tor and beneficiary of a credit transfer. If between the parties an obligation could be discharged by credit transfer to an account in any of one or more States or if the transfer was not for the purpose of discharging an obligation, the law of the State where the beneficiary's bank is located governs the mutual rights and obligations of the originator and the beneficiary.

Comments

1. The Working Group at its seventeenth session requested the secretariat to prepare a draft provision on conflict of laws (A/CN.9/317, para. 165). The draft provision set out above was prepared for the eighteenth session of the Working Group, but it was not considered at that session.

2. The problem of conflict of laws is considered in more detail in the accompanying report of the Secretary-General, A/CN.9/WG.IV/WP.42, especially in light of the decisions of the Working Group at its eighteenth session that the text under preparation should be in the form of a model law for adoption by national legislative bodies and that it should be restricted to international credit transfers.

C. International credit transfers: major issues in the Model Law on International Credit Transfers: report of the Secretary-General[a]

(A/CN.9/WG.IV/WP.42) [Original: English]

CONTENTS

1. The discussion at the eighteenth session of the Working Group indicated general satisfaction with the overall structure of the draft Model Law on International Credit Transfers as it appears in the annex to the report of that session of the Working Group (A/CN.9/318). The discussion at the eighteenth session also showed that there were certain major issues that did not lend themselves to proper solution by an article-by-article analysis. This report is intended to give the basis for a discussion of those issues in a more comprehensive manner.

[a]Working paper submitted to the Working Group on International Payments at its nineteenth session.

I. ACCEPTANCE

2. The strongest controversy in the Working Group has been whether the concept of acceptance of a payment order by the receiving bank should be retained in the Model Law. Use of the concept has been advocated as a convenient means to describe in a single word a number of different actions of different receiving banks that should have the same legal consequences, making it possible to use the word in various substantive provisions. In response, it has been said that use of the term "acceptance" is not necessary and that it would cause difficulties in many legal systems because it seems to suggest that a

contract is created as a result of the receiving bank's actions.

3. Although the controversy in the Working Group as to the use of the concept of acceptance has been strong, it does not appear to represent a conflict about the substantive rights and obligations of the parties to the credit transfer. On the contrary it appears to represent only a matter of approach to the drafting of appropriate solutions to the underlying problems.

4. The decision whether the concept of acceptance should be retained in the Model Law depends upon whether it is the most efficient way to express the desired legal results. That in turn involves a discussion of both the criteria for determining when a receiving bank has accepted a payment order and the consequences of acceptance. At the current stage of the development of the Model Law, where the very use of the concept is not settled, it is not surprising that neither the criteria nor the consequences of acceptance are agreed upon and that the text of the draft Model Law as it appears in the annex to A/CN.9/318 is not completely consistent.

5. The substantive issues that are resolved in the current draft by use of the concept of acceptance are of vital importance. Most of them have not as yet been discussed by the Working Group in depth. Therefore, even though the final decision on the substance of those issues should be separated from the question whether they should be resolved by use of the concept of acceptance, both questions will be treated in this report.

6. Under the current text the acceptance of a payment order by the receiving bank has the following consequences:

(a) The receiving bank undertakes certain obligations to execute the payment order or to aid in overcoming problems that have arisen in its execution;

(b) The sender becomes obligated to pay the receiving bank for the payment order and, if the receiving bank has a right of reimbursement from the sender by debit to an account held by the receiving bank for the sender, the account is deemed to be debited;

(c) When the receiving bank is the beneficiary's bank, the right of the sender to revoke a payment order issued to it is terminated;

(d) When the receiving bank is the beneficiary's bank, the beneficiary's bank becomes indebted to the beneficiary and the obligation of the originator to the beneficiary is discharged.

A. Obligations of the receiving bank

1. Obligations of notification—no acceptance necessary

7. The only obligations imposed by the draft Model Law on a bank that receives a payment order are certain obligations of notification of problems. Those obligations of notification arise independently of any acceptance of the payment order by the receiving bank; indeed, they assume that the payment order has not been accepted. The obligations of notification imposed by the draft Model Law are as follows:

(a) A receiving bank must notify the sender of a discrepancy in the amount of the payment order as described in words and in figures. That obligation may be negated by agreement between the sender and the receiving bank (article 3(1));

(b) The beneficiary's bank must notify the sender and the originator's bank, if the originator's bank is identified on the payment order, of a discrepancy in the identification of the beneficiary as described in words and in figures (article 3(2));

(c) In the absence of an agreement otherwise, a receiving bank that decides not to comply with a payment order must notify the sender, unless one of the reasons for the decision is insufficient funds (article 5(1));

(d) A receiving bank must notify the sender when a payment order is received that contains information indicating that it has been misdirected (article 5(1 *bis*)).

2. Obligation to execute the payment order

(a) Existence of the obligation

8. Under article 5(1) of the draft Model Law an obligation to take actions intended to execute a payment order arises only if the receiving bank accepts the payment order. In some cases banks agree with specific senders or in an interbank agreement, such as a clearing-house arrangement, to execute payment orders received from those senders. Even in those cases, however, the obligation remains only contractual until each specific payment order is accepted, when an additional obligation under the Model Law is undertaken. Nevertheless, it should be noted that, according to article 9(7), the remedies available for breach of the contractual obligation are limited to those available under the Model Law.

9. An obligation to take actions intended to execute a payment order, as distinguished from an obligation to execute the order properly, is an obligation to take action in the future. Such an obligation does not normally arise under the draft Model Law in the case of a receiving bank that is not the beneficiary's bank since the most common means of acceptance is by sending a payment order intended to carry out the payment order received (article 6(1)*(a)*). Under article 5(4) the beneficiary's bank always undertakes obligations to take action in the future but, unless the payment order contains an execution date or a pay date, those obligations run only to the beneficiary and are subsequent to the completion of the credit transfer.

10. Article 4(4), which governs the duties of the sender to pay the receiving bank, provides for one case in which a receiving bank may undertake a duty to execute a payment order in the future. It anticipates that a receiving bank may accept an order on day one with an execution date of day five or may accept an order that provides for a number of payments to be made at various dates in the future. Such a receiving bank may be any bank in the

credit transfer chain, but it is most likely to be the originator's bank.

11. The current draft has no provision indicating how the receiving bank would accept the order prior to its execution date. Presumably, it would do so by an overt act, such as notification to the credit party of its receipt of, and of its intention to execute, the order. (The bank could also accept the order by executing it prior to the execution date. See A/CN.9/WG.IV/WP.41, comment 14 to article 4. However, that possibility is not relevant to this discussion since the bank would have no remaining obligation to execute the payment order in the future.) When a receiving bank has accepted an order in those circumstances, it can no longer reject the order for any reason, including insufficient funds. It may be noted that the sender would lose its right to revoke or amend the payment order if the receiving bank was the beneficiary's bank (article 8(3)), but not in the case of other receiving banks (article 8(1)). See paragraph 27, below.

12. An obligation to take action intended to execute the payment order can also arise when the payment order calls for current execution if the receiving bank fails to act within a prescribed period of time. According to article 6(1)*(b)*, a receiving bank other than the beneficiary's bank accepts a payment order if it does not give a notice required by article 5(1) that it will not comply with the order. Since there has been acceptance of the order but no execution of it, the bank has an obligation to act, an obligation it is unlikely to carry out but which gives a basis for the remedies available to the originator or the sender. No similar provision exists in the current text of article 6(2) in regard to the beneficiary's bank.

(b) Evaluation of the use of acceptance

13. It is difficult to avoid use of the concept of acceptance or its equivalent in respect of article 4(4) if the assumption of that article is maintained, i.e. that a bank can accept a payment order after its receipt and prior to its execution date for execution on the execution date. While the obligation to execute the order on the execution date could be considered to be merely contractual, as is the case for the obligation arising out of an agreement to comply with payment orders to be received in the future, it seems more appropriate for it to be a legal obligation based on the Model Law. This is particularly true since it is not clear that all legal systems would find the necessary elements of contract in the situation.

14. The use of the concept of acceptance is perhaps unnecessary when the obligation to execute the order arises out of a failure to give a required notice in regard to a payment order that was intended for immediate execution. In most cases execution would never occur, and the liability of the receiving bank could be based on the failure to give the notice required by article 5(1) rather than on a failure to execute the payment order. In the rare case where execution would occur, though late, the liability regime could be drafted to give the proper result without referring to acceptance. However, the use of the concept of acceptance in these cases leads to proper results.

15. Since acceptance by the beneficiary's bank essentially marks the completion of the funds transfer, the advisability of retaining the concept in respect of the beneficiary's bank is discussed in that context in paragraphs 28 to 42, below.

16. It should be noted that the current text of article 5 of the Model Law does not specifically state that a receiving bank that accepts a payment order must execute that order. Instead, it sets forth specific obligations of the receiving bank that would lead to proper execution of the payment order.

3. *Obligation to execute properly*

17. A receiving bank that accepts a payment order is obligated by article 5 not only to take actions intended to comply with the payment order received, but also to take actions that in fact comply with the order. In the case of a receiving bank other than the beneficiary's bank, the obligation under article 5(3) is to issue a proper payment order to a proper bank within a proper period of time. Furthermore, under article 9(2) it is liable to its sender and to the originator for the losses caused by the non-execution or improper execution of the originator's payment order, with right of reimbursement from its receiving bank unless it was itself the bank where the non-execution or improper execution originated. In the case of the beneficiary's bank, its obligation is to make the funds available to the beneficiary in the manner specified in article 5(4).

18. It is not necessary to use the concept of acceptance in this context. Article 5(3)*(a)* and article 9(2) could be restated to say that a receiving bank other than the beneficiary's bank that undertakes to execute a payment order must take certain actions and would be liable for certain consequences. However, the drafting of the provisions would be more complicated. In respect of the beneficiary's bank, the advisability of retaining the concept of acceptance is discussed in the context of completion of the credit transfer in paragraphs 28 to 42, below.

4. *Assistance in correcting problems*

(a) Receiving bank other than beneficiary's bank

19. Whether or not the receiving bank executes the order received, it may turn out that the transfer is not completed successfully. When the transfer is a failure, a receiving bank other than the beneficiary's bank is obligated, according to article 5(3)*(b)*, to refund to its sender any funds it has received. Article 5(3)*(c)* sets forth an obligation of the receiving bank to assist in completing the transfer for the correct amount when the transfer was for too small an amount.

20. In general, it is not necessary to use the concept of acceptance for these two situations. The obligation could be said to be that of a receiving bank other than the beneficiary's bank that has issued a payment order intended to execute the order received, without referring to acceptance of the order received.

21. The use of the concept of acceptance or its equivalent would be necessary when the receiving bank has undertaken an obligation to act in the future, especially as anticipated in article 4(4), but has not issued its own payment order as required. While the failure of the bank to fulfil its obligation to carry out the payment order it has accepted is the same as described in paragraphs 11 to 13, above, the failure gives rise to damages under article 9, and to an obligation to aid in correcting the problem under article 5(3)*(b)* and *(c)*.

22. In article 5(3)*(b)* the circumstances that constitute a failure of the transfer are currently described in terms of a proper payment order not having been "issued to or accepted by the beneficiary's bank". Other wording could undoubtedly be found, but the provision would probably be more complicated in its presentation.

(b) Beneficiary's bank

23. According to article 8(7) the beneficiary's bank has the right to reverse a credit to the beneficiary's account in certain cases of error, but is not required to do so. The right of reversal of the credit is set forth without reference to whether the beneficiary's bank had accepted the payment order received, although it would in fact have done so under article 6(2).

B. Payment of the order by the sender

24. According to article 4(4)

> "A sender becomes obligated to pay the receiving bank for the payment order when the receiving bank accepts it, but payment is not due until the execution date, unless otherwise agreed."

25. The sender's obligation to pay the receiving bank arises at the same time that the receiving bank undertakes obligations in respect of the payment order, since one obligation is the counterpart of the other. Without use of the concept of acceptance, it would be awkward to draft a provision that was equally applicable to receiving banks that were and receiving banks that were not the beneficiary's bank and to receiving banks that undertook an obligation to execute the order in the future and those that executed the order on, before or after the execution date. However, it does not seem appropriate that the sender is obligated to pay the receiving bank when acceptance has occurred through the failure of the receiving bank to give a notice required under article 5(1) that it would not comply with the payment order.

26. When payment is to be made by debit to an account held by the receiving bank for the sender, article 11(4) provides that the account is deemed to be debited when the receiving bank accepts the payment order, even if no entry has as yet been made to the account. This provision is but a special application of article 4(4). It will have its most important effect when there is legal process against the sender's account, e.g. attachment of the account or sequestration of the funds, or insolvency proceedings have commenced against the sender.

C. Revocation or amendment of payment order

27. The concept of acceptance is not used in respect of the time until which a sender can revoke or amend a payment order sent to a receiving bank other than the beneficiary's bank. Instead, article 8(1) provides that the revocation or amendment is effective "if it is received in sufficient time for the receiving bank to act on it before the receiving bank has re-transmitted the order". If the payment order had a future execution date, the revocation or amendment would be effective until the order was executed even if the revocation or amendment was received after the receiving bank had accepted the order, a situation anticipated in article 4(4).

D. Completion of the credit transfer

1. Consequences of completion

28. The Model Law provides that when the payment order is accepted by the beneficiary's bank,

(a) the payment, and therefore the transfer, can no longer be revoked or amended (article 8(3));

(b) the beneficiary's bank is indebted to the beneficiary (article 11(2));

(c) the obligation of the originator to the beneficiary is discharged (article 11(2));

(d) the beneficiary's bank undertakes certain obligations to make the funds available to the beneficiary (article 5(4) and 7(1)*(c)*);

(e) a determination can be made whether the credit transfer was executed within the proper time (articles 9(2), 7(1)*(c)* and *(d)*).

Taken together, these consequences of acceptance may be considered to constitute completion of the credit transfer.

29. By this set of provisions any given credit transfer would be completed for almost all purposes at a single point of time, i.e. when the beneficiary's bank accepts the payment order. Actions and obligations of the beneficiary's bank subsequent to acceptance would, with few exceptions, be of relevance only to the beneficiary.

30. The same result could be achieved by using a different word in the Model Law, such as "completed" or "final". However, the use of such a word in the text of the Model Law might create its own difficulties since it might imply that the beneficiary's bank had no further obligations under the Model Law or other applicable law to take actions as a result of the transfer. Furthermore, in many cases there would not have been full and final settlement between all of the banks in the credit transfer chain. Therefore, use of the concept of acceptance in the text of the Model Law may seem to be the more advisable solution.

31. In respect of discharge of the underlying obligation, the view has been expressed in the Working Group that no rule should be included in the Model Law because such a rule properly belongs in a legal text relating to the dis-

charge of monetary obligations and not in a legal text on credit transfers. Moreover, although the point has not yet been discussed in depth, it has been suggested that the time of discharge—whether set out in the Model Law or in a separate text—might appropriately be at a different time from that when the credit transfer was completed. It has also been suggested that the approach of the current draft of the Model Law is correct; the time of discharge of an obligation should be set forth in the Model Law and, even if set forth in a separate text, discharge should take place at the same time as the other aspects of completion of the credit transfer occur.

2. *Criteria for completion/acceptance*

32. Although the draft Model Law provides that the five consequences set out in paragraph 28 would occur when a payment order was accepted by the beneficiary's bank, article 6(2) provides that different payment orders would be accepted at different points of time. When a given payment order would be accepted would depend on various factors in the relationship between the sender and the beneficiary's bank and on the means by which the beneficiary's bank processes the payment order and the resulting credit to the beneficiary's account.

33. It would be possible for there to be a single event or point of time when all beneficiary's banks would be considered to have accepted all payment orders received. Any of the points of time indicated in Chapter IV of the UNCITRAL Legal Guide on Electronic Funds Transfers[1] might be used. However, the use of a single event or point of time to govern all credit transfers and all beneficiary's banks would work best if all beneficiary's banks processed all payment orders in the same way and in the same sequence. That may be the case in some countries; it is not the case in others and it is certainly not on a world-wide scale. Therefore, in order to have a clear rule that could be applied in many different situations, an event that was both objective and universal in its significance would have to be chosen.

34. Receipt of the payment order by the beneficiary's bank would meet those criteria, but would be too early in most cases. Credit to the beneficiary's account with no right to reverse the credit except for correction of error under article 8(7) would be a significant event, but it is often difficult to determine when that event occurs in an electronic environment. Moreover, in many situations the time when the account is credited is determined by the administrative convenience of the bank rather than by considerations related to the consequences of acceptance noted above. The latest event that might be chosen would be giving the beneficiary notice that the credit was available for use.

35. It could be considered to be undesirable for the consequences of completion of an international credit transfer for credit to the beneficiary's account to take place at as late a point of time as the giving of notice to the beneficiary. In almost every credit transfer involving credit to the beneficiary's account, the beneficiary's bank is chosen by the beneficiary. Errors or delays in crediting the beneficiary's account should be at the risk of the beneficiary and not at the risk of either the originator or any of the banks prior to the beneficiary's bank. It is particularly pertinent that a delay in credit to an account or notification of the credit to the beneficiary may be the result of banking practices in the State where the beneficiary's bank is located or of an agreement between the beneficiary and its bank, practices or agreement that may be completely unknown to either the originator or to the banks prior to the beneficiary's bank. This analysis suggests that the transfer should be considered to be completed at the earliest possible time.

36. If this analysis is accepted, further consideration might be given to the relatively rare cases where the beneficiary does not have an account at the beneficiary's bank.

37. The current draft of subparagraph *(a)* of article 6(2) implements the policy of early completion of the transfer. If the sender and the beneficiary's bank have agreed that the bank will execute payment orders received from the sender without notification that cover is in place, the beneficiary's bank is considered to have accepted the payment order as soon as the order is received. That rule would be applicable to the London Clearing House Automated Payment System (CHAPS), but not to the New York Clearing House Interbank Payments System (CHIPS). Subparagraph *(a)* may be contrasted with the rule governing a receiving bank that was not the beneficiary's bank. According to article 5(1) such a bank would be contractually obligated to execute the payment order but it would not have the obligations of a bank that had accepted the payment order until it sent its own payment order intended to carry out the payment order received.

38. Subparagraph *(b)* of the draft of article 6(2) presented to the Working Group at its eighteenth session in A/CN.9/WG.IV/WP.39 also implemented the policy that the beneficiary's bank should be considered to have accepted the payment order at the earliest possible point of time. Subparagraph *(b)* provided that acceptance took place

> "when the bank receives both the payment order and notice that cover is available, provided that there was a prior relationship with the sender".

39. Those two provisions also reflected the judgment that there was only one valid reason for the beneficiary's bank to fail to comply with a payment order that was complete and correct on its face, namely that the bank had not as yet received reimbursement from the sender. Subparagraph *(b)* did not face the question of the extent to which a receiving bank should be expected to accept payment by credit in its account with the sender or in its account with a third bank.

40. Other reasons for failing to comply that have been suggested in regard to originator's banks or intermediary banks, such as suspected laundering of money received from illegal sales of narcotic drugs, seem to be less

[1] A/CN.9/SER.B/1, United Nations publication Sales No. E.87.V.9

applicable to a beneficiary's bank where credit is to be entered to the beneficiary's account. It would be unlikely that the bank could be sufficiently suspicious of an individual transfer for it to reject a payment order unless there had been a prior pattern of suspicious transfers. In that case, the bank could be expected to close the account or report its suspicions to the proper authorities rather than to reject the payment order.

41. The Working Group at its eighteenth session rejected the approach of the draft text in A/CN.9/WG.IV/WP.39 by deleting article 6(2)*(b)* and deciding that a volitional element should be added to article 6(2)*(a)*, although it did not add that element to the text due to a lack of time (A/CN.9/318, para. 137). It stated that the beneficiary's bank might have reasons to reject a payment order received in addition to the non-receipt of payment for the order. It was suggested that the beneficiary might have instructed the bank not to accept the particular payment order or not to accept a particular category of payment orders. In addition, the beneficiary's bank should not be held to have accepted a payment order that is so incomplete or incorrect that it cannot or should not be implemented. Compare the situation of the receiving bank under article 4(2) if the authentication of the order appears to be improper. It would seem, however, that those particular problems could be accommodated in a general rule of early completion of the transfer. In any case, the Working Group has not as yet formulated an alternative policy as to when the beneficiary's bank should be considered to have accepted the payment order, or, alternatively, when the credit transfer should be considered to be completed.

42. Subparagraphs *(c)*, *(d)* and *(e)* constitute three different volitional acts that might be performed by a beneficiary's bank in a given transfer that might be considered to be acceptance of the payment order, thereby bringing it to completion. They would apply to those situations where the beneficiary's bank executed the payment order before payment was provided under either subparagraph *(a)* or the now deleted subparagraph *(b)*.

II. EFFECT OF BANK INSOLVENCY ON THE CREDIT TRANSFER

43. The insolvency of a bank can affect the credit transfer in a number of different ways. The current text of the draft Model Law has no provisions that were intended to deal with that problem. However, existing provisions provide solutions for some of the situations.

44. Article 5(3)*(b)* provides that where the beneficiary's bank does not accept a payment order consistent with the contents of the payment order issued by the originator, each receiving bank must refund to its sender any funds received from the sender. This provision was drafted with the case in mind of the payment order that designates an incorrect beneficiary's bank or an incorrect beneficiary or that is delayed at some point and is never completed. The originator and all receiving banks are expected to be restored to their original position. If the funds cannot be recovered from the incorrect beneficiary or the bank that holds them, the loss should be suffered by the bank that made the error. However, it appears that article 5(3)*(b)* might place the loss on a bank that sent the order to an insolvent bank or beneficiary since its obligation to refund would exist whether or not it received a refund from the insolvent bank or beneficiary. That result was anticipated by the Working Group at its eighteenth session, A/CN.9/318, para. 153. See also, A/CN.9/WG.IV/WP.41, comment 14 to article 5.

45. Article 5(3)*(b)* would also apply to the case where the credit transfer failed because an intermediary bank that had received payment from its sending bank ceased payments before executing the order received. As above, article 5(3)*(b)* would place the risk of non-reimbursement on the bank that sent the order to the failed intermediary bank. This may be thought to be an appropriate solution, except in the case where the originator or a prior sending bank designated the use of the failed intermediary bank. It may be thought that in such a case the credit risk should fall upon the originator or the bank that designated the use of the intermediary bank that failed.

46. A somewhat different problem arises if a receiving bank has executed the payment order and its sender is unable to pay the receiving bank for it. The current text of the draft Model Law has no rule where the receiving bank is the beneficiary's bank. Whether the beneficiary's bank would have a right to reverse the credit to the beneficiary's account would probably be governed by the law of the State where the beneficiary's bank was located. See paragraphs 69 to 80, below. When the receiving bank was not the beneficiary's bank, under article 4(4) it would be bound on its own order as a sender and would suffer the loss. This result is clearly appropriate when the sender is the originator.

47. The appropriateness of the result is less clear when the sender is a bank. Although it contributes to financial prudency on the part of receiving banks, it does so by encouraging receiving banks to delay the execution of payment orders they receive until they have received payment from their senders. That reduces the operational efficiency of the receiving banks individually and has serious effects on the operational efficiency of the funds transfer system as a whole. It slows the flow of money through the system and it makes it impossible for originators or their banks to plan the amount of time necessary for a credit transfer to be carried out if the transfer must pass through at least one intermediary bank or through a clearing house.

48. Different practices have arisen to counteract this latter problem. Two of particular importance to international credit transfers are the practices followed by CHAPS in London and CHIPS in New York.

— Under the CHAPS rules, the receiving bank is required to give same day credit to its credit party. This obligation remains even if there is a failure of one of the settlement banks to settle its balances at the end of the day. Such a rule protects the efficiency of the payment system. Financial prudency is guaranteed by various administrative and regulatory procedures outside the payment system itself. While these procedures assure all parties that no receiving bank will suffer loss if a sending bank fails to settle its net debit balance, they depend upon the particular organization of the banking system in the United Kingdom and the expectation that the Bank of England will guarantee the settlement.

— Under the CHIPS rules, the failure of a participating bank to settle its net debit balance at the end of the day can result in the withdrawal from the settlement of all transfers to and from that bank made during the day. Although the procedure has never been resorted to, the possibility means that receiving banks are not required to give credit to their credit parties until after final settlement at the end of the day. Nevertheless, in order to accommodate their customers and to increase the efficiency of the payment system, receiving banks often execute payment orders when they are received and prior to settlement. However, the practice has been to grant credit to the credit party on a provisional basis subject to the bank receiving settlement, and that practice has been assumed to be legally permissible even though there is no directly relevant authority. As a result, there has been the continuing possibility that the entire day's settlement for transactions made through CHIPS would be reversed.

49. The problems posed by the CHIPS rules and the dangers they present for the payment system as a whole have received a great deal of attention in the United States and various steps have been taken to reduce those problems. Of direct interest to the Model Law are new provisions that have been inserted into the February 1989 version of the proposed new article 4A of the Uniform Commercial Code. The provisions seem to be of sufficient general interest to discuss them at length.

50. Draft section 4A-207(1) provides that when a receiving bank other than the beneficiary's bank executes a payment order it has received, it accepts the order, thereby becoming bound by it. Such a receiving bank takes the credit risk if it has not already received payment for the order it received.

51. If the receiving bank is the beneficiary's bank, the solution is somewhat more nuanced. Draft section 4A-207(2)*(a)* provides that the beneficiary's bank accepts a payment order, thereby becoming bound by it,

> "at the time the bank . . . (ii) notifies the beneficiary of receipt of the order or that the account of the beneficiary has been credited with respect to the order *unless the notice indicates* that the bank is rejecting the order or *that funds may not be withdrawn until receipt of payment from the sender of the order.*" (Emphasis supplied.)

52. Draft section 4A-207(2)*(a)* will no longer permit banks to follow their current practice of granting withdrawable credit that nevertheless remains provisional until receipt of settlement. While that provision will be applicable to any situation where the beneficiary's bank has not as yet received payment for the payment order received, it will be of greatest significance in the context of a net settlement arrangement, of which CHIPS is by far the most important in the American credit transfer context.

53. Those two provisions of draft section 4A-207 standing by themselves would discourage receiving banks from making funds available to the beneficiary or other credit party prior to settlement. That would be considered to be undesirable, since it would reduce the efficiency of the payment system.

54. The problem is overcome by paragraphs (1) to (3) of draft section 4A-403, which are, because of their importance, set out in full.

> "(1) Payment of the sender's obligation under Section 4A-402 [similar to article 4(4)] to pay the receiving bank occurs at the earliest of the following times:
>
> "*(a)* If the sender is a bank, payment occurs when the receiving bank receives final settlement of the obligation through the Federal Reserve System or through a funds transfer system.
>
> "*(b)* If the sender is a bank and (i) the sender credited an account of the receiving bank with the sender, or (ii) caused an account of the receiving bank in another bank to be credited, payment occurs when the credit is withdrawn or, if not withdrawn, at midnight of the day on which the credit is withdrawable and the receiving bank has knowledge of the fact.
>
> "*(c)* If the receiving bank debited an account of the sender with the receiving bank, payment occurs when the debit is made to the extent the debit is covered by a withdrawable credit balance in the account.
>
> "(2) If the sender and receiving bank are members of a funds transfer system that nets obligations multilaterally among participants, the receiving bank receives final settlement when settlement is complete in accordance with the rules of the system. The obligation of the sender to pay the amount of a payment order transmitted through the funds transfer system may, to the extent permitted by the rules of the system, be satisfied by setting off and applying against the senders's obligation the right of the sender to receive payment from the receiving bank of the amount of any other payment order transmitted to the sender by the receiving bank through the funds transfer system. The aggregate balance of obligations owed by each sender to each receiving bank in the funds transfer system may, to the extent permitted by the rules of the system, be satisfied by setting off and applying against such balance the aggregate balance of obligations owed to the sender by other members of the system. The aggregate balance shall be determined after the right of setoff stated in the second sentence of this subsection has been exercised.
>
> "(3) If two banks transmit payment orders to each other under an agreement that settlement of the obligations of each bank to the other under Section 4A-402 [similar to article 4(4)] shall be made at the end of the day or other period, the total amount owed with respect to all orders transmitted by one bank shall be set off against the total amount owed with respect to all orders transmitted by the other bank. To the extent of the setoff each bank has made payment to the other. If the setoff does not result in full payment of the total amount owed with respect

to all orders transmitted by one of the banks, the amount of the setoff shall be applied to the various orders transmitted by that bank in proportion to the amounts of the orders. If, after the setoff, the net amount owing by the bank is paid, that amount shall be similarly applied to the orders transmitted by the bank."

55. As a result of those provisions, a receiving bank incurs no greater credit risk prior to settlement than its net credit balance with the particular sending bank, whether that balance has arisen from direct bilateral netting or, to the extent permitted by the rules of the system, from multilateral netting arrangements.

56. The new draft provision appears to be inspired by the conclusions of the report issued by the Bank for International Settlements in February 1989 "Report on Netting Schemes". While the report was drafted with particular regard to foreign exchange contracts, it states that its conclusions are also applicable to payment netting arrangements.

57. The Working Group may wish to consider whether the Model Law should contain provisions directed towards the consequences of the failure of a sender, including a sending bank, to pay the receiving bank. If it does, it may wish to consider whether a provision should be prepared for inclusion in the Model Law based upon the solutions contained in the proposed section 4A-403 of the Uniform Commercial Code.

III. EFFECT OF MODEL LAW ON ACCOUNT RELATIONSHIP

58. The mandate of the Commission to the Working Group was to prepare a text that would govern a credit transfer from customer to customer. Various delegates to the Working Group have insisted that the most important aspect of the preparation of the Model Law was to establish the rights and obligations of the customers in a credit transfer, since it could be assumed that banks could regulate most of the questions that would arise between themselves on the basis of interbank agreements.

59. A funds transfer, whether by means of a credit transfer or of a debit transfer, results in a debit to the account of the transferor of the funds and a credit to the account of the transferee of the funds. Therefore, a law that governs the complete transfer from bank customer to bank customer must have some provisions specifying the right of the originator's bank to debit the originator's account, the obligation of the beneficiary's bank to credit the beneficiary's account and the consequences of the entering of the debits and credits by the banks. By including such provisions, the law will affect the rights and obligations of those customers and their banks in respect of the account relationship.

60. This would not create difficult problems if the Model Law was being prepared for adoption by a particular State, since the drafters could take account of the existing law governing the account relationship. If the new law on credit transfers required changes in the law governing account relationships, the appropriate provisions could be included either in the text of the new law or as amendments to any other law in that State governing the account relationship.

61. The Model Law must be prepared in the expectation that the States in which it will be adopted will have a wide range of legal rules in respect of the account relationship. It may be desirable, therefore, for the Model Law to have as little affect on the account relationship as would be compatible with the mandate to prepare rules that govern the transfer from customer to customer. Nevertheless, since the text under preparation is in the form of a model law and not of a convention, it may be permitted to include provisions that are thought to be appropriate from a substantive point of view, even if they might be thought to go beyond the limits of what some States would include in a law on credit transfers or they might be in conflict with legal rules on the account relationship in some States.

62. The account relationships that are affected by a credit transfer are not only those of the originator in the originator's bank and the account of the beneficiary in the beneficiary's bank, but also the accounts that banks have with one another that are used to pay for payment orders sent between them.

63. The originator's account is affected by articles 4(4) and 11(4) governing a sender's obligation to pay for a payment order it has sent. In the current text of article 4(4), a sender becomes obligated to pay the receiving bank for the payment order when the receiving bank accepts it. According to article 11(4)

> "To the extent that a receiving bank has a right of reimbursement from a sender by debit to an account held by the receiving bank for the sender, the account shall be deemed to be debited when the receiving bank accepts the payment order."

64. Article 11(4) is apt to have its greatest importance when the sender becomes insolvent or there is legal process against the sender's account prior to the entry of the debit to the sender's account. It assumes that debiting the account of the sender has the legal effect of reducing the amount owed by the bank to its customer or increasing the amount owed by the customer to the bank. It is not, however, so stated in the provision or elsewhere in the draft Model Law. The effect of the provision would be that the book-keeping entry would not have to be made to achieve that result. To this degree article 11(4) enters into the law governing the account relationship between the originator and the originator's bank.

65. However, article 11(4) is unlikely to be applied very often in respect of the account of an originator since banks seldom act on the instructions of a customer prior to debiting the customer's account. Article 11(4) could be expected to be more often applied to the account of a sending bank that is being serviced by the receiving bank, since it is reasonable to believe that banks are more apt to execute a payment order they have received from another

bank before debiting the sending bank's account than to execute a payment order received from a non-bank customer prior to debiting the sender's account.

66. The extent to which the Model Law must enter into the account relationship between the beneficiary and the beneficiary's bank depends in large measure on the events marking completion of the credit transfer, i.e. acceptance of the payment order by the beneficiary's bank. If the credit transfer is considered to be completed and any obligation of the originator to the beneficiary is discharged at an early point of time after receipt of the payment order by the beneficiary's bank, such as is suggested in paragraphs 37 and 38, above, the crediting of the funds to the beneficiary's account or the making of the funds available to the beneficiary need not be considered in the Model Law. The single exception would be those cases when the payment order contained a payment date or an execution date, since the originator or the sender has directed that action be taken by a certain time and has an interest that it be done by that time.

67. If the credit transfer is to be considered completed only upon a volitional act of the beneficiary's bank in respect of the beneficiary or its account, consideration would have to be given as to whether the Model Law should include standards as to when and how the beneficiary's bank would have to act, since the originator would have a legitimate interest in prompt action by the bank.

68. The current text of the draft Model Law sets out in article 7 the time within which a beneficiary's bank, as a receiving bank, must act. Beneficiary's banks are specially mentioned in article 7(1)*(c)* and *(d)*. The actions required of a beneficiary's bank that has accepted a payment order are set out in article 5(4).

IV. CONFLICT OF LAWS

69. At its seventeenth session the Working Group requested the Secretariat to prepare a provision on conflict of laws in respect of credit transfers (A/CN.9/317, para. 165). A provision was prepared for the eighteenth session of the Working Group as article 12 of the draft Model Law presented in A/CN.9/WG.IV/WP.39. The Working Group did not consider article 12 at its eighteenth session, and it remains unchanged in the text before this session of the Working Group.

70. The purpose of the Model Law is to provide a means of unifying the basic legal principles and rules governing international credit transfers. To the extent the Model Law is eventually adopted by individual States, problems of conflict of laws are reduced. However, not all States will adopt the Model Law or adopt it in its pure form and the Model Law is unlikely to cover all conceivable issues.

71. The first problem to be considered is the territorial application of the Law. In addition, consideration may be given to a provision governing the conflict of laws where the dispute arises in a State that has adopted the Model Law but the other State or States concerned have not, or where the text of the Model Law does not govern the issue at hand.

72. Problems in respect of the territorial application of the Model Law are illustrated by article 1(1) on its substantive sphere of application. Under that article the Model Law does not apply to the transfer unless there are at least two banks in different States and each of those two banks has a customer. It does not matter whether the customer of either or both of the banks is itself a bank. As a result, for the Model Law to apply under article 1(1) at least two payment orders must be issued, from originator to originator's bank and from originator's bank to beneficiary's bank. See discussion in A/CN.9/WG.IV/WP.41, comments 1 to 8 on article 1.

73. The requirement that there be a minimum of two payment orders for the credit transfer to come within the sphere of application of the Model Law emphasizes the dual nature of the relationships involved in the transfer and of the law governing those relationships. The transfer consists first of all of a series of bilateral relationships between a sender (originator or sending bank) and a receiving bank, and many of the provisions of the Model Law govern that relationship. The transfer itself is, however, defined as the "complete movement of funds from the originator to the beneficiary", and a certain number of provisions consider the relationships from that point of view.

74. While it would be desirable for a single law to govern the entire credit transfer so that the rights and obligations of all of the parties to the transfer would be consistent, that result cannot be achieved by application of rules of conflict of laws, including a provision on the territorial application of the Model Law. Some of the rules in any legal system have operational significance for the banks, such as the existence or extent of any obligation of a receiving bank to react to a payment order received or the right of a sender to revoke or amend its payment order. Those rules must be known by the personnel of the receiving bank for the bank to carry out its obligations properly.

75. This suggests that, if the law of the several States involved in a credit transfer are to apply to the various segments of the transfer, the law applicable to any given segment should be the law of the receiving bank. In a transfer involving only two banks in different States, the law governing the segment from the originator to the originator's bank would be governed by the law of the State where the originator's bank was located and the segment from the originator's bank to the beneficiary's bank by the law of the State where the beneficiary's bank was located. Similarly, if there was a third country intermediary bank, which might be a reimbursing bank, the law governing the segment where that bank was the receiving bank would be the law of the State where that bank was located. Finally, the consequences of the credit transfer on the beneficiary's account would be governed by the law of the State where the beneficiary's bank was located.

76. The general appropriateness of this suggested rule can easily be verified by examination of the current draft

of the Model Law. Most of the provisions set out either an operational rule to be carried out by the receiving bank or the legal consequences of a failure by the receiving bank to carry out its obligations.

77. A general rule that the law governing a segment is the law of the State where the receiving bank is located must, nevertheless, take account of the fact that certain provisions in the draft Model Law are stated in terms of the sender or consider a relationship other than that of the sender and receiving bank. Those provisions may be considered to be representative of the problems that will be faced in applying any set of rules on conflict of laws to credit transfers. The provisions that need to be considered are as follows:

Article 4.

(1) The paragraph as drafted would seem to indicate that the question whether the actual sender had power to bind the purported sender would be determined by the relevant law applicable to the purported sender.

(2) and (3) The two paragraphs are drafted in terms of whether the purported sender is bound by the payment order. However, the verification of the authentication of the payment order would take place at the receiving bank. Therefore, it would seem appropriate that the law of the State where the receiving bank is located would determine the commercial reasonableness of the authentication provided and of the legal effect of compliance with the required procedures by the receiving bank. Since paragraph (3) is an exception to paragraph (2), it should be subject to the same law.

(4) The obligation of the sender to pay the receiving bank arises because the receiving bank has acted at the request of the sender. The determination as to which actions of the receiving bank give rise to the sender's obligation would seem to be determined best by the law of the State where the receiving bank is located.

Article 5.

Subparagraph (3)*(b)* provides that, where the transfer is not successfully carried out the receiving bank must refund to its sender any funds it has received from its sender and "the receiving bank is entitled to the return of any funds it has paid to its receiving bank". In effect, paragraph (3)*(b)* calls for the return of the funds paid by the receiving bank under article 4(4) in its capacity as a sender and the quoted portion of the provision is redundant, although it serves the general purpose of assuring the bank that it is not intended to bear the ultimate loss. Since the law governing the obligation of the receiving bank as a sender would be governed by the law of the State where "its receiving bank" is located, the law of "its receiving bank" would appropriately govern the obligation to return the funds.

Article 8(1) to (4).

Although phrased in terms of the sender's right to revoke or amend a payment order, the substantive rules depend upon whether the receiving bank has acted on the payment order.

(5) Although the paragraph is drafted in terms of the rights and obligations of the sender, it could equally well be drafted in terms of the rights and obligations of the receiving bank.

(6) This paragraph should be compared with article 4(1), (2) and (4). If viewed as a question of the personal capacity of the sender, the law of the sender would be appropriate. If viewed as the authority of a receiving bank to act on a payment order received and to debit the account of the sender or otherwise receive payment from the sender, the law of the receiving bank would be appropriate.

Article 11(1) to (3).

The paragraphs relate to the discharge of the underlying obligation. It would seem that the appropriate law would be the law of the State where the obligation is to be discharged, as provided in article 12(2). The determination of the State where the obligation is to be discharged would be outside the scope of the Model Law.

78. There may be occasions when banks or other entities which regularly exchange payment orders may wish to choose the law of some other jurisdiction to govern their rights and obligations in respect of those payment orders. The current draft of article 12(1) suggests that in addition to the law of the receiving bank, the parties might choose the law of the sender or the law of the State in whose currency the payment orders are denominated. Yet another conceivable choice might be the law of the State where the communication service the two banks use for international payment orders is located.

79. After the Working Group has considered the territorial application of the Model Law, it may wish to consider whether the Model Law should contain an additional provision on choice of law. If a separate provision is to be prepared, the Working Group may think it appropriate for that provision to be consistent with the provision on the territorial application of the Model Law.

80. The unfortunate aspect of the analysis of territorial application of the Model Law and of choice of law in general is that a single international credit transfer will always be governed by the law of at least two, and often more, States. That emphasizes the importance of preparing a Model Law that has a high likelihood of widespread adoption.