Issues*

As described in the Guide to Enactment (paras. 89 and 90), a settlement resulting from conciliation in terms of enforceability can be understood as distinctly different things, either enforceable as a contract or enforceable as an arbitral award.<sup>431</sup> Here, it is the

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<sup>431</sup>In some countries, such as Bermuda and India, as mentioned in the Guide to Enactment, and Croatia, for the purpose of its enforcement, the settlement agreement itself has the status and effect as an award on agreed terms. I have chosen not to discuss that possibility here because of the problems that are inherent in that solution. The major problem is that, without the scrutiny by an arbitral tribunal, there is a substantial risk of the settlement agreement not meeting minimum requirements necessary for enforcement. Most of the issues discussed in this paper in connection with awards on agreed terms also present themselves with respect to enforceable settlement agreements but an additional problem in this case is that there is no correcting mechanism similar to that which is performed by the arbitral tribunal in the case of awards on agreed terms.

latter case that will be discussed. More precisely, the discussion will concentrate on a settlement being enforceable after having been recorded in an arbitral award, often called a “consent award”, an “award on consent” or an “award on agreed terms”.

A number of issues present themselves if the law should permit a settlement reached in conciliation to be recorded in an enforceable arbitral award. The aim is here to highlight issues that may have to be resolved or at least understood if UNCITRAL should wish to present a solution for legislators to consider for introduction in their arbitration laws. To a large extent this paper draws on problems that have been experienced in various countries, and takes in many instances as a starting point the UNCITRAL Model Law on International Commercial Arbitration, being the model for arbitration laws in about 55 countries. In its article 30 provisions on awards on agreed terms can be found.

International conventions in the field of enforcement of arbitral awards are also relevant in this context. Here, I will look only at the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958. The New York Convention does not specifically address awards on agreed terms but the predominant view seems to be that it does also cover such awards.<sup>432</sup>

My hope is that the discussions in this paper will be useful if UNCITRAL should prepare a proposal on a legislative solution for the enforceability of settlement agreements.

### *Form requirements*

The requirements as to form vary from country to country. The Arbitration Model Law (article 31) prescribes that the award shall be in writing and be signed by the arbitrators (with one exception of no relevance here), that the date and place of the arbitration shall be stated, and that reasons are to be stated in the award, unless the parties have agreed that no reasons are required or the award is an award on agreed terms. The New York Convention requires an award to be in writing but does not require reasons to be given.<sup>433</sup>

Although typically not spelled out in the legislative text of arbitration laws, including the Arbitration Model Law, other requirements exist as to what is required to make a decision of an arbitral tribunal an award, such as the specification of the parties with their addresses, information detailed enough to define the dispute between the parties, and a clear and precise decision finally disposing of a disputed claim.

In principle, there seems to be no reason to deviate from these form requirements in case of awards on agreed terms.

In the case of an award on agreed terms, there is no identifiable need for reasons for the award other than a description that there has been a settlement. Thus, it seems justified

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<sup>432</sup>For example, Gino Lörcher, “Enforceability of agreed awards in foreign jurisdictions”, *Arbitration International*, vol. 17, No. 3 (2001), p. 275.

<sup>433</sup>The requirement of writing seems for good reasons to be taken for granted. As to reasons for an award, see, for example, Albert Jan van den Berg, *The New York Arbitration Convention of 1958: Towards a Uniform Judicial Interpretation* (Deventer, Kluwer Law; Boston, Taxation Publishers, 1981), pp. 380-382.

to dispense from the requirement that reasons should be included in the award. As already mentioned, this is also the solution adopted by the Arbitration Model Law (article 31 (2)) and other arbitration laws.<sup>434</sup>

Where parties have settled their dispute, and as the role of the arbitral tribunal is limited (see below), it could be considered if it should be possible for the parties to agree that only the chairman is required to sign the award. The Arbitration Model Law does not include that possibility.

Another question is whether the arbitral tribunal should include the settlement agreement in its entirety or only make extracts from the settlement agreement and, if so, in which situations.

Questions that may be referred to as a matter of form are: is there a requirement of clarity for the settlement to be recorded in an award? Must payment and other performance obligations being agreed in the settlement be written with the same precision as reliefs ordered in an award? Or should the arbitral tribunal reformulate such obligations in the award into orders?

I would assume that the answer to these questions is that the award on agreed terms must be clear enough for enforcement to be possible without any reformulation or interpretation of its meaning. The purpose of recording a settlement in an award is to provide for finality and enable expedited enforcement. Therefore, an award on agreed terms should meet at least those requirements which are needed for enforcement purposes.

In cases where the parties request the arbitral tribunal to make an award on agreed terms, there seems to be a risk that problems of clarity and precision can arise as the parties when negotiating a settlement are more focused on the substance of the settlement than on the need to meet the formal requirements of an award.

#### *The scope and contents of the settlement*

A situation that can arise is that the settlement of the parties disposes of only some of the claims being arbitrated. Such a situation should not be a problem as it is equivalent to the one when a partial award disposing of some of the claims in the arbitration is made. The remaining issues will then have to be arbitrated.

A more difficult situation is where the settlement includes matters that are not within the jurisdiction of the arbitrators, either because such matters fall outside the arbitration agreement or because they have not been submitted to the arbitrators for determination.

If the settlement disposes of matters not covered by the arbitration agreement, clearly the arbitral tribunal does not have jurisdiction to render an award on such matters. Maybe there is a possibility to rectify the situation by the parties, with the concurrence of the arbitrators, extending the arbitration agreement to cover also those matters. Whether such extension can be implied by the fact that the parties request the settlement to be recorded in

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<sup>434</sup>For example, the English Arbitration Act, 1996, section 52 (4); and the German Code of Civil Procedure, section 1053.

an award is doubtful. The requirement of the New York Convention that the arbitration agreement has to be in writing (article II (2) and the recommendation adopted by UNCITRAL in 2006 regarding the interpretation of that paragraph and article VII (1) of the New York Convention)<sup>435</sup> should be taken into account.

Also, if the matters being settled are not covered by the submission to arbitration, the arbitral tribunal does not have jurisdiction. Again, here there may be a possibility to rectify the situation by introducing the matters into the arbitration with the concurrence of the arbitrators.

Where the settlement includes claims that are outside the arbitration, the New York Convention leaves the door open for a partial enforcement of matters dealt with in an award, which are covered by the submission to arbitration, if they can be separated from those matters not submitted to arbitration (article V (1) (c)). However, that possibility may not be applicable to an award on agreed terms as a settlement is typically a package deal covering several items where some items can not be separated from other items.

A particular situation is the one where the settlement includes matters that are tried in a different forum, which would mean that there could be a problem of *lis pendens*.

A further issue can be that the settlement obliges or gives rights to a party that is not a party to the arbitration. This could be the case for example where one or both of the parties belong to a group of companies where the agreed performance should be made or rights be exercised by a subsidiary, parent or sister company. An award on agreed terms cannot of course bind or give rights to the third party. A subsidiary question is whether the arbitral tribunal notwithstanding this shall record the settlement in an award.<sup>436</sup> In such situations, the dispute before the arbitral tribunal is settled and the arbitration shall be terminated. If the law obliges the arbitral tribunal to record the settlement in an award or both parties request the arbitral tribunal to record the settlement in an award, what shall the arbitral tribunal do?

Another question is whether it shall be possible to record declaratory settlements in the form of an award on agreed terms. The motive for having settlements recorded in awards on agreed terms is that the form of an award can expedite enforcement, which may not be satisfied in respect of declaratory settlements. On the other hand, the possible *res judicata* effect<sup>437</sup> could be sufficient reason.

It is not unusual that settlements enter into force only when certain events have occurred or certain conditions have been met by one of the parties or are revocable if certain events did not occur or certain conditions are not met. The enforcement of awards based on such settlements may be called into question on the basis that such settlements

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<sup>435</sup> Recommendation regarding the interpretation of articles II (2) and VII (1) of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done in New York, 10 June 1958, adopted by the United Nations Commission on International Trade Law on 7 July 2006 at its thirty-ninth session (A/61/17), annex II.

<sup>436</sup> For example Japan, Arbitration Law of 2003, article 38; Hungary, Act No. LXXI of 1994 on Arbitration, section 39; China, Arbitration Law of 1995, articles 51 and 52; Germany, Code of Civil Procedure, section 1053; and Canada, Québec, Code of Civil Procedure, article 945.1.

<sup>437</sup> The *res judicata* effect is another aspect of the finality of awards and there are also issues relating to the *res judicata* effect of awards on agreed terms similar to those arising with respect to enforcement. However, that effect is not the subject matter of this paper.

are not final. In particular, settlements where there are conditions for revocation are problematic. Similar concerns may arise with respect to settlements that provide for performance in the future.

Further, it is not unusual for settlement agreements to contain a mechanism for settlement of disputes arising out of the settlement agreement, typically arbitration. What is the effect of a provision of that nature in a settlement agreement? Is not a settlement agreement with such a provision inconsistent with the notion of an enforceable award? How can a final and binding award be subject to settlement of disputes outside the challenge mechanism?

Generally, the right to have an award on agreed terms requires a request by both parties, or at least a request by one party and the agreement of the other.<sup>438</sup> The question can then arise as to what an arbitral tribunal should do if the settlement agreement provides that the parties shall request an award on agreed terms but one of the parties fails to make such a request. Shall the arbitral tribunal notwithstanding this grant a request by only one party on the theory that the settlement agreement itself can constitute the request by the other party? Or shall (may?) the arbitral tribunal give an award at the request of the non-failing party ordering the failing party to request an award on agreed terms?<sup>439</sup>

Awards can be challenged on a number of grounds typically referable to excess of mandate, errors in the procedure, invalidity of the arbitration agreement, the subject matter not being capable of settlement by arbitration and violation of *ordre public*.<sup>440</sup> The question arises as to what extent such grounds for setting aside an award are applicable to awards on agreed terms. The mere fact that the parties have settled their differences and have requested an award on agreed terms may be considered a waiver of the right to challenge an award relying on any of these grounds, except as to matters that are not arbitrable or that constitute a violation of *ordre public*, which should not be waiveable. The reason for these grounds being non-waiveable exceptions is of course the fact that the particular legal system has determined that cases falling within the exceptions may not be left to resolution by arbitration, and, therefore, it should not be possible to circumvent that determination by entering into a settlement. What cannot be arbitrated cannot be subject to a settlement.

The same considerations could be applied to enforcement under the New York Convention.

### *The role of the arbitral tribunal*

The Arbitration Model Law states in article 30 that the arbitral tribunal can refuse (“object”) to record a settlement in the form of an award. The same approach is taken by

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<sup>438</sup> See, for example, the UNCITRAL Model Law on International Commercial Arbitration, article 30 (1), and Frank-Bernd Weigand, ed., *Practitioner’s Handbook on International Arbitration* (Munich, C. H. Beck; Copenhagen, Djøf, 2002), pp. 1262-1263.

<sup>439</sup> A/40/17, para. 250.

<sup>440</sup> See, for example, the UNCITRAL Model Law on International Commercial Arbitration, article 34.

the arbitration law in a number of countries.<sup>441</sup> The implication of this principle is that the arbitral tribunal has the power to scrutinize the settlement. The extent of such scrutiny varies from country to country. Such scrutiny may or may not involve the issues discussed above, but may be limited to questions as to possible violations of *ordre public*,<sup>442</sup> and, perhaps, infringements of laws of a lower degree such as anti-corruption law and law addressing money-laundering, if not belonging to the sphere of *ordre public*.

In most modern arbitration laws and rules of arbitration there is a possibility for the arbitral tribunal to correct certain errors in an award.<sup>443</sup> The question then arises as to how that power shall be understood in the context of awards on agreed terms. Does it only extend to errors in the recording of the settlement agreement or does it also extend to errors in the settlement agreement itself? The same issue arises with respect to the power of the arbitral tribunal to interpret an award.

Another issue that relates to the role of the arbitral tribunal is how to deal with a situation where the parties settle their dispute and only then start arbitration for the purpose of obtaining an award on agreed terms. For example, article 30 of the Arbitration Model Law, which empowers the arbitral tribunal to make awards on agreed terms, applies where the dispute being arbitrated is settled during the arbitral proceedings. The same approach can be found in arbitration laws of various countries.<sup>444</sup> Arbitration presumes conceptually that there is a dispute that needs to be determined and an award is conceptually the outcome of arbitration. In the countries that have this approach, it does not seem possible to proceed to arbitration when the settlement has been reached and consequently in such cases the parties will not have the possibility to have the settlement recorded in an award on agreed terms. In those countries where a settlement reached in conciliation can have the same effect as an award, this problem does not arise.<sup>445</sup>

### *Summing up*

This paper has tried to show that a number of issues will have to be addressed if UNCITRAL should wish to develop a solution for legislators to apply if it is found desirable to make settlement agreements awards on agreed terms for the purpose of enforcement. All these issues may not necessarily have to be introduced in legislation but may need to be understood by the legislator. A forceful advocate for UNCITRAL to present a solution is the Grand Old Man Professor Pieter Sanders.<sup>446</sup> Whether his proposal is the right one may need to be analysed in the light of the discussions in this paper.

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<sup>441</sup> For example, England, section 51 (2) of the Arbitration Act of 1996, and Sweden, section 27 of the Arbitration Act of 1999. So do many arbitration rules, for example, the UNCITRAL Arbitration Rules, article 34; the ICC Rules of Arbitration, article 26; the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce, article 39 (1); the LCIA Arbitration Rules, article 26.8; and the Swiss Rules of International Arbitration, article 34 (1).

<sup>442</sup> For example, Germany, the Code of Civil Procedure, article 1053.

<sup>443</sup> Article 33 of the Arbitration Model Law.

<sup>444</sup> For example, Germany, article 1053 of the Code of Civil Procedure, and section 51 of the English Arbitration Act of 1996.

<sup>445</sup> For example, Bermuda, section 20 of the International Conciliation and Arbitration Act of 1993; India, the Arbitration and Conciliation Act of 1993; and Croatia, article 10 (2) of the Law on Conciliation.

<sup>446</sup> Pieter Sanders, "UNCITRAL's Model Law on International Commercial Conciliation", *Arbitration International*, vol. 23, No. 1 (2007), pp. 136-139.

#### 4. Unresolved issues in investment arbitration

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The rapid proliferation of investor-State arbitrations during the last decade has inevitably given rise to the development of diverging views on a number of issues in arbitral case law and in legal writings. The most hotly debated and yet unresolved issues in investment arbitration today concern in particular the level of protection afforded to investors and related questions of arbitral jurisdiction. For example, the effect of most-favoured-nation clauses or the effect of so-called umbrella clauses on the jurisdiction of arbitral tribunals are questions that have yet to yield a consistent case law. The impact of these international law mechanisms, which are well-known in treaty law, on the protection afforded to investors is therefore a central topic when addressing today's unresolved issues in investment arbitration. A related question, perhaps more enduring, is the extent to which arbitrators having to decide similar questions, in particular when such questions arise under the same investment treaty or similarly drafted investment treaties, must give weight to decisions previously rendered by other tribunals and whether a precedent system exists in investment arbitration. These topics will be addressed in turn. A further question inevitably arises in relation to the forefront role of the International Centre for Settlement of Investment Disputes (ICSID) established by the Washington Convention of 1965 in the development of investment arbitration: in view of the International Centre's undeniable success during the last decade, will other arbitration forums grow to compete with ICSID arbitration in investor-State disputes?

*(a) Will the International Centre remain the preferred option in investment arbitration?*

The number of ICSID cases has increased steadily since 1997. In only 10 years, the number of cases pending before the Centre has risen from 48 by year end 1997<sup>447</sup> to more than 119 pending cases by year end 2007. Despite this great success and the clear advantages to settling one's dispute within the tried and tested framework of the Centre, the evolution of arbitral practice as well as state practice has evolved to highlight the idiosyncrasies of ICSID arbitration.

These specific aspects relate in particular to the objective jurisdictional conditions of the existence of an "investment" made by an "investor" pursuant to article 25 of the ICSID Convention. Of interest for the future development of ICSID arbitration are also the possible impact of the newly introduced rule 41 (5) of the ICSID Arbitration Rules and the effect of the denunciation of the ICSID Convention by States parties.

*(i) The definition of an "investment" under the International Centre Convention*

It is commonplace today to observe that the ICSID Convention and more specifically its article 25, which governs the Centre's jurisdiction, does not define an investment and

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<sup>447</sup> See Emmanuel Gaillard, *La jurisprudence du CIRDI* (Paris, Pedone, 2004), p. 422. By comparison, in 1987, only 11 cases were pending before the Centre (*ibid.*, p. 199).

that this omission was intentional. The report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States has made clear that:<sup>448</sup>

“No attempt was made to define the term ‘investment’ given the essential requirement of consent by the parties, and the mechanisms through which Contracting States can make known in advance, if they so desire, the classes of disputes which they would or would not consider submitting to the Centre (Article 25 (4)).”

In this light, arbitral tribunals have developed a body of case law establishing the criteria to determine whether an investment qualifies as such under the ICSID Convention. There is general agreement that an investment has to satisfy three criteria, namely: (a) a contribution made by the investor; (b) a certain duration of the project; and (c) a participation in the risks of the transaction. The unresolved issue lies, however, in the role played by a potential fourth criterion—found in the preamble to the ICSID Convention—for an investment to be protected, namely, that it must contribute to the economic development of the host State.

Arbitral tribunals have approached this question in one of three ways. The first approach, as demonstrated by the Tribunal in *Československá Obchodní Bank, A.S. v. The Slovak Republic*,<sup>449</sup> is that while a contribution to the economic development of the host State may exist in a given case, it is not a formal prerequisite for a finding that an investment exists.<sup>450</sup>

“The broad meaning which must be given to the notion of an investment under article 25 (1) of the Convention is opposed to the conclusion that a transaction is not an investment merely because, as a matter of law, it is a loan. This is so, if only because under certain circumstances a loan may contribute substantially to a State’s economic development.

“It would seem that the resources provided through CSOB’s banking activities in the Slovak Republic were designed to produce a benefit and to offer CSOB a return in the future, subject to an element of risk that is implicit in most economic activities. The Tribunal notes, however, that these elements of the suggested definition, while they tend as a rule to be present in most investments, are not a formal prerequisite for the finding that a transaction constitutes an investment as that concept is understood under the Convention.”

The second approach, as illustrated by the decision in *Salini v. Morocco*,<sup>451</sup> is to consider the contribution to the economic development of the host State to be a fourth requirement for an investment to be protected under the ICSID Convention:<sup>452</sup>

<sup>448</sup> Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (1965), ICSID Doc. ICSID-2, *History of the ICSID Convention*, vol. II-2, p. 1069, para. 27.

<sup>449</sup> *Československá Obchodní Banka, A.S. v. The Slovak Republic* (ICSID Case No. ARB/97/4), Decision on Objections to Jurisdiction, dated 24 May 1999”, *ICSID Review*, vol. 14, 1999, p. 251.

<sup>450</sup> *Ibid.*, paras. 76 and 90.

<sup>451</sup> *Salini Costruttori SpA and Italstrade SpA v. Kingdom of Morocco* (ICSID Case No. ARB/00/4), Decision on Jurisdiction dated 23 July 2001, *International Legal Materials*, vol. 42, No. 3 (2003), p. 609; “*Salini Costruttori SpA and Italstrade SpA v. Kingdom of Morocco* (ICSID Case No. ARB/00/4)”, *ICSID Reports*, vol. 6, 2004, p. 400, para. 52. See also “*Joy Mining Machinery Limited v. The Arab Republic of Egypt* (ICSID Case No. ARB/03/11), Award on Jurisdiction dated 6 August, 2004”, *ICSID Review*, vol. 19, 2004, p. 486.

<sup>452</sup> *Salini v. Morocco* (see footnote 451 above), para. 52.

“The doctrine generally considers that investment infers: contributions, a certain duration of performance of the contract and a participation in the risks of the transaction (cf. commentary by E. Gaillard, cited above, p. 292). In reading the Convention’s preamble, one may add the contribution to the economic development of the host State of the investment as an additional condition.

“In reality, these various elements may be interdependent. Thus, the risks of the transaction may depend on the contributions and the duration of performance of the contract. As a result, these various criteria should be assessed globally even if, for the sake of reasoning, the Tribunal considers them individually here.”

The final approach, discussed notably in *L.E.S.I.-Dipenta v. Algeria*,<sup>453</sup> is that the contribution to the economic development of the host State should not be considered an independent requirement for a finding that an investment exists, although it may be implicitly included in the other three criteria.<sup>454</sup>

“It seems compatible with the aim of the Convention that, in order to be an investment under the terms of the provision, the contract must meet the following three requirements:

- “(a) The contracting party must have made a contribution to the country concerned;
- “(b) This contribution must cover a suitable length of time;
- “(c) It must entail a certain risk for the contracting party.

“However, it is not necessary for the contract to also specifically promote the economy of the country, a condition which, in any event, is already covered by the three requirements.”

The issue was again raised before the ad hoc Committee in *Patrick Mitchell v. Democratic Republic of Congo*.<sup>455</sup> The Committee decided that for an investment to qualify as such under the ICSID Convention it had to contribute to the economic development of the host State. The Committee emphasized that the requirement was to be found in the preamble to the Convention, which referred to “the need for international cooperation for economic development, and the role of private international investment therein”<sup>456,457</sup>

<sup>453</sup> “*Consorzio Groupement L.E.S.I.-Dipenta v. People’s Democratic Republic of Algeria* (ICSID Case No. ARB/03/8), Award (in French) dated 10 January 2005”, *ICSID Review*, vol. 19, 2004, p. 426.

<sup>454</sup> *L.E.S.I.-Dipenta v. Algeria* (see footnote 453), para. 13 (iv). See also *Lesi & Astaldi v. Algeria* (ICSID Case No. ARB/05/3), Decision on Jurisdiction dated 12 July 2006, available in French from <http://icsid.worldbank.org>; *Bayindir Insaat Ticaret ve Sanayi A.S. v. Islamic Republic of Pakistan* (ICSID Case No. ARB/03/29), Decision on Jurisdiction dated 14 November 2005, available from <http://icsid.worldbank.org>, para. 137 (“Lastly, relying on the preamble of the ICSID Convention, ICSID tribunals generally consider that, to qualify as an investment, the project must represent a significant contribution to the host State’s development. In other words, investment should be significant to the State’s development. As stated by the tribunal in *L.E.S.I.*, often this condition is already included in the three classical conditions set out in the ‘Salini test’.”)

<sup>455</sup> *Patrick Mitchell v. Democratic Republic of the Congo* (ICSID Case No. ARB/99/7), Decision on the Application for Annulment of the Award, dated 1 November 2006, available from <http://ita.law.uvic.ca/>.

<sup>456</sup> *Ibid.*, para. 28: “The Preamble of the Washington Convention sets forth a number of basic principles as to its purpose and aims, which imbue the individual provisions of the Convention, including Article 25.”

<sup>457</sup> *Ibid.*, para. 27.

“There are four characteristics of investment identified by ICSID case law and commented on by legal doctrine, but in reality they are interdependent and are consequently examined comprehensively. The first characteristic of investment is the commitment of the investor, which may be financial or through work. ... Other characteristics of investment are the duration of the project and the economic risk entailed, in the sense of an uncertainty regarding its successful outcome. The fourth characteristic of investment is the contribution to the economic development of the host country.”

The Committee concluded:<sup>458</sup>

“It is thus quite natural that the parameter of contributing to the economic development of the host State has always been taken into account, explicitly or implicitly, by ICSID arbitral tribunals in the context of their reasoning in applying the Convention, and quite independently from any provisions of agreements between parties or the relevant bilateral treaty.”

In the case at hand, the Committee held that:<sup>459</sup>

“As a legal consulting firm is a somewhat uncommon operation from the standpoint of the concept of investment, in the opinion of the *ad hoc* Committee it is necessary for the contribution to the economic development or at least the interests of the State, in this case the DRC, to be somehow present in the operation.”

Finding that the tribunal had not provided “the slightest explanation as to the relationship between the ‘Mitchell & Associates’ firm and the DRC”,<sup>460</sup> the Committee annulled the award for failure to state reasons on the qualification of those services as an investment.

This decision was received in the investment arbitration community with criticism.<sup>461</sup> For example, the *ad hoc* Committee’s finding that services could not be considered an investment because they did not contribute to the economic development of the host State was in contradiction to the clear and specific language of the bilateral investment treaty between the Democratic Republic of the Congo and the United States of America, which defined “investment” as specifically including “service contracts”. It was also in contradiction to the Committee’s emphasis on the fact that the economic development of the host State:<sup>462</sup>

“... does not mean that this contribution must always be sizeable or successful; and, of course, ICSID tribunals do not have to evaluate the real contribution of the operation

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<sup>458</sup> *Ibid.*, para. 29.

<sup>459</sup> *Ibid.*, para. 39.

<sup>460</sup> *Ibid.*, para. 40.

<sup>461</sup> See in particular Emmanuel Gaillard, “Chronique des sentences arbitrales CIRDI”, *Journal du droit international*, 2007, p. 255, at p. 340; Julien Fouret and Dany Khayat, “Le Centre international pour le règlement des différends relatifs aux investissements (CIRDI)”, *Revue Québécoise de Droit International*, vol. 19, No. 1 (2006), p. 341; W. Ben Hamida, “Two nebulous ICSID features: the notion of investment and the scope of annulment control – *ad hoc* committee’s decision in *Patrick Mitchell v. Democratic Republic of Congo*”, *Journal of International Arbitration*, vol. 24, No. 3 (2007), p. 287. See also E. Gaillard and Y. Banifatemi, “A black year for ICSID”, *New York Law Journal*, 22 February 2007.

<sup>462</sup> *Patrick Mitchell v. Democratic Republic of the Congo* (see footnote 455 above), para. 33.

in question. It suffices for the operation to contribute in one way or another to the economic development of the host State, and this concept of economic development is, in any event, extremely broad but also variable depending on the case.”

Although other tribunals followed suit,<sup>463</sup> the case law today on the definition of an investment under the ICSID Convention is clearly unsettled as to the requirement of a contribution to the economic development of the host State. In the face of such inconsistency, it is worthy of note that an investor choosing UNCITRAL arbitration over ICSID arbitration on the basis of the same bilateral investment treaty would reasonably not need to establish a contribution to the economic development of the host State, which the arbitral case law has found in the preamble of the ICSID Convention. The rigidity introduced into the definition of an “investment” may thus result in the development of different regimes of investment protection—to the detriment of legal certainty and predictability—either within ICSID case law or based on the choice of another forum by the investor, possibly making other options such as UNCITRAL arbitration (if provided by the relevant instrument) more attractive to investors.

(ii) *The definition of an “investor” under the ICSID Convention and the question of dual nationality*

The definition of an “investor” is provided by article 25 of the ICSID Convention, both as regards legal persons and natural persons. As regards the latter, article 25 sets forth that an investor must be a national of a contracting State other than the State party to the dispute on the date on which the parties consented to submit the dispute to arbitration as well as on the date on which the request for arbitration was registered. Dual nationals who also hold the nationality of the State party to the dispute are expressly excluded from the definition of an investor under article 25 (2):

“‘National of another contracting State’ means: (a) any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered . . . , but does not include any person who on either date also had the nationality of the Contracting State party to the dispute.”

The question of dual nationals is specific to ICSID arbitration and the application of article 25 (2) (a). The first decision to address this question was *Champion Trading and others v. The Arab Republic of Egypt*:<sup>464</sup> the Tribunal held that dual nationals who held the nationality of the host State could bring a claim under the ICSID Convention. In that respect, the Tribunal did not take into account the rule of effective nationality under international law in order to determine whether the claimants were, effectively, nationals of the host State.

<sup>463</sup> See in particular *Malaysian Historical Salvors SDN, BHD v. The Government of Malaysia* (ICSID Case No. ARB/05/10), Award on Jurisdiction dated 17 May 2007, para. 135 (“To determine whether the Contract is an ‘investment’, the litmus test must be its overall contribution to the economy of the host State, Malaysia.”). This award is currently the subject of annulment proceedings.

<sup>464</sup> “*Champion Trading Company and others v. The Arab Republic of Egypt* (ICSID Case No. ARB/02/9), Decision on Jurisdiction dated 21 October 2003”, ICSID Review, vol. 19, 2004, p. 275, at p. 288.

The exclusion of dual nationals under the ICSID Convention was confirmed in *Soufraki v. United Arab Emirates*.<sup>465</sup> The Tribunal in that case found the timing of the determination of the nationality to be a critical question. The dates used by the Tribunal to determine the claimant's nationality for the purposes of the bilateral investment treaty at issue were the date of the parties' consent to ICSID arbitration and the date of the registration of the claimant's request for arbitration by ICSID.<sup>466</sup> The question was revisited in *Siag and Vecchi v. The Arab Republic of Egypt*.<sup>467</sup> In this case, both claimants had previously been Egyptian nationals but had lost their Egyptian nationality by operation of the law prior to bringing their ICSID claim. At the same time, the claimants also held Italian and Lebanese nationality. The Tribunal upheld its jurisdiction since the claimants had lost their Egyptian nationality. In a dissenting opinion, Professor Orrego Vicuña argued about the importance of the timing of the acquisition and loss of nationality. He focused on the requirement in the ICSID Convention that a claimant did not have the nationality of the respondent State "on the date on which the parties consented to submit" the dispute to arbitration and observed that in cases where a State gave consent by way of an investment treaty, the date on which both parties consented to arbitration might not occur until much later, and possibly as late as the notice of arbitration. Professor Orrego Vicuña's suggestion was that, in order to "prevent many kinds of abuse"<sup>468</sup> and to avoid the possibility of investors manipulating their nationality up until giving their consent to arbitration, the ICSID Convention should be interpreted as requiring that an investor not have the nationality of the respondent State at the time of the expression of consent of both the investor and the host State. He also raised the possibility of requiring the investor not to hold the nationality of the respondent State at the time the investment was made.

Given the exclusion and the timing requirements contained in article 25 (2) of the ICSID Convention as regards natural persons, the question arises as to whether ICSID arbitration is the most favourable option in the case of dual nationality, especially when such dual nationality is in doubt, for example because an investor has the nationality of the host State without such nationality being effective or because an investor has lost the nationality of the host State before submitting an ICSID claim. To the extent that the same exclusion may not exist under other dispute resolution arrangements offered by the relevant investment treaties, such as under the UNCITRAL Arbitration Rules for example, these other options may be viewed by investors as being more advantageous.

(iii) *The expedited procedure under rule 41 (5) of the International Centre Arbitration Rules*

The new rule 41 (5) of the ICSID Arbitration Rules provides a party with an opportunity to file an objection with the arbitral tribunal that a claim is manifestly without legal merit, such objection resulting, if successful, in the dismissal of the claim. This objection has to be filed within 30 days of the constitution of the tribunal, or, in any event,

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<sup>465</sup> *Hussein Nuaman Soufraki v. United Arab Emirates* (ICSID Case No. ARB/02/7), Award of 7 July 2004, available from [www.investmentclaims.com](http://www.investmentclaims.com) and [www.ita.law.uvic.ca](http://www.ita.law.uvic.ca).

<sup>466</sup> *Ibid.*, para. 84.

<sup>467</sup> "*Siag and Vecchi v. The Arab Republic of Egypt* (ICSID Case No. ARB/05/15), Decision on Jurisdiction dated 11 April 2007", *Mealey's: International Arbitration Report*, document No. 05-070627-006Z; available from the ICSID website <http://icsid.worldbank.org>.

<sup>468</sup> *Ibid.*, see the dissenting opinion by Professor Orrego Vicuña, p. 65.

before the tribunal's first session. The rule came into effect on 10 April 2006 and resulted from the consultations undertaken by the ICSID secretariat during 2004 and 2005. It was justified by the fact that:<sup>469</sup>

“The Secretary-General's power to screen requests for arbitration does not extend to the merits of the dispute or to cases where jurisdiction is merely doubtful but not manifestly lacking. In such cases, the request for arbitration must be registered and the parties invited to proceed to constitute the arbitral tribunal.

“It is suggested to make it clear, by the introduction of a new paragraph (5), that the tribunal may at an early stage of the proceeding be asked on an expedited basis to dismiss all or part of a claim on the merits. The change would be helpful in addressing any concerns about the limited screening power of the Secretary-General.”

There is no parallel to rule 41 (5) in other arbitration rules, including the UNCITRAL Arbitration Rules or the Rules of the Arbitration Institute of the Stockholm Chamber of Commerce. The ICC Pre-Arbitral Referee Procedure, although similarly concerned with expedited procedures, is directed towards a temporary solution and does not affect the merits of an arbitration that, if initiated, will be a separate proceeding with arbitrators different from the referee who decided the claim.<sup>470</sup>

While this provision has not yet been tested, it is possible to foresee a number of difficulties as regards its implementation. A first question is whether a respondent State may use this provision as a procedural weapon to add an extra layer of proceedings and thus delay the arbitration. Indeed, rule 41 (5) makes it clear that the tribunal's decision “shall be without prejudice to the right of a party to file an objection pursuant to [rule 41] paragraph 1 (on jurisdiction), or to object, in the course of the proceeding, that a claim lacks legal merit”. There is therefore a risk that the same objections will be presented at different stages of the arbitral proceeding or that the respondent State takes advantage of the rule to submit its objections piecemeal.

The rule may also raise issues relating to the arbitrators' impartiality—or at least appearance of impartiality—since the arbitrators who decide on an objection under rule 41 (5) are the same as those who will decide, in the event the objection is dismissed, on questions of jurisdiction and the merits of the dispute. In cases where a party's objection is not unanimously rejected, the question remains as to whether the arbitrator who has found that the claim is manifestly without legal merit under the expedited procedure of rule 41 (5) will have prejudged the claim when the remainder of the arbitral proceeding would address the same or related questions bearing on the tribunal's jurisdiction and/or the merits of the dispute.

Finally, rule 41 (5) does not prescribe how an objection should be dealt with, simply stating that the tribunal “shall decide after giving the parties the opportunity to present

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<sup>469</sup>International Centre for Settlement of Investment Disputes, “Suggested changes to the ICSID Rules and Regulations”, working paper of the ICSID secretariat, 12 May 2005, available from <http://ita.law.uvic.ca/documents/052405-sgmanual.pdf>, p. 7.

<sup>470</sup>See article 1.1 of the ICC Rules for a Pre-Arbitral Referee Procedure: “These Rules concern a procedure called the ‘Pre-Arbitral Referee Procedure’, which provides for the immediate appointment of a person (the ‘Referee’) who has the power to make certain Orders prior to the arbitral tribunal or national court competent to deal with the case (the ‘Competent Authority’) being seized of it.” The powers of the referee are set forth in article 2 of the Rules.

their observations on the objection”. Will the actual procedure that will be adopted at a rule 41 (5) hearing allow for witnesses to be called? What sort of time limits will there be? Will decisions be published? Considering that a successful objection under this rule will effectively bring the case to an end, questions of procedure are of crucial concern to ensure that a claimant has a fair opportunity to present its claim.

(iv) *The effect of denunciation of the International Centre Convention*

In April 2007, the member States of the Bolivarian Alternative for Latin America and the Caribbean (ALBA), namely, Bolivia, Cuba, Nicaragua and Venezuela, proclaimed their intention to withdraw from the International Monetary Fund and the World Bank. Bolivia was the first—and so far only—State to implement this resolution, and submitted a notice of denunciation of the ICSID Convention on 2 May 2007.<sup>471</sup> Pursuant to article 71 of the Convention, this denunciation was to take effect six months after the receipt by ICSID of Bolivia’s written notice of denunciation, namely on 3 November 2007.

At this time, the exact consequences of Bolivia’s denunciation are unclear. One of the important questions is what becomes of the denouncing State’s existing rights and obligations under the Convention at the time of denunciation. Article 72 of the ICSID Convention covers situations where a denouncing State, one of its constituent subdivisions or agencies, or one of its nationals, has given consent to the jurisdiction of the Centre prior to the notice of denunciation:

“Notice by a contracting State pursuant to Articles 70 or 71 shall not affect the rights or obligations under this Convention of that State or of any of its constituent subdivisions or agencies or of any national of that State arising out of consent to the jurisdiction of the Centre given by one of them before such notice was received by the depositary.”

The notion of “consent to the jurisdiction of the Centre” will thus be at the heart of this derogatory regime. In other words, the issue will be whether general consent to ICSID arbitration given by a State in an investment treaty constitutes ongoing “consent to the jurisdiction of the Centre” even after that State’s denunciation of the ICSID Convention. The position has been taken by some authors that the denouncing State’s consent must be “perfected” before the notice of denunciation.<sup>472</sup> Others believe that in cases in which the investor has accepted the State’s general consent prior to the receipt of the notice of denunciation by the Centre or within the six-month period set forth in article 72, the effectiveness of the existing rights and obligations should raise little difficulty as the host State is still a contracting party at those times, but that in the more difficult situations where the investor’s acceptance of the general offer by the host State contained in an investment treaty occurs after the denunciation of the ICSID Convention has taken effect and the host State has ceased to be a contracting party, effect should be given to the wording of the arbitration clause in the relevant investment treaty or contractual arrangement: where an unqualified consent to arbitration exists,

<sup>471</sup> See “Bolivia submits a notice under article 71 of the ICSID Convention”, *ICSID News Release*, 16 May 2007, available from the ICSID website at <http://icsid.worldbank.org>.

<sup>472</sup> See Christoph Schreuer, *The ICSID Convention: A Commentary* (Cambridge, Cambridge University Press, 2001), p. 1286.

as opposed to an agreement to consent, the rights and obligations attached to such consent should not be affected by the denunciation of the ICSID Convention pursuant to its article 72.<sup>473</sup>

These questions will probably be addressed by the arbitral tribunal constituted in the case registered by the ICSID secretariat against Bolivia in October 2007 despite Bolivia's objections.<sup>474</sup> In the meantime, however, in view of the uncertainties entailed in the application of article 72 of the ICSID Convention by arbitral tribunals, investors faced with a denunciation may consider other alternatives provided by the relevant instrument.

More generally, in view of the restrictions that ICSID arbitration may impose on investors and the uncertainties resulting from the case law or the applicable provisions, the question today is whether the success of ICSID arbitration will be maintained in the years to come or whether investors will find new interest in the other options existing in the relevant instrument. The UNCITRAL Arbitration Rules, in particular, may gain additional support based on the ongoing amendments to the rules. For example, the proposed change to article 1 (1) of the UNCITRAL Arbitration Rules to cover disputes "in respect of a defined legal relationship, whether contractual or not" and not merely "disputes in relation to [a] contract" as is the case today, will no doubt be perceived as a step towards certainty in that the new language will unquestionably cover legal disputes arising from an investment treaty.<sup>475</sup> Further, the proposed change to article 33 (1), which deals with the applicable law, to refer to the "rules of law" applicable to a dispute rather than simply the "law", opens up the possibility of the application to UNCITRAL arbitral proceedings not only of the rules specific to one legal system but also of transnational rules and the rules of international law.<sup>476</sup>

(b) *The impact of the treaty mechanism on the protection afforded to investors*

Because the vast majority of investor-State arbitrations are today based on investment treaties, either bilateral or multilateral, questions of treaty law are increasingly becoming critical to the resolution of important questions relating to the jurisdiction of tribunals or the merits of the disputes.

The effect of some treaty mechanisms on the protection that is accorded to investors has not yet rendered consistent interpretations by arbitral tribunals. Two of the most controversial questions are the applicability of most-favoured-nation (MFN) clauses to the treaty's dispute-settlement arrangements and the extent to which a tribunal's jurisdiction based on an investment treaty can cover claims arising out of an underlying contract.

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<sup>473</sup> See the article by Emmanuel Gaillard and Yas Banifatemi, "The denunciation of the ICSID Convention", *New York Law Journal*, 21 June 2007, with an analysis of the history of the ICSID Convention in this regard.

<sup>474</sup> *E.T.I. Euro Telecom International N.V. v. Republic of Bolivia* (ICSID Case No. ARB/07/28), registered on 31 October 2007.

<sup>475</sup> See report of the Working Group on Arbitration and Conciliation on the work of its forty-sixth session (New York, 5-9 February 2007) (A/CN.9/619), paras. 22-24.

<sup>476</sup> As regards the application of international law under the ICSID Convention, see Emmanuel Gaillard and Yas Banifatemi "The meaning of 'and' in article 42 (1), second sentence, of the Washington Convention: the role of international law in the ICSID choice of law process", *ICSID Review*, vol. 18, 2003, p. 375.

(i) *The applicability of most-favoured-nation clauses to dispute-settlement mechanisms*

Under an MFN clause, the beneficiary of the clause may invoke and rely on the more favourable treatment that is accorded to the nationals of a third country by the State party to the treaty against whom the provision is invoked. While it is widely accepted that the MFN clause will apply to the substantive protections accorded in the investment treaty, the debate centres around whether the MFN clause extends to the dispute-settlement provisions of the treaty. This issue arises at the jurisdictional stage of arbitral proceedings and the case law on the matter diverges sharply.

One line of cases<sup>477</sup> has had no difficulty establishing that the MFN clause extends to the dispute-settlement provisions of the treaty. In each instance, the tribunal came to this conclusion after analysing the language of the MFN clause and the intention of the parties to the treaty. In the words of the *Maffezini* Tribunal, in particular:<sup>478</sup>

“A number of bilateral investment treaties have provided expressly that the most favoured nation treatment extends to the provisions on settlement of disputes. ...

“Notwithstanding the fact that the basic treaty containing the clause does not refer expressly to dispute settlement as covered by the most favoured nation clause, the Tribunal considers that there are good reasons to conclude that today dispute settlement arrangements are inextricably related to the protection of foreign investors. ...

“If a third-party treaty contains provisions for the settlement of disputes that are more favourable to the protection of the investor’s rights and interests than those in the basic treaty, such provisions may be extended to the beneficiary of the most favoured nation clause.”

In parallel, a number of arbitral tribunals have found that, on the contrary, the MFN clause cannot apply to the dispute-settlement provisions of an investment treaty.<sup>479</sup> As with

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<sup>477</sup> “*Emilio Agustín Maffezini v. Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision on Jurisdiction dated 25 January 2000”, *International Law Review*, vol. 124, 2003, p. 9; “*Siemens AG v. Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction dated 3 August 2004”, *Journal de Droit International*, vol. 132, 2005, p. 142 (excerpts), also available from the ICSID website <http://icsid.worldbank.org>; *Gas Natural SDG, S.A. v. Argentine Republic* (ICSID Case No. ARB/03/10), Decision of the Tribunal on Preliminary Questions on Jurisdiction dated 17 June 2005, available from [www.asil.org/pdfs/GasNat.v.Argentina.pdf](http://www.asil.org/pdfs/GasNat.v.Argentina.pdf); *Suez, Sociedad General de Aguas de Barcelona S.A., and InterAguas Servicios Integrales del Agua S.A. v. Argentine Republic* (ICSID Case No. ARB/03/17), Decision on Jurisdiction dated 16 May 2006, available from ICSID website <http://icsid.worldbank.org>; *National Grid PLC v. Argentine Republic*, UNCITRAL arbitration, Decision on Jurisdiction dated 20 June 2006, available from <http://ita.law.uvic.ca/>.

<sup>478</sup> *Maffezini v. Spain* (see footnote 477 above), paras. 52-56. See also *Siemens v. Argentina* (see footnote 477 above), paras. 102-103 (“the term ‘treatment’ and the phrase ‘activities related to the investments’ are sufficiently wide to include settlement of disputes”).

<sup>479</sup> “*Salini Costruttori S.p.A. and Italstrade S.p.A. v. Hashemite Kingdom of Jordan*, ICSID Case No. ARB/02/13, Decision on Jurisdiction dated 29 November 2004”, *International Legal Materials*, vol. 44, 2005, p. 569, paras. 115-119 (“[The arbitration clause of the BIT] does not envisage ‘all rights or all matters covered by the agreement’. Furthermore, the Claimants have submitted nothing from which it *might* be established that the common intention of the Parties was to have the most-favoured clause apply to dispute settlement”, para. 118); “*Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction dated 8 February 2005”, *International Legal Materials*, vol. 44, 2005, p. 721, paras. 183-227 (“It is not evident that when parties have agreed in a particular BIT on a specific dispute resolution mechanism, as is the case with the Bulgaria-Cyprus BIT (*ad hoc* arbitration), their agreement to most-favoured nation treatment means that they intended that, by operation of the MFN clause, their specific agreement on such a dispute settlement mechanism could be replaced by a totally different dispute resolution mechanism (ICSID arbitration). It is one thing to add to the treatment provided in one treaty more favourable treatment provided elsewhere. It is quite another thing to replace a procedure specifically negotiated by parties with an entirely different mechanism”, para. 209); and “*Telenor Mobile Communications A.S. v. Republic of Hungary*, ICSID Case No. ARB/04/15, Award dated 13 September 2006”, *ICSID Review*, vol. 21, No. 2 (2006), p. 488, para. 92.

the cases applying the MFN clause to the dispute-settlement provisions of the treaty, these tribunals also considered the specific language of the clause and the intention of the parties in reaching their decisions. Their point of emphasis was, however, that an MFN clause does not apply to the dispute-settlement provisions of a treaty unless the parties to the treaty have expressly indicated otherwise. As stated by the Tribunal in *Plama v. Bulgaria*:<sup>480</sup>

“An MFN provision in a basic treaty does not incorporate by reference dispute settlement provisions in whole or in part set forth in another treaty, unless the MFN provision in the basic treaty leaves no doubt that the Contracting Parties intended to incorporate them.”

This approach was approved and echoed by the Tribunal in *Telenor v. Hungary*:<sup>481</sup>

“In the absence of language or context to suggest the contrary, the ordinary meaning of ‘investments shall be accorded treatment no less favourable than that accorded to investments made by investors of any third State’ is that the investor’s substantive rights in respect of the investments are to be treated no less favourably than under a BIT between the host State and a third State, and there is no warrant for construing the above phrase as importing procedural rights as well. It is one thing to stipulate that the investor is to have the benefit of MFN investment treatment but quite another to use an MFN clause in a BIT to bypass a limitation in the very same BIT when the parties have not chosen language in the MFN clause showing an intention to do this, as has been done in some BITs.”

All these cases in reality show that the question of the applicability of an MFN clause to dispute-settlement arrangements is chiefly determined by the language of the clause, and there is hardly any controversy over the necessity of giving effect to the language of the relevant instrument and the intention of the State parties in incorporating such a clause in their treaty. When the provision expressly sets forth limitations, such as article 1103 (2) of the North American Free Trade Agreement (NAFTA) for example,<sup>482</sup> such limitations must be given effect. Equally, when the contracting parties have expressly included dispute-settlement arrangements in the scope of their MFN clause, such as article 3 (3) of the model United Kingdom BIT,<sup>483</sup> such intention must be given effect. The question arises, by definition, in those instances where the clause is broadly phrased and the contracting parties to the treaty have neither expressly excluded dispute-resolution mechanisms nor clarified their intention of including such mechanisms in the protection that is accorded to the beneficiaries of the MFN clause. In those situations, which remain

<sup>480</sup> *Plama v. Bulgaria* (see footnote 479 above), para. 223.

<sup>481</sup> *Telenor v. Hungary* (see footnote 479 above), para. 92. See also para. 95:

“Those who advocate a wide interpretation of the MFN clause have almost always examined the issue from the perspective of the investor. But what has to be applied is not some abstract principle of investment protection in favour of a putative investor who is not a party to the BIT and who at the time of its conclusion is not even known, but the intention of the States who are contracting parties. The importance to investors of international arbitration cannot be denied, but in the view of this Tribunal its task is to interpret the BIT and for that purpose to apply ordinary canons of interpretation, not to displace, by reference to general policy considerations concerning investor protection, the dispute resolution mechanism specifically negotiated by the parties.”

<sup>482</sup> Article 1103 (2), of NAFTA provides for more favourable treatment “with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.” Dispute settlement is evidently not provided for under this MFN provision.

<sup>483</sup> Article 3 (3) provides that “for the avoidance of doubt it is confirmed that the treatment provided for in paras. (1) and (2) above shall apply to the provisions of articles 1 to 11 of this Agreement” (which include the arbitration clause).

unsettled in the arbitral case law, the intention of the contracting parties can reasonably be interpreted to include the whole range of the rights accorded to the investors of a third country, including the dispute-settlement provisions of the treaty.<sup>484</sup>

(ii) *Treaty-based jurisdiction over contractual claims*

The other sharp controversy in the investment arbitration community concerns the question whether a tribunal's jurisdiction based on an investment treaty may cover a claim arising out of a contract relating to the investment. This question in reality covers two types of controversy, namely, the effect of broadly phrased dispute-resolution clauses and the effect of observance of undertakings clauses (also known as "umbrella" clauses).

1. A first question, as yet unsettled, concerns the effect of broadly phrased dispute-resolution clauses contained in investment treaties: does a tribunal's jurisdiction cover contractual claims where the dispute-resolution clause provides that "any" or "all" disputes "with respect to", "relating to" or "concerning" investments between a contracting party to the treaty and an investor of the other contracting party can be submitted to international arbitration?

The first decision to address this question was *Salini v. Morocco*. The Tribunal in that case held that the terms of the dispute-settlement provision were "very general" and that "the reference to expropriation and nationalisation measures, which are matters coming under the unilateral will of a State, cannot be interpreted to exclude a claim based in contract from the scope of application of this article".<sup>485</sup> However, it restricted its jurisdiction to only those contractual claims arising out of a "breach of a contract that binds the State directly. The jurisdiction offer contained in article 8 does not ... extend to breaches of a contract to which an entity other than the State is a named party".<sup>486</sup> The same approach was adopted by the Arbitral Tribunal in *Impregilo v. Pakistan*.<sup>487</sup>

Other tribunals have applied a wider philosophy, namely that not only contracts entered into by the State are covered but all contractual claims may be covered by a broad-dispute resolution clause. This was notably the position taken by the ad hoc Committee in *Vivendi v. Argentina*<sup>488</sup> and the Tribunal in *SGS v. Philippines*.<sup>489</sup>

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<sup>484</sup> See the article by Yas Banifatemi on the MFN treatment, based on a speech given in London on 14 September 2007 at the Investment Treaty Forum on the Emerging Jurisprudence of International Investment Law, to be published by Oxford University Press.

<sup>485</sup> *Salini v. Morocco* (see footnote 451 above), para. 59.

<sup>486</sup> *Ibid.*, para. 61.

<sup>487</sup> *Impregilo SpA v. Islamic Republic of Pakistan* (ICSID Case No. ARB/03/3), Decision on Jurisdiction dated 22 April 2005, paras. 198 and 211 (available from the ICSID website: <http://icsid.worldbank.org>); see also para 214 ("The jurisdiction offer in this BIT does not extend to breaches of a contract to which an entity other than the State is a named Party").

<sup>488</sup> "*Compañía de Aguas del Aconquija, S.A. et Compagnie Générale des Eaux (Vivendi Universal) v. Argentine Republic*, ICSID Case No. ARB/97/3, Decision of the ad hoc Committee of 3 July 2002", *International Legal Materials*, vol. 41, 2002, p. 1135; *ICSID Reports*, vol. 6, 2004, p. 340, para. 55 (the provision "does not use a narrower formulation, requiring that the investor's claim allege a breach of the BIT itself. Read literally, the requirements for arbitral jurisdiction in article 8 do not necessitate that the Claimant allege a breach of the BIT itself: it is sufficient that the dispute relate to an investment made under the BIT").

<sup>489</sup> "*SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision on Jurisdiction dated 29 January 2004", *Mealey's: International Arbitration Report*, vol. 19, C-1, February 2004; *ICSID Reports*, vol. 9, 2005, p. 518, para. 131 ("The term 'disputes with respect to investments' ... is not limited by reference to the legal classification of the claim that is made. A dispute about an alleged expropriation contrary to article VI of the BIT would be a 'dispute with respect to investments'; so too would a dispute arising from an investment contract such as the CISS Agreement.").

The most restrictive approach was adopted by the Tribunal in *SGS v. Pakistan*,<sup>490</sup> holding that a broad dispute-resolution clause in an investment treaty does not provide sufficient basis for a treaty-based tribunal to have jurisdiction over purely contractual claims and that a treaty-based jurisdiction could cover alleged breaches of contract only where such breaches also constitute or amount to breaches of the substantive standards of the BIT.<sup>491</sup> Similarly, the Tribunal in *L.E.S.I.-Dipenta v. Algeria* decided that contractual claims brought before a tribunal having jurisdiction on the basis of a treaty must also amount to a violation of the treaty standards.<sup>492</sup>

The question is therefore still unsettled as to whether, in the presence of a broadly phrased dispute-settlement provision in an investment treaty, the investor must allege, in order to establish the jurisdiction of the treaty-based tribunal over its contractual claims, that the substantive standards of the treaty under which it is initiating the arbitration against the host State were violated or whether it is sufficient for the tribunal to rule on contractual breaches without being required to pass judgement on the substantive provisions of the treaty.<sup>493</sup>

2. The case law is just as shifting and unpredictable in the different situation where the investment treaty under consideration contains an observance of undertakings clause (or “umbrella” clause). Under this type of provision, contracting States mutually undertake to ensure the observance of the commitments entered into with respect to the investments or the investors of the other contracting party. The question is therefore whether the breach of a contractual commitment amounts to a violation of the treaty under this type of provision. Although it creates a treaty standard of protection and thus arguably embodies a substantive obligation, the observance of undertakings clauses has been examined in arbitral case law as the jurisdictional basis on which an investor could invoke the host State’s international responsibility for treaty violations constituted by breaches of contract.

The first decision rendered on this issue was in *SGS v. Pakistan*.<sup>494</sup> The Tribunal held that, in the absence of a “clear and convincing evidence that such was indeed the shared intent of the Contracting Parties” to the treaty,<sup>495</sup> the clause under consideration was not

<sup>490</sup> “*SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision of 27 August 2003”, *ICSID Review*, vol. 18, 2003, p. 307; *International Legal Materials*, vol. 42, 2003, p. 1290.

<sup>491</sup> *Ibid.*, paras. 161-162 (“We recognize that disputes arising from claims grounded on alleged violation of the BIT, and disputes arising from claims based wholly on supposed violations of the PSI Agreement, can both be described as ‘disputes with respect to investments’, the phrase used in article 9 of the BIT. That phrase, however, while descriptive of the factual subject matter of the disputes, does not relate to the legal basis of the claims, or the cause of action asserted in the claims. In other words, from that description alone, without more, we believe that no implication necessarily arises that both BIT and purely contract claims are intended to be covered by the Contracting Parties in article 9. ... Thus, we do not see anything in article 9 or in any other provision of the BIT that can be read as vesting this Tribunal with jurisdiction over claims resting *ex hypothesi* exclusively on contract. ... We conclude that the Tribunal has no jurisdiction with respect to claims submitted by SGS and based on alleged breaches of the PSI Agreement which do not also constitute or amount to breaches of the substantive standards of the BIT.”).

<sup>492</sup> *L.E.S.I.-Dipenta v. Algeria* (see footnote 437 above), para. 25 (“The defendant’s written consent does not necessarily indicate that the consent is broad in scope and can therefore serve as a basis for any violations that the plaintiff may claim. In fact, the consent is only valid when admitted by the bilateral agreement. [...] Consent is not given extensively for all claims and proceedings that may be related to an investment. The measures taken should focus on a violation of the bilateral agreement, particularly when this is unjustified or discriminatory, in law or in fact. However, it is not necessarily so in every case of breach of contract.”).

<sup>493</sup> On this question, see Emmanuel Gaillard, “Investment treaty arbitration and jurisdiction over contractual claims: the SGS cases considered”, in *International Investment Law and Arbitration: Leading cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law*, Todd Weiler, ed. (London, Cameron May, 2005), p. 325.

<sup>494</sup> *SGS v. Pakistan* (see footnote 490 above), paras. 163-173.

<sup>495</sup> *Ibid.*, para. 167.

specific enough to transform contractual obligations undertaken by the respondent State with respect to investments into violations of the treaty.<sup>496</sup>

“Applying [the] familiar norms of customary international law on treaty interpretation, we do not find a convincing basis for accepting the Claimant’s contention that article 11 of the BIT has had the effect of entitling a Contracting Party’s investor, like SGS, in the face of a valid forum selection contract clause, to ‘elevate’ its claim grounded solely in a contract with another Contracting Party, like the PSI Agreement, to claims grounded on the BIT, and accordingly to bring such contract claims to this Tribunal for resolution and decision.”

As a result, the Tribunal declined jurisdiction over the claimant’s claims alleging a violation of the observance of undertakings provision, and retained its jurisdiction only over those claims alleging a violation of other BIT provisions such as fair and equitable treatment or the prohibition of expropriation measures without effective and adequate compensation.

The question of the meaning and scope of the observance of undertakings clause was raised again in *SGS v. Philippines*.<sup>497</sup> The Tribunal decided that such a clause “has to be construed as intended to be effective within [the framework of the BIT]”,<sup>498</sup> and that the breach of a contractual commitment constitutes a breach of the observance of undertakings clause under the treaty. The Tribunal, however, also decided that its jurisdiction should not be exercised over claims asserted under this type of clause where the underlying contract contains a choice of forum mechanism.<sup>499</sup>

“To summarize the Tribunal’s conclusions on this point, article X (2) makes it a breach of the BIT for the host State to fail to observe binding commitments, including contractual commitments, which it has assumed with regard to specific investments. But it does not convert the issue of the extent or content of such obligations into an issue of international law. That issue (in the present case, the issue of how much is payable for services provided under the CISS Agreement) is still governed by the investment agreement.”

Accordingly, rather than determining itself the question of “the extent of the obligation” under the contract, the Tribunal decided to stay the proceedings “pending a decision [by the Philippine courts] on the amount due but unpaid under the CISS Agreement, a matter which (if not agreed by the parties) is to be determined by the agreed contractual forum under article 12 of the CISS Agreement”.<sup>500</sup>

Following these two decisions, a number of other arbitral tribunals have upheld their jurisdiction to hear a claim arising out of the violation of an observance of undertakings

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<sup>496</sup> *Ibid.*, para. 165; see more generally the Tribunal’s reasoning at paras. 166-173. In the same vein, see *Joy Mining v. Egypt* (see footnote 451 above), para. 81; *Salini v. Jordan* (see footnote 479 above), paras. 126-127, and para. 96 (“[The dispute settlement procedures provided for in the Contract] cannot cover claims based on breaches of the BIT (including breaches of those provisions of the BIT guaranteeing fulfilment of contracts signed with foreign investors).”) [Emphasis added.].

<sup>497</sup> *SGS v. Philippines* (see footnote 489 above), paras. 113-129.

<sup>498</sup> *Ibid.*, para. 115.

<sup>499</sup> *Ibid.*, para. 128.

<sup>500</sup> *Ibid.*, para. 177 (c).

clause finding its source in the breach of a contractual commitment.<sup>501</sup> Of special interest is the decision in *Noble Ventures v. Romania* where the Tribunal held that an observance of undertakings clause “introduces an exception to the general separation of States’ obligations under municipal and under international law”.<sup>502</sup> The expression “shall observe any obligation it may have entered into with regards to investments” in article II (2) (c) of the United States of America-Romania BIT constituted, in the Tribunal’s opinion, a direct formulation of the contracting States’ “aim to equate contractual obligations governed by municipal law to international treaty obligations as established in the BIT”.<sup>503</sup>

Other tribunals, however, have reached the opposite result by applying a restrictive approach.<sup>504</sup> In particular, the reasoning of the Tribunal in *El Paso v. Argentina* was that, to give a “broad interpretation” to an observance of undertakings clause that refers to “any” obligation undertaken by the State, and not only “contractual” obligations, would have the effect of internationalizing all municipal law commitments of the State and “far-reaching consequences”.<sup>505</sup> It therefore held that:<sup>506</sup>

“In conclusion, in this Tribunal’s view, following the important precedents set by Tribunals presided by Judge Feliciano [in *SGS v. Pakistan*], Judge Guillaume [in *Salini v. Jordan*] and Professor Orrego Vicuña [in *Joy Machinery v. Egypt*], an umbrella clause cannot transform any contract claim into a treaty claim, as this would necessarily imply that any commitments of the State in respect to investments, even the most minor ones, would be transformed into treaty claims.”

Evidently, in the light of such sharply diverging views taken by the various tribunals (and in legal writings), the question of the effect of an observance of undertakings clause is today a source of uncertainty in investor-State arbitrations. Interestingly, this question also illustrates the manner in which the different tribunals have given weight to the “precedents” of other tribunals—either to approve or to dispute a reasoning—a question that is becoming a new source of debate in investment arbitration.

### (c) *The notion of a “precedent” in investment arbitration*

Because arbitral tribunals constituted in investment matters increasingly refer in their decisions to awards rendered by other tribunals having dealt with the same issues, especially as regards similar issues arising under the same or similarly drafted treaty provisions, the

<sup>501</sup> *Noble Ventures Inc. v. Romania* (ICSID Case No. ARB/01/11), award dated 12 October 2005, para. 62 (available from <http://ita.law.uvic.ca/>); “*Eureko v. Poland*, ad hoc arbitration, partial award dated 19 August 2005”, *ICSID Reports*, vol. 12, p. 331; “*LG&E v. Argentina*, ICSID Case No. ARB/02/1, award dated 3 October 2006”, *International Legal Materials*, vol. 46, No. 1 (2007), p. 40, and “*Enron v. Argentina*, ICSID Case No. ARB/01/3, award dated 22 May 2007”, *Mealey’s: International Arbitration Report*, document No. 05-070627-007A.

<sup>502</sup> *Noble Ventures Inc. v. Romania* (see footnote 501 above), para. 55.

<sup>503</sup> *Ibid.*, paras. 46-62, in particular at para. 61. For a commentary of this decision, see in particular Emmanuel Gaillard, “Chronique des sentences arbitrales CIRDI”, *Journal du droit international*, 2007, p. 288.

<sup>504</sup> “*El Paso Energy International Company v. Argentine Republic*, ICSID Case No. ARB/03/15, Decision on Jurisdiction dated 27 April 2006”, *ICSID Review*, vol. 21, No. 2 (2006), p. 488; *Pan American Energy LLC and BP Argentina Exploration Company v. Argentine Republic* (ICSID Case No. ARB/03/13), Decision on Jurisdiction dated 27 July 2006, available from <http://ita.law.uvic.ca/>.

<sup>505</sup> *El Paso Energy v. Argentina* (see footnote 504 above), para. 77; see also para. 82.

<sup>506</sup> *Ibid.*, para. 82.

question has arisen in practice whether the body of arbitral case law provides “precedents” for current or future arbitral tribunals.<sup>507</sup>

There exists a general agreement that no rule of precedent exists in international arbitration. No arbitral tribunal is bound to follow a prior decision by another arbitral tribunal on the same issue. This is illustrated by the diverging decisions on key issues referred to above. While one will often find that a tribunal refers to the decisions of prior tribunals, it will mostly be to find guidance or indicate their agreement or disagreement with the reasoning of such tribunal, and not in reliance on that decision as being binding. The discrepancies found in the arbitral case law, however, highlight the need of consistency on key legal issues that frequently feature in investment arbitration, as a consistent body of case law would improve the predictability of the outcome and contribute to legal certainty.<sup>508</sup> In the words of the Tribunal in *Saipem v. Bangladesh*:<sup>509</sup>

“The Tribunal considers that it is not bound by previous decisions. At the same time, it is of the opinion that it must pay due consideration to earlier decisions of international tribunals. It believes that, subject to compelling contrary grounds, it has a duty to adopt solutions established in a series of consistent cases. It also believes that, subject to the specifics of a given treaty and of the circumstances of the actual case, it has a duty to seek to contribute to the harmonious development of investment law and thereby to meet the legitimate expectations of the community of States and investors towards certainty of the rule of law.”

There will always be a certain variability in the outcome of investment disputes, since the language of the applicable provisions and the intention of the parties will be the deciding factors in interpreting an investment treaty. Subject to this variability, the increased transparency of and accessibility to the international arbitration process<sup>510</sup> may, in time, contribute to the ironing out of many of the unresolved issues in investment arbitration.

## 5. Comments, evaluation and discussion

*Don Wallace, Jr.*

*Chairman, International Law Institute, United States of America*

This question is addressed to Ms. Banifatemi. Firstly, a substantive point, then maybe a question. The last point about precedent. Situations vary. Arbitrators sitting on NAFTA

<sup>507</sup> See, in this respect, the proceedings of the Conference on the Precedent in International Arbitration, organized in Paris on 14 December 2007 by the International Arbitration Institute, in *Precedent in International Arbitration*, Emmanuel Gaillard and Yas Banifatemi, eds., *IAI Series on International Arbitration*, No. 5 (Huntington, New York, Juris Publishing, 2008).

<sup>508</sup> See in particular Gabrielle Kaufmann-Kohler, “Arbitral precedent: dream, necessity, or excuse?”, *Arbitration International*, vol. 23, 2007, p. 357. See also Andrea K. Bjorklund, “Investment treaty arbitral decisions as *jurisprudence constante*”, in *International Economic Law: The State and Future of the Discipline*, Colin B. Picker, Isabella Bunn D. and Douglas W. Arner, eds. (Oxford, Hart Publishing, 2008).

<sup>509</sup> “*Saipem SpA v. People’s Republic of Bangladesh*, ICSID Case No. ARB/05/7, Decision on Jurisdiction dated 21 March 2007”, *Mealey’s: International Arbitration Report*, vol. 22, No. 4, at B-1, para. 67.

<sup>510</sup> In this respect, it is worth noting that the wide publication of arbitral awards has greatly contributed to promoting the decisions in international investment arbitration. A large number of awards in the investment arbitration field are already published both in written and online publications. The newly added rule 48 (4) of the ICSID Arbitration Rules, which came into effect on 10 April 2006, also provides that “the Centre shall not publish the award without the consent of the parties. The Centre shall, however, promptly include in its publication experts of the legal reasoning of the Tribunal.” On the question of the impact of the publication of awards, see the contribution by Thomas Wälde, in *Precedent in International Arbitration* (see footnote 507 above).

chapter 11 cases, in each case, have the same treaty and the same words again and again and they have really focused on them, thanks to commentators on NAFTA. But clauses in the great array of BITs, take MFN, take umbrella, the wording may be exquisitely, subtly different in many cases and while there are some who think that we should create a sort of world law for all these BITs, nonetheless, that is a pretty non-positivist approach to law. Take the question of the application of MFN clauses to procedural issues. Some treaties mention “all matters”, some mention “treatment”, and so on, so I think one really has to be a little bit more discriminating.

I guess my question is, are you going to propose something? You are right about ICSID versus UNCITRAL rules. In a case in which I am involved, we recently picked the ICSID additional facility (and lost) rather than UNCITRAL. Are you suggesting that we abandon ICSID and use only the UNCITRAL Arbitration Rules with all of the problems of ad hoc arbitration, or are you suggesting that the ICSID system should be changed? ICSID does currently need permanent direction, which they have not had and which has led to serious delays, but I am curious whether you have any specific suggestions you would like to make about the improvement of ICSID.

*Yas Banifatemi*

*Partner, Shearman & Sterling, France*

I understand the second question as not being related to the first one, but totally separate.

On the precedent, I totally agree with you. As regards umbrella clauses, MFN clauses or even the issue of the denunciation of the ICSID Convention, I think that it always depends on what provision we are talking about. An umbrella clause that says “shall observe” is not the same as a clause that says “will do its best to provide a framework”, so obviously the jurisdictional outcome depends always on the text of the provision.

Regarding ICSID, the question is: what do you propose to your clients when you are acting as counsel? As counsel to my clients, I have to do my best for their claim to be successful and make sure that they do not encounter jurisdictional hurdles related to ICSID arbitration that they would otherwise not encounter in UNCITRAL arbitration. I am a great fan of ICSID arbitration, and I have done a great deal of ICSID arbitration. It is often considered that one of the major advantages of ICSID arbitration is the better enforcement of ICSID awards. I wish that there were some statistics about the extent to which they are enforced and whether ICSID arbitration is better, for example, than UNCITRAL arbitration in that respect. That aside, I am not sure I would always recommend ICSID to a client. For instance, take the example of the denunciation of the ICSID Convention. If you take the French-Venezuela BIT, I believe that the only possibility is ICSID arbitration. In other treaties you have a choice between different options, including UNCITRAL and ICSID. If I think that my client stands better chances with arbitration under the UNCITRAL Arbitration Rules, I will tell them to avoid ICSID because otherwise you will have the hurdle of whether the denunciation has an effect on the existing rights and obligations, whereas if you choose the UNCITRAL Arbitration Rules you will not have that issue.

I am not necessarily proposing anything. I take ICSID as a user and, as a user, I like competition. I think that ICSID is a good system. Other systems are as good and I am also happy when I have an investment arbitration under the UNCITRAL Arbitration Rules. They are flexible, and if I want an institution to administer the arbitration I go to the Permanent Court of Arbitration. So it is always a question of what is best for my client.

*Danny McFadden*

*Director, Centre for Effective Dispute Resolution, United Kingdom of Great Britain and Northern Ireland*

My question arises out of the talk by Mr. Zamora that there should be a general duty for the arbitrator to encourage amicable settlements.

*José María Abascal Zamora*

*Counsel and Arbitrator, Abascal & Asociados, Mexico*

I was not referring to settling a dispute, that is a very delicate thing that you need to be very careful about. I was referring to encouraging parties to find solutions by ongoing dialogue, as, for instance, when a party wants a long extension to make a pleading before drafting the terms of reference and the opposite party wants only one week.

*Tore Wiwen-Nilsson*

*Partner, Mannheimer Swartling Advokatbyrå, Sweden*

I could make a very brief comment to your question whether there should be a duty to encourage settlements. I think many of us know that the role of an arbitrator with respect to settlement is very different in different countries. This is common in Germany, it is not common in other places, even not recommended or even forbidden in some places. So it is a very delicate thing sitting as an arbitrator to promote some kind of settlement because everybody will then try to read into the arbitrator's mind, his body language. So there should be no duty. It is for the arbitral tribunal to sense by good judgement when it is right to do so.

*Omar M. H. Aljazy*

*Managing Partner, Aljazy & Co. Advocates, Jordan*

My question goes to Mr. Wiwen-Nilsson. Do you think that many developing countries recently adopted alternative dispute resolution (ADR) legislation to shorten the period of legal procedures in court? Do you think there is room through the judiciary framework in the court to resolve a commercial dispute through mediation?

*Tore Wiwen-Nilsson*

*Partner, Mannheimer Swartling Advokatbyrå, Sweden*

It depends on how I understand your question. In England, for example, it is mandatory in construction disputes to have mediation and that has turned out to be successful, but if you mean that the court itself should engage in some kind of ADR procedure, I would think not.

*Omar M. H. Aljazy*  
*Managing Partner, Aljazy & Co. Advocates, Jordan*

There are incentives for this, in Jordan, if the dispute has been resolved completely through judicial mediation, then the plaintiff can recover half of the judicial fees paid by him to file the lawsuit, otherwise the mediator must submit a report to the judge in charge either at the Case Management Department or at another competent court in which he indicates that the disputing parties have not succeeded in resolving their dispute through mediation.

*Horacio Bazoberry*  
*Permanent Representative of Bolivia to the United Nations (Vienna)*

My question is essentially for Ms. Banifatemi. Of course, it was an overview but a very important question was raised, on how investments are dealt with. As you know, a series of investments are being made in developing countries and they do not always have a positive effect on the developing countries in question, but we are talking about Latin America, Africa or wherever and very often this has led developing countries seeking to protect themselves, if I might use that term, from adverse investments. I am talking about capital that appears and as soon as there are profits, the capital vanishes once the profits have been taken. So I am thinking of things from the economic development point of view and thinking of economic development as a parameter that could be used to decide what the nature of an investment is, and I am wondering whether arbitration could be applied to this matter. Do you think, therefore, that this kind of pattern of development should be reinforced thanks to UNCITRAL? Does UNCITRAL have a role to play here?

*Yas Banifatemi*  
*Partner, Shearman & Sterling, France*

I consider that some of the improvements of the UNCITRAL Arbitration Rules, for instance article 1, which expands the definition not only to the parties to a contract but to the parties to a legal—I do not remember the exact wording—to a “legal relationship”, would definitely take investment arbitration into account more easily. The other useful improvement is the fact that the applicable rules would be the “rules of law” and not only “the law” so that both the parties and the arbitral tribunal may have access to more than one legal system and in particular to the rules of international law and to transnational rules. That would be applicable in particular to investment cases.

If I now go back to your question regarding the definition of what an investment is, I am not aware that the draft revised version of the UNCITRAL Arbitration Rules is proposing a precise definition of an investment. The four criteria that I mentioned, which are the product of case law and of what the doctrine considered at some stage as what an investment should be, are a contribution by the investor (either in know-how or in another way), risk, duration and the question of the economic development of the host country. But that is the construction of the case law. I am not sure to what extent, if you want to keep the flexibility that, for example, the drafters of the Washington Convention wanted to have in order to protect in the best manner and most efficiently investments, it would actually help to have a limited and not flexible definition of what an investment is.

## VI. Closing remarks

*Dobrosav Mitrović*

*Chairman of the fortieth session of UNCITRAL*

We have come to the closure of the Congress. Over the past four days we have received a great deal of information and heard various opinions, observations, comments and proposals. Our Congress has thus been devoted to the current state of international trade law and its future. It is necessary to consider how to develop international trade law in the future, in what form and from what source. In addition to conventions, which constitute the classic form, model laws and legislative guides have been drawn up for the benefit of States, as well as other mechanisms for regulating the various professional associations. It seems there will be an increasing need for specialized texts concerning the various aspects of international trade. It is also necessary to take *lex mercatoria* into consideration. We know that legislative standards are often general, setting out principles and leaving it to the judges to interpret them. However, players in international trade want more precise and often rather technical rules that are more detailed and specific. They want to know their risks. We might also consider the possibility that existing international trade law, created for the most part by UNCITRAL, calls for special training for jurists wishing to specialize in this field. Might it be possible to propose the establishment by UNCITRAL of a school for jurists wishing to study this area of law? This could be one of the Commission's tasks or undertakings. From a more critical point of view, we must ask ourselves why some conventions are not in force, or if they are in force, why only a small number of States are party to them. Why have some instruments not been widely accepted? We must examine the results of our work, particularly the work of UNCITRAL to harmonize and unify international trade law. Regionalism and globalism have been mentioned with reference to the harmonization of international trade law. Regionalism is in fashion. One might say that it is desirable at the present level of development around the world, but is it not the case that regionalism will be an obstacle to globalization in the future, that it will create new barriers in the world that will eventually have to be removed or surmounted, perhaps with difficulty? The message might therefore be yes to regionalism but yes also to globalism in formulating and developing international trade law.

The future may bring us new forms of legal regulation of international trade, but we can be sure that new areas for regulation await us. A number of proposals have been made, and I would like add a couple more. For example, foreign trade transactions relating to gas, electricity or the use of natural resources. And one might also add competition, concessions, contractual obligations and so forth.

I would like to thank firstly the 60 rapporteurs, who presented their reports. My thanks go also to the chairs of the 14 working sessions. I would also like to thank the secretariat and all those who contributed to the organization of this Congress. I thank the interpreters, whose work has not been easy, especially since 15 different topics have been addressed. I thank all the participants in the Congress, who have come from 85 countries and all the

continents. And lastly, thanks go to the person who has been at the heart of this Congress, Mr. Jernej Sekolec, and also to his second-in-command, Mr. José Angelo Estrella Faria. Thank you all, and I give the floor to Mr. Sekolec.

*Jernej Sekolec*  
*Secretary of UNCITRAL*

In conclusion, I would like to point out a fact that may not have been noticed by some of the participants, perhaps many of them, namely that Governments represented in UNCITRAL have agreed to remove their name plates and to listen to views, criticisms and unfiltered proposals that we have heard these days from persons who were not appointed by Governments. This readiness of Governments in UNCITRAL to listen to such voices of practice has been a prominent element of the Commission's methods of work.

Mr. Chairman, I will not repeat your thanks directed to the panellists and to the audience. I would just like to say that a number of views and proposals expressed here have been challenging and stimulating and deserve to be reflected upon in greater detail by Governments, in capitals of member States, in the secretariat and elsewhere; for this reason we will make sure that the proceedings of the Congress are published. We are constrained by existing resources, but we will try to publish them in more than one language.

At the end, Mr. Chairman, I would like to say thank you to you. This Congress has been carried out under your authority and your chairmanship. You presided the first session and the last session and you magnanimously yielded your chair to a number of chairpersons, experts in the different areas.

You thanked me, Mr. Chairman; however my job has actually been very easy. I had brilliant colleagues who did a lot of work in the preparation of this Congress. I am very grateful to them.

## Annex I

### LegaCarta countries\*

<i>ISO code</i>	<i>Country name</i>	<i>Rank by score</i>	<i>Score</i>	<i>Rank by ratifications</i>	<i>Number of ratifications (of 213 instruments)</i>	<i>Ratification rate (percentage)</i>
FR	France	1	69.37	2	151	70.89
IT	Italy	2	67.82	3	150	70.42
NL	Netherlands	3	67.33	1	153	71.83
ES	Spain	4	67.24	5	142	66.67
SE	Sweden	5	65.72	4	144	67.61
HU	Hungary	6	64.73	11	139	65.26
CH	Switzerland	7	64.60	7	140	65.73
DE	Germany	8	64.55	5	142	66.67
DK	Denmark	9	63.87	7	140	65.73
SI	Slovenia	10	63.23	18	131	61.50
NO	Norway	11	63.07	12	138	64.79
GB	United Kingdom of Great Britain and Northern Ireland	12	62.95	13	137	64.32
FI	Finland	13	62.77	7	140	65.73
SK	Slovakia	14	62.30	24	124	58.22
PL	Poland	15	62.13	13	137	64.32
BE	Belgium	16	61.90	7	140	65.73
RO	Romania	17	61.54	21	126	59.15
PT	Portugal	18	61.48	15	134	62.91
GR	Greece	19	61.03	16	132	61.97
CZ	Czech Republic	20	61.01	20	128	60.09
HR	Croatia	21	60.33	16	132	61.97
BG	Bulgaria	22	60.08	23	125	58.69
LV	Latvia	23	59.70	33	106	49.77
LU	Luxembourg	24	59.42	21	126	59.15
AT	Austria	25	59.31	19	129	60.56
CY	Cyprus	26	59.09	25	123	57.75
LT	Lithuania	27	57.91	33	106	49.77
EE	Estonia	28	54.79	37	100	46.95
IE	Ireland	29	54.24	26	117	54.93
US	United States of America	30	54.00	35	105	49.30
JP	Japan	31	53.43	27	116	54.46

\*This annex is referred to in the presentation “Managing complexity: experience of the International Trade Centre UNCTAD/WTO in trade law technical assistance” by Jean-François Bourque on page 82 of this publication.

<i>ISO code</i>	<i>Country name</i>	<i>Rank by score</i>	<i>Score</i>	<i>Rank by ratifications</i>	<i>Number of ratifications (of 213 instruments)</i>	<i>Ratification rate (percentage)</i>
AU	Australia	32	50.36	29	112	52.58
EG	Egypt	33	49.94	36	104	48.83
CN	China	34	49.14	41	96	45.07
MX	Mexico	35	49.11	31	108	50.70
TR	Turkey	36	48.91	30	109	51.17
CA	Canada	37	48.16	43	95	44.60
IL	Israel	38	46.31	44	93	43.66
YU	Serbia and Montenegro	39	46.16	28	113	53.05
KR	Republic of Korea	40	45.78	52	90	42.25
MK	The former Yugoslav Republic of Macedonia	41	45.46	44	93	43.66
AR	Argentina	42	45.01	48	91	42.72
RU	Russian Federation	43	44.48	32	107	50.23
UA	Ukraine	44	43.37	39	99	46.48
BY	Belarus	45	43.03	55	86	40.38
NG	Nigeria	46	42.96	48	91	42.72
TN	Tunisia	47	42.67	37	100	46.95
NZ	New Zealand	48	42.42	41	96	45.07
MT	Malta	49	42.24	60	82	38.50
MA	Morocco	50	41.97	39	99	46.48
IN	India	51	41.04	52	90	42.25
MD	Republic of Moldova	52	40.89	71	78	36.62
ZA	South Africa	53	40.53	48	91	42.72
GE	Georgia	54	40.50	64	80	37.56
EC	Ecuador	55	40.41	67	79	37.09
SN	Senegal	56	40.39	56	85	39.91
CU	Cuba	57	40.30	46	92	43.19
AL	Albania	58	40.19	58	83	38.97
IS	Iceland	59	40.12	71	78	36.62
SG	Singapore	60	39.26	75	76	35.68
PE	Peru	61	38.94	67	79	37.09
MU	Mauritius	62	38.58	71	78	36.62
UY	Uruguay	63	38.47	62	81	38.03
CL	Chile	64	38.42	60	82	38.50
LK	Sri Lanka	65	38.39	64	80	37.56
BR	Brazil	66	38.04	46	92	43.19
PA	Panama	67	37.96	78	73	34.27
MN	Mongolia	68	37.22	76	75	35.21
KE	Kenya	69	37.06	58	83	38.97
BB	Barbados	70	36.73	81	71	33.33
DZ	Algeria	71	36.43	48	91	42.72
TT	Trinidad and Tobago	72	36.40	74	77	36.15
LR	Liberia	73	36.24	57	84	39.44
GA	Gabon	74	36.23	86	69	32.39

<i>ISO code</i>	<i>Country name</i>	<i>Rank by score</i>	<i>Score</i>	<i>Rank by ratifications</i>	<i>Number of ratifications (of 213 instruments)</i>	<i>Ratification rate (percentage)</i>
GN	Guinea	75	36.05	84	70	32.86
CO	Colombia	76	35.49	89	67	31.46
SV	El Salvador	77	35.44	100	62	29.11
KG	Kyrgyzstan	78	35.42	89	67	31.46
PH	Philippines	79	35.06	81	71	33.33
AZ	Azerbaijan	80	35.03	67	79	37.09
VE	Venezuela	81	34.84	91	66	30.99
JO	Jordan	82	34.81	78	73	34.27
HN	Honduras	83	34.60	104	61	28.64
PK	Pakistan	84	34.45	64	80	37.56
PY	Paraguay	85	34.27	108	60	28.17
CM	Cameroon	86	33.94	84	70	32.86
MY	Malaysia	87	33.72	81	71	33.33
LS	Lesotho	88	33.61	119	57	26.76
BA	Bosnia and Herzegovina	89	33.53	77	74	34.74
KW	Kuwait	90	32.96	91	66	30.99
IR	Islamic Republic of Iran	91	32.75	52	90	42.25
JM	Jamaica	92	32.36	98	63	29.58
AM	Armenia	93	32.13	104	61	28.64
VC	Saint Vincent and the Grenadines	94	32.09	123	56	26.29
GT	Guatemala	95	32.08	104	61	28.64
UG	Uganda	96	31.96	108	60	28.17
SY	Syrian Arab Republic	97	31.95	67	79	37.09
MG	Madagascar	98	31.82	100	62	29.11
TZ	United Republic of Tanzania	99	31.77	96	64	30.05
BJ	Benin	100	31.66	100	62	29.11
CR	Costa Rica	101	31.64	104	61	28.64
TG	Togo	102	31.58	98	63	29.58
ZM	Zambia	103	31.54	114	59	27.70
OM	Oman	104	31.49	100	62	29.11
ID	Indonesia	105	31.26	86	69	32.39
GH	Ghana	106	31.17	88	68	31.92
AE	United Arab Emirates	107	31.13	91	66	30.99
MW	Malawi	108	30.51	123	56	26.29
ML	Mali	109	30.50	126	55	25.82
NI	Nicaragua	110	30.49	117	58	27.23
CI	Côte d'Ivoire	111	30.39	96	64	30.05
LB	Lebanon	112	30.28	62	81	38.03
SA	Saudi Arabia	113	30.05	108	60	28.17
BO	Bolivia	114	29.79	126	55	25.82
BH	Bahrain	115	29.67	108	60	28.17
BF	Burkina Faso	116	29.65	128	54	25.35

<i>ISO code</i>	<i>Country name</i>	<i>Rank by score</i>	<i>Score</i>	<i>Rank by ratifications</i>	<i>Number of ratifications (of 213 instruments)</i>	<i>Ratification rate (percentage)</i>
NE	Niger	117	29.62	117	58	27.23
MC	Monaco	118	29.59	78	73	34.27
KH	Cambodia	119	29.14	132	53	24.88
UZ	Uzbekistan	120	29.13	95	65	30.52
FJ	Fiji	121	28.80	114	59	27.70
MR	Mauritania	122	28.76	128	54	25.35
AG	Antigua and Barbuda	123	28.71	138	51	23.94
BW	Botswana	124	28.58	145	48	22.54
BD	Bangladesh	125	28.39	114	59	27.70
CD	Democratic Republic of the Congo	126	28.18	128	54	25.35
LC	Saint Lucia	127	28.05	128	54	25.35
SC	Seychelles	128	27.80	108	60	28.17
TH	Thailand	129	27.79	108	60	28.17
VN	Viet Nam	130	27.53	123	56	26.29
KZ	Kazakhstan	131	27.37	91	66	30.99
LI	Liechtenstein	132	26.85	151	46	21.60
CG	Republic of the Congo	133	26.83	134	52	24.41
NA	Namibia	134	26.74	134	52	24.41
DO	Dominican Republic	135	26.63	134	52	24.41
ZW	Zimbabwe	136	26.40	141	50	23.47
RW	Rwanda	137	26.03	134	52	24.41
KN	Saint Kitts and Nevis	138	25.95	148	47	22.07
SL	Sierra Leone	139	25.91	138	51	23.94
CF	Central African Republic	140	25.89	154	45	21.13
QA	Qatar	141	25.73	132	53	24.88
MZ	Mozambique	142	25.66	154	45	21.13
GY	Guyana	143	25.44	143	49	23.00
DM	Dominica	144	25.34	157	44	20.66
GM	Gambia	145	25.19	138	51	23.94
BS	Bahamas	146	24.97	119	57	26.76
NP	Nepal	147	24.80	145	48	22.54
SR	Suriname	148	24.61	148	47	22.07
BZ	Belize	149	24.57	161	43	20.19
GD	Grenada	150	23.47	168	39	18.31
PG	Papua New Guinea	151	23.20	141	50	23.47
HT	Haiti	152	23.11	148	47	22.07
LY	Libyan Arab Jamahiriya	153	22.89	119	57	26.76
SZ	Swaziland	154	22.55	166	40	18.78
TO	Tonga	155	22.47	119	57	26.76
DJ	Djibouti	156	21.78	169	38	17.84
BI	Burundi	157	21.75	169	38	17.84
SD	Sudan	158	21.69	143	49	23.00
MV	Maldives	159	21.32	161	43	20.19

<i>ISO code</i>	<i>Country name</i>	<i>Rank by score</i>	<i>Score</i>	<i>Rank by ratifications</i>	<i>Number of ratifications (of 213 instruments)</i>	<i>Ratification rate (percentage)</i>
MM	Myanmar	160	20.67	169	38	17.84
TD	Chad	161	20.55	174	35	16.43
AO	Angola	162	20.45	161	43	20.19
TM	Turkmenistan	163	20.28	157	44	20.66
BN	Brunei Darussalam	164	19.78	178	32	15.02
KP	Democratic People's Republic of Korea	165	19.58	145	48	22.54
SB	Solomon Islands	166	18.75	175	34	15.96
CV	Cape Verde	167	18.68	151	46	21.60
LA	Lao People's Democratic Republic	168	18.46	166	40	18.78
WS	Samoa	169	18.32	157	44	20.66
TJ	Tajikistan	170	17.92	165	41	19.25
AF	Afghanistan	171	17.90	172	37	17.37
ET	Ethiopia	172	16.93	157	44	20.66
IQ	Iraq	173	16.91	154	45	21.13
GW	Guinea-Bissau	174	16.66	183	27	12.68
VU	Vanuatu	175	16.41	151	46	21.60
YE	Yemen	176	16.20	164	42	19.72
MH	Marshall Islands	177	15.94	172	37	17.37
SM	San Marino	178	15.76	178	32	15.02
KM	Comoros	179	15.30	175	34	15.96
ST	Sao Tome and Principe	180	13.95	178	32	15.02
ER	Eritrea	181	13.44	181	30	14.08
GQ	Equatorial Guinea	182	12.94	175	34	15.96
FM	Federated States of Micronesia	183	12.66	185	23	10.80
BT	Bhutan	184	12.02	182	29	13.62
KI	Kiribati	185	10.50	184	26	12.21
AD	Andorra	186	10.49	187	20	9.39
VA	Holy See	187	8.96	191	16	7.51
PW	Palau	188	8.41	188	19	8.92
SO	Somalia	189	8.01	188	19	8.92
NR	Nauru	190	7.92	186	22	10.33
TV	Tuvalu	191	6.03	188	19	8.92
TL	Timor-Leste	192	5.12	192	11	5.16

*Source:* LegaCarta (6 July 2007).



## Annex II

### **Resolutions of disputes between the regulator and operators in the Nigerian telecommunications sector\***

Part X of the Nigerian Communications Act of 2003 (hereinafter called “the Act”) provides for the review of decisions made by the Nigerian Communications Commission (“the Commission”). Where a dispute or grievance arises as a result of a decision of the Commission, certain steps may be taken.

The first step is provided in paragraph 86 of the Act. It states that an aggrieved person or a person whose interest is adversely affected by any decision of the Commission may request in writing for a statement of the reasons of the decision. Upon receipt of the request, the Commission shall provide a statement of the reasons for the decision and any other relevant information taken into account in reaching the decision.<sup>a</sup>

Where the aggrieved person is not satisfied with the reasons given in the statement, within 30 days after the date of receipt of the statement, he may request in writing that the Commission reviews its decision. His request should contain the reasons and basis for his request. Thereafter, the Commission shall meet to review the decision in the light of the reasons contained in the request. The Commission must conclude the review within 60 days of receipt of the request and inform the aggrieved person of its final decision and the reasons therefore.

Where the aggrieved person is not satisfied with the final decision of the Commission, it can appeal to a court of competent jurisdiction for a judicial review of the decision or any other action.

Pursuant to paragraph 88 (3) of the Act, the steps listed above are to be followed in sequential order. Accordingly, each step is a condition precedent to a further step. This provision of the law was upheld in *Econet Wireless v. NCC*<sup>b</sup> where the Federal High Court in Abuja held that the procedural steps necessary to be taken by Econet had not been followed as a result of which the suit was struck out.

We are not aware of any dispute between operators and the Commission before any court in Nigeria at present. However, in 2004, Nigeria Communications Limited (MTN) did refer a dispute concerning interconnection rates to the Federal High Court. At first, the Court granted the application of MTN to stay the implementation of interconnection rates

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<sup>a</sup>This annex is referred to in the presentation “Public procurement, long-term government contracts and dispute settlement: the need for national systems to prevent and resolve disputes between regulators and private operators of infrastructure and providers of public services” by Professor Don Wallace, Jr., on page 358 of this publication.

<sup>a</sup>The Commission is not required to give the requested statement if it is confidential, may involve the unreasonable disclosure of personal information or is likely to prejudice fair trial.

<sup>b</sup>Suit No. FHC/ABJ/CS/58/2004.

by MTN. In a subsequent decision, upon the application of the Commission, the court set aside its earlier order stating that the order could not be enforced for MTN alone as its services could not be isolated from the services of other operators.

Regular interactions and frequent exchanges of information between the Commission and operators have helped to reduce the number of disputes referred for resolution. This is because grievances can be raised in such forums and settled without need for formal dispute notification and resolution procedures.

In addition, due to the fact that most decisions affect operators on a class basis, most cases, complaints and grievances are made on a collective basis. Where an individual operator has a grievance, recourse must first be had to the procedure established under the Act for review of decisions. The dispute can only be referred for resolution by a court of competent jurisdiction after the procedure has been followed without a satisfactory outcome for the aggrieved person. It is believed that the procedure has so far worked well in resolving grievances and disputes between operators and the Commission, hence the paucity of court cases.

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